# Vaba d.d. banka Varaždin

Annual Report

for 2014

## Contents

**Introduction** ... 1
**Macroeconomic environment and banking sector in the Republic of Croatia in 2014** ... 3
**Description of the Bank's operations** ... 6
**Statement on the application of the Code of Corporate Governance** ... 13
**Responsibilities of the Management and Supervisory Boards for the preparation and approval of the annual financial statements** ... 16
**Independent Auditor's Report** ... 17
**Balance sheet as at 31 December 2014** ... 19
**Income statement for 2014** ... 20
**Statement of comprehensive income for 2014** ... 21
**Statement of changes in equity for 2014** ... 22
**Statement of cash flows for 2014** ... 23
**Notes to the financial statements for the year 2014** ... 24

# Introduction

The annual report comprises a summary of operation and key financial indicators, a description of operation and the audited financial statements for the year ended 31 December 2014 together with the Independent Auditor's Report.

## Legal status

The Annual Report includes the Bank's financial statements prepared in accordance with accounting regulations applicable to banks in the Republic of Croatia and audited in accordance with International Standards on Auditing.

The Annual report was prepared by the Management of the Bank in compliance with the Accounting Act and the Companies Act, which prescribe reporting to shareholders at the General Assembly meeting.

## Abbreviations

In the Annual Report, Vaba d.d. banka Varaždin is referred to as the "Bank" or "Vaba", the Croatian National Bank is referred to as the "CNB", the Republic of Croatia as the "Government" and the Croatian Bank for Reconstruction and Development is referred to as the "CBRD".

## Exchange Rates

The following CNB exchange rates were used for translation of foreign currencies into Croatian kuna:

| | | |
|---|---|---|
| 31 December 2013 | EUR 1 = HRK 7.637643 | USD 1 = HRK 5.549000 |
| 31 December 2014 | EUR 1 = HRK 7.661471 | USD 1 = HRK 6.302107 |

## Summary of operation and key financial indicators

| [HRK'000] | 31/12/2013 | 31/12/2014 |
|---|---|---|
| Net interest income | 30,474 | 14,799 |
| Net fee and commission income | 4,612 | 5,378 |
| Trading and other income | (2,049) | 11,338 |
| **Operating income** | **33,037** | **31,515** |
| Result before impairment losses | (12,238) | (14,453) |
| **Net profit / (loss) for the year** | **(109,449)** | **(11,911)** |
| **Total assets** | **1,217,629** | **1,345,888** |
| **Loans and advances to customers** | **675,689** | **654,038** |

The Bank’s operations in 2014 were most significantly influenced by the macroeconomic environment highlighted by long-term recessionary movements, further weakening payment abilities of the real sector and retail which in recent years experienced a constant process of deleveraging. Furthermore, the institute of pre-bankruptcy settlements comprising a part of the Bank's portfolio and the change in the regulatory environment relating to the recognition of impairment allowances (Amendment to the CNB Decision on the classification of placements and off-balance sheet potential liabilities, which became effective at the end of 2013) formed the basis for corrections of items of assets and receivables, whereby, after the impairment performed at the end of 2013, there was an increase in the loan portfolio of risk group BC which generates interest income at the time of collection.

Also, during 2014 the Bank undertook activities in order to stabilise the sources of funding (primarily retail deposits), and securing high levels of liquidity. As a result of these activities, liquidity levels of the Bank were high throughout the year, with the biggest growth of the source of funding relating to retail term deposits. Retail term deposits represent primary and stable source of funding and at the same time confirming trust and the Bank’s status on the market.

The year 2014 was marked by further active management of general and administrative expenses.

The Bank’s activities during 2014 were directed towards capital increase which was performed successfully in the amount of HRK 75 million by payment in cash by J&T Banka, Prague. The capital increase was entered into the Commercial Court register as at 26 June 2014. As at 31 December 2014, total share capital amounted to HRK 128.6 million (HRK 75.0 million as at 31 December 2013).

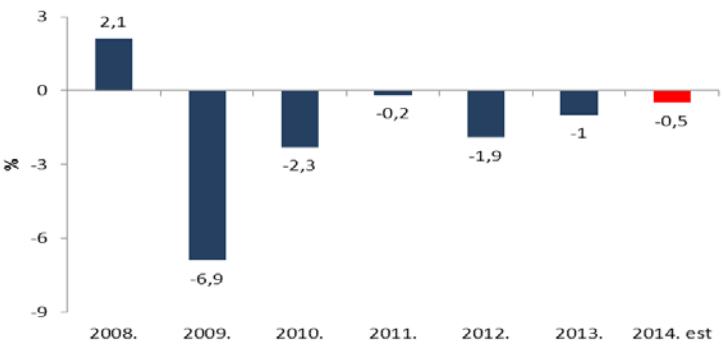
# Macroeconomic environment and banking sector in the Republic of Croatia in 2014

## ECONOMIC ACTIVITY

In 2014, there was still no economic recovery and again a decline in real GDP was recorded, as opposed to the countries in Central and Eastern Europe and the EU as a whole.

In the third quarter of 2014, the GDP declined by 0.5% compared to the same quarter last year, while compared to the previous quarter it remained unchanged. According to CNB estimates, the real GDP could be reduced in 2014 by 0.5% as a result of the continued weakening of domestic demand, while a positive contribution to GDP change could be realised only through the export of goods and services, driven by good performance of merchandise exports and the recovery of major international trading partners.

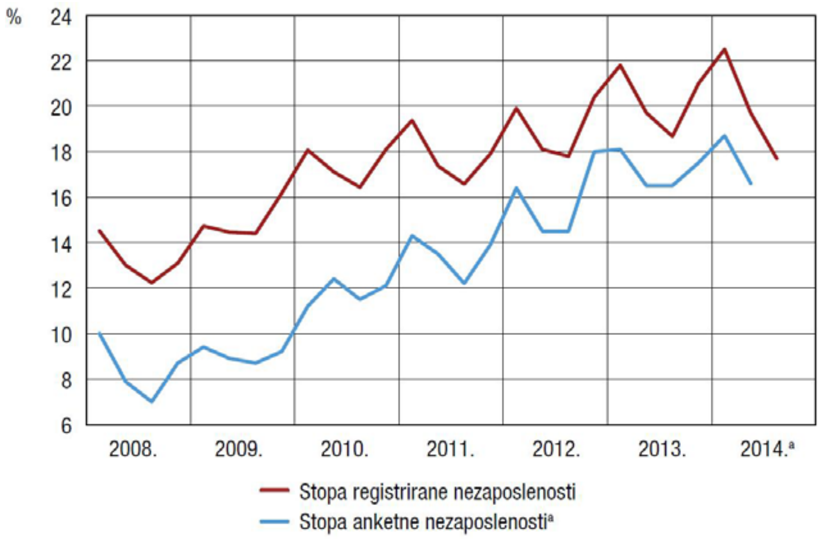
Graph 1: Real annual GDP growth




## LABOUR MARKET

For the third subsequent quarter, the number of employed persons remained unchanged, and the stagnation is primarily maintained by decreasing the number of employees in most activities as defined in the National Classification of Activities. The total annual decline in the number of employees in 2014 was 2.1%, and is expected to be mitigated to 1.00% in 2015. In the third quarter the number of deletions of unemployed persons from the Croatian Employment Service records increased as a result of non-compliance with legal provisions.
The further expected reduction in the number of employees in 2015 reflects the planned reduction in the number of employees in public and civil services.

Graph 2: Unemployment rate



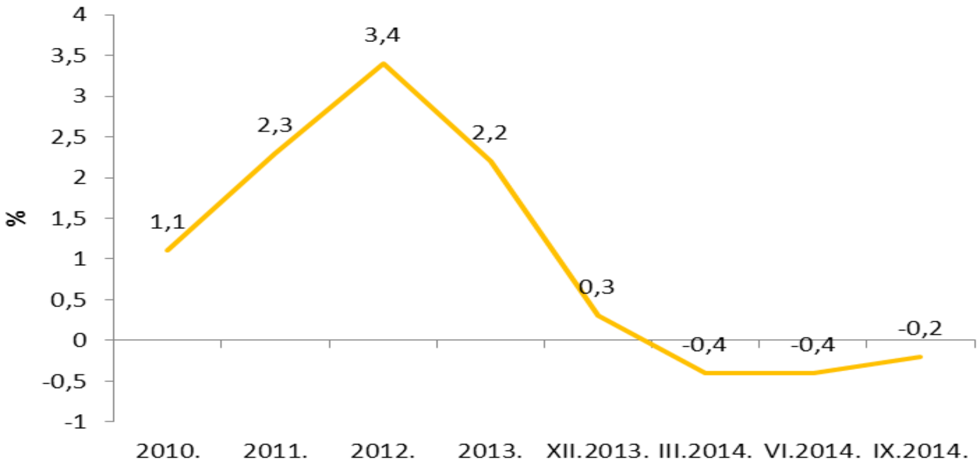

[a]2013 data and the data from the first two quarters of 2014 are based on the result of the Census of Population and Housing in the Republic of Croatia from 2011, while the data published to date were calculated based on the 2001 Census. Sources: Croatian Bureau of Statistics; Croatian Employment Service

## INFLATION

In December 2014, after two months of slow growth (average 0.3%), the annual rate of change in consumer prices returned to negative value (-0.5%). This concludes the year 2014 which will remain the first year during which the Croatian economy operated in terms of a decline in the general level of consumer prices, the an annual average level of -0.2%. This development reflects the price of weak aggregate demand, which has not recovered after the previous five years of decline and a decrease in raw material prices on the world market, primarily food that dragged inflation down throughout the year, as well as crude oil which suddenly started declining during the last quarter.

In 2015, it is expected that the average annual consumer price inflation rate will be moving up to 1%.

Graph 3: Annual change rate of consumer price index




## PERSONAL CONSUMPTION

In the third quarter, private consumption declined by 0.8% as a result of the stagnation in the labour market and negative expectations regarding future developments in economic activity. By the end of 2014, similar trends are expected to continue, and it is likely that, at the level of the entire year, the share of private consumption in overall economic activity will be noticeable negative.

A slight recovery in private consumption is expected in 2015, mainly driven by the positive effects of changes in personal income tax. A significant recovery in private consumption could be limited by unfavourable expectations and deleveraging of households and unfavourable movements in the labour market.

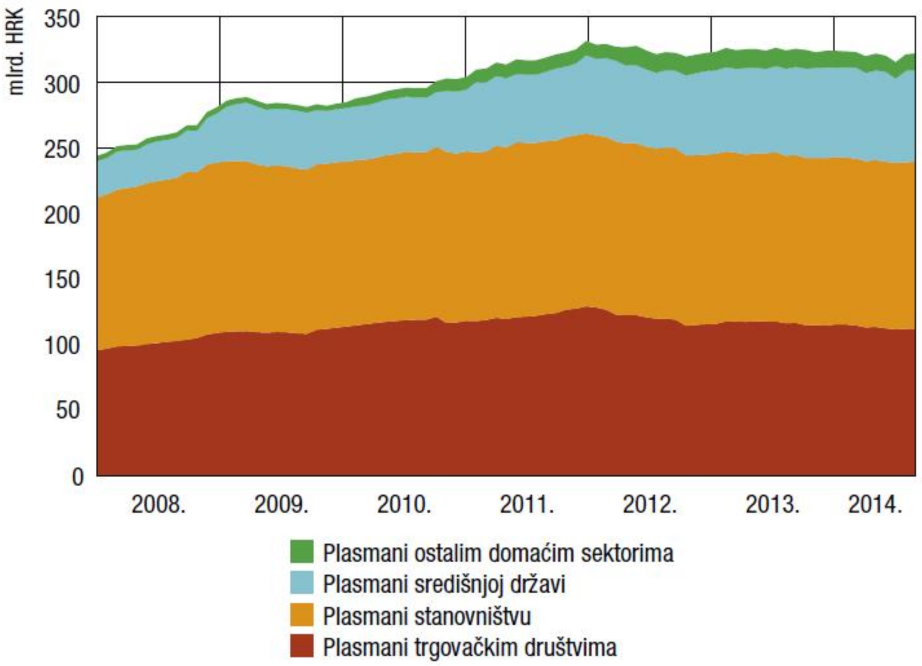
## FINANCING CONDITIONS AND THE BANKING SECTOR

In the second half of 2014 the financing terms of the domestic sector continued to slowly improve due to very high liquidity in the international and domestic financial market. The increase in placements is inhibited by negative risks associated with the economic recovery and the reluctance of lenders to assume new risks.

With respect to companies and households there is a decrease in the average nominal interest rates of almost all groups of loans. The cost of government borrowing declined in the first half of the year due to high liquidity in the financial markets. Domestic nominal interest rates for companies slightly decreased in the period from July to October compared to the first half of the year, loans of credit institutions to companies decreased in the third quarter of 2014, while on the other hand the corporate sector increased the level of foreign debt, whereby the decline in financing with domestic credit institutions was partly compensated (the total debt of companies at the end of September was 0.5% lower than in the previous year). In the third quarter, for the sixth consecutive year the trend of deleveraging the retail sector continued. The decline in placements to retail in the third quarter of 2014 was 0.5%, while the year on year decrease was 1.2%. Interest rates on loans to retail on average have declined compared to the first half of the year, the exception being housing loans.

In 2015, one cannot expect a turnaround in domestic credit activities to other domestic sectors and placements to credit institutions are expected to stagnate, while a slight recovery of credit activity can be expected in the medium term.

Graph 4: Structure of placements of credit institutions




**MONETARY POLICY**

In the second half of 2014, the CNB continued to implement expansionary monetary policy while maintaining the stability of the nominal exchange rate against the Euro.

The average excess of HRK liquidity on the accounts of credit institutions in the period from July to November was slightly lower than in the first half of the year and amounted to HRK 5.0 billion. High levels of liquidity contribute to maintaining overnight interest rates in the interbank market at extremely low levels, and indirectly more favourable short-term government borrowings in the market of treasury bills. The increase in total liquid funds shows that domestic sectors steadily increase their real financial assets in banks despite the decline in economic activity and available income.

The monetary policy of the CNB in 2015 will retain its expansionary character with continuing a stable exchange rate policy.

Graph 5: Average middle exchange rate HRK/EUR


*Source: CNB bulletin – December 2014*

## Description of the Bank's operations

Vaba d.d. banka Varaždin is registered as a limited company at the Commercial Court in Varaždin, under Reg. no.: 50000185, with its registered office in Varaždin, Aleja kralja Zvonimira 1, for the following purposes:

- Receipt of all types of deposits or other redeemable funds and lending from those funds, for its own account,
- Receipt of all types of deposits or other redeemable funds,
- Providing all types of loans, including consumer loans and mortgage loans if allowed by separate laws, financing of commercial business, including export financing based on forfeiting,
- Factoring,
- Finance lease,
- Issuing of bank guarantees or other guarantees,
- Trading for its own account or on behalf of its customers of:
    - money market instruments,
    - transferrable securities,
    - foreign currencies, including money exchange,
    - financial futures and options,
    - currency and interest instruments,
- Payment operations within the country (in accordance with the Law on payment operations),
- Services tied with lending, such as gathering of data, analysis and issuing information on credit ability of sole traders and enterprises,
- Issuing of other payment instruments and managing them in accordance with separate laws, if these services are not considered to be payment operations in accordance with separate laws,
- Safe rentals,
- Mediation in financial affairs,
- Investments and other services and activities in accordance with separate laws regulating capital markets, as follows:
    - trading for its own account,
    - services of offerings, i.e. sale of financial instruments without purchase obligation,
    - safekeeping and administration of financial instruments on behalf of clients, including custodian and similar services, such as money and securities management,
- Representation in the sale of insurance policies in accordance with legislation regulating insurance.

As of 31 December 2014, the Bank operates through 10 branches (Varaždin, Ludbreg, Ivanec, Novi Marof, Čakovec, Zagreb, Slavonski Brod, Nova Gradiška, Pula).

## MISSION

An individual approach to each client and our high quality and professional services, based on the competence of our employees, we create value added for our customers. This contributes to the growth of our organization and improves the quality of the life of our community. We appreciate the personal contribution of each of our employees, whose creativity and knowledge are our greatest value.

## VISION

Our vision is to continuously exceed expectations and be the first to innovate and create new values. We want to be a leader in creating high quality financial solutions for our customers and be the best in the area of development and prosperity for all of our employees.

## Operations with retail, craftsmen and small entrepreneurs

Retail banking is carried out through 10 branches (two in Varaždin and one in Ludbreg, Ivanec, Novi Marof, Čakovec, Zagreb, Slavonski Brod, Nova Gradiška and Pula). The Bank has 10 ATM machines installed in the branches.

During 2014, the Bank continued to improve deposit and loan products for customers, in line with their needs and market trends. Although during 2014, there was a trend in deleveraging the retail sector in the Republic of Croatia, the Bank's adequate business policies provided positive trends in the movements of the retail portfolio.

In 2014, there was a significant growth in the segment of retail banking: retail term savings increased by 14% with a significant decline in average interest rates, the number of users of current accounts increased by 22%, the number of credit card users by 56%.

In the craftsmen and small entrepreneurs segment within the Retail sector in 2014, new credit lines were signed with the Ministry of Entrepreneurship and Crafts, the Varaždin County Guarantee Agency, for the purpose of improving conditions for granting loans to small entrepreneurs.

Additional emphasis was placed on the optimisation of business processes and the implementation of new IT solutions in order to optimise all resources and improve services to clients.

## Corporate banking

The Corporate Banking Sector's operations in 2014 were mainly influenced by changes in the Bank's ownership structure.

The beginning of the year was marked by a significant decrease in regulatory capital and consequently a decrease in large exposures, and due to the lack of placements there was a significant drop in the loan portfolio.

In this period the focus of the Operations sector related to maintaining the existing quality portfolio aiming at meeting the regulatory constraints and managing the portfolio of clients who are simultaneously affected by the general and the current lack of liquidity in order to keep delays within acceptable deadlines, and due receivables to a minimum.

The capital increase by the new owners in May brought the possibility of larger placements, but concurrent changes in the approval process have not led to a significant growth in the portfolio, which would be expected after the capital increase.

A significant part of activities during the rest of the year continued to be related to the management of clients who are in the process of pre-bankruptcy settlement.

In mid 2014, the Bank invested time in adapting to new the operating rules/procedures of the new owner, and the approaching of the year-end brought a stabilisation in the ways and modalities of placement approval, which led to greater market presence.

In accordance with an internal decision at the end of the year, a part of the clients from Sector (generally those outstanding over 90 days) were transferred to the management of the Workout department.

## Treasury activities

In 2014, the Croatian monetary and foreign exchange market operated under the influence of the loose monetary policy of the Croatian National Bank and the European Central Bank and, consequently, in an environment of very high HRK and foreign currency liquidity of the banking sector.

In such circumstances, with the stagnation of credit activity, interest rates on the money market also declined as well as the average cost of bank financing both in HRK and in other currencies.

The general decline in interest rates in the Eurozone and in Croatia as well as the extremely high liquidity of the financial sector have stimulated the purchase of bonds issued by the Republic of Croatia and thus the yields on these issues during the year have declined. The yield on the 10-year government bond with a currency clause and a maturity in 2024 decreased from approx. 5.7% at the beginning of the year to approx. 4% at the end of the year with an extremely low price volatility.

The trend of the slow increase in the Euro exchange rate against the HRK in recent years was continued in 2014, and therefore the average middle exchange rate of the CNB in 2014 was 7.63, while in 2013 it was 7.574. The volatility of the Euro exchange rate in 2014 was low and ranged between HRK 7.563 and 7.673, which represents a very narrow range.

The increase in bond prices had a positive impact on revenue of the Treasury and the income from securities trading in 2014 amounted to HRK 6.833 million, while in 2014 the Bank earned HRK 2.463 million of net foreign exchange differences. The total net trading income in 2014 amounted to HRK 9.296 million.

## System of internal control and internal audit

The internal control system is a set of processes and procedures established for adequate risk control, monitoring the efficiency and effectiveness of the Bank's operations, the reliability of its financial and other information and compliance with regulations, internal regulations, standards and codes to ensure the stability of the Bank.

In accordance with the Credit Institutions Act and the Decision on the internal controls system, the Bank has established an internal controls system comprising:

1. adequate organisational system,
2. organisational culture,
3. adequate control activities and segregation of duties,
4. adequate internal controls integrated in the business processes and activities of the Bank,
5. adequate administrative and accounting procedures,
6. activities in the area of the Bank's control functions.

The Bank has regulated and established adequate control activities and the segregation of duties, adequate internal controls and adequate administrative and accounting procedures performed in the course of the Bank’s regular activities.

Based on the legal requirements, the Bank has established three control functions independent of the business processes and activities in which risks arise, i.e. which it monitors. These are:

1. the risk control function,
2. the compliance monitoring function,
3. the internal audit function.

The risk control function ensures the Bank’s compliance with strategies and policies of risk management, through risk analysis, reporting to the Board and others on the risks and involvement in creating, applying and monitoring methods and models for risk management and carries out an assessment of internal capital adequacy of the Bank and coordinates the development of the Bank’s recovery plans.

The compliance monitoring function ensures that the Bank operates in accordance with the relevant legislation, standards, codes and internal acts. The activities of the compliance monitoring function include recognising and assessment of the compliance risk the Bank is, or could be, exposed to, advising the Board and other responsible persons on the application of relevant legislation, standards and rules, assessment of legislative changes to the Bank’s operations, checking of compliance of new products and procedures with the applicable legislation and with the legislation changes, and advising on the preparation of the compliance related educational programmes.

The internal audit function, as part of the internal supervision, tests and values the adequacy and effectiveness of the internal controls system, rates the adequacy and effectiveness of risk management procedures and risk assessment methodology, rates the effectiveness of the compliance monitoring function, rates the reporting system to the Board and the Management, rates the correctness and reliability of the accounting evidence system and of the financial statements, rates strategies and procedures of assessment of internal capital adequacy ratios, audits the IT system, checks the reliability of the reporting system and the timing and accuracy of reports as required by the Credit Institutions Act, rates the safety of the assets, rates the system of gathering and the accuracy of the information being publicly announced and performs all other activities needed for reaching the objectives of the internal audit.

Each control function prepares reports in accordance with its respective activities which are based on the operational plans in accordance with the Credit Institutions Act and the Decisions based on the Act.

## Development plan

The business strategy of the Bank's further development is focused on the implementation of the long-standing and successful business models of J&T Banka in the Czech Republic, Slovakia and Russia.

These business models require certain adjustments to the Croatian market in order to meet all regulatory requirements. Depending on their life cycle, the size of private property and risks tendencies, the clients will be offered an optimal and individual combination of financial products and services. For this purpose it will be necessary to build a small number of exclusive branches in which the Bank's employees will have a direct relationship with clients all over the country.

In addition special emphasis will be placed on enhanced marketing activities in order to develop the Bank's reputation and the clients' trust in the institution. Active marketing will be the cornerstone of the Bank's new stability, new strategy, new products and the overall image and strength of the entire group, which will be the Bank's support.

STRATEGIC OBJECTIVES:

- A stable position in the TOP 10 banks (by size) – approx. 300% increase in total balance sheet,
- Expand the 1% share in the Croatian market,
- Implementation of the J&T standards,
- Change in communication and visual identity of the Bank,
- Rationalisation and further improvement in operating efficiency,
- Diversification of risk and management of assets and liabilities according to best professional standards,
- Achieve sustainable return on share capital.

The recent share capital increase by J&T Banka will enable the Bank further business development, business improvement and achievement of strategic objectives. The above should contribute to enhancing the quality of the Bank's operations to the satisfaction of customers, regulators, employees and shareholders.

## Operations in 2014

As at 31 December 2014, the Bank had total assets of HRK 1,345.89 million (HRK 1,217.63 million as at 31 December 2013).

Gross loans amounted to HRK 752.61 million, of which 78.7% relate to placements to legal entities and 21.3% to the retail sector. In respect of the stated loans, a provision for identified losses was made in the total amount of HRK 98.8 million which represents 13.1% of total gross loans.

According to CNB regulations, the Bank makes provisions for potential losses on a portfolio basis for items not identified as impaired on an individual basis. The amount of the above provisions as at 31 December 2014 amounts to EUR 8.8 million (EUR 7.5 million as at 31 December 2013).

The term deposits of the retail sector comprise the largest share in the structure of the Bank's funding and amount to HRK 942.8 million at 31 December 2014 and make up 70.05% of the total sources of funding, while the Bank's capital as of 31 December 2014 amounts to HRK 123.7 million and comprises 9.2% of total sources of funding.

In 2014, interest income was below interest income in 2013 (HRK 57.6 million in 2014, HRK 72.5 million in 2013), while interest expense remained at the level of the previous year (not including deposit insurance premiums) and amounts to HRK 42.8 million, and net interest income amounted to HRK 14.8 million (HRK 30.5 million in 2013).
The highest share in interest income comprises interest income from legal entities (66.7%), while interest income from the retail sector is at the level of 18.3%. In the structure of interest expense, the highest share of interest expense relates to the retail sector (88.4%) which is followed by legal entities (4%).

In 2014, fee and commission income increased compared to 2013 (14%), while expenses increased by HRK 0.13 million and the realised net fee and commission income in 2014 increased by HRK 0.8 million compared to 2013.

Other operating income in 2014 amounted to HRK 11.34 million (2013: HRK -2.0 million).

Total operating income in 2014 was lower compared to 2013 (HRK 31.51 million in 2014, HRK 33.04 million in 2013), general and administrative expenses were higher compared to the previous year (HRK 46.0 million in 2014, HRK 45.3 million in 2013) and the loss before impairment amounted to HRK 14.5 million, while in 2013 a loss was realised in the amount of HRK 12.2 million.

During 2014, the Bank collected receivables provided for in the previous year on deposits to banks in the net amount of HRK 9.5 million, while at the same time in the portfolio of loans, bills of exchange and receivables the Bank made specific provisions in the additional amount of HRK 5.6 million (HRK 86.4 million at the end of 2013), whereby a positive effect of impairment was realised in 2014 in the net amount of HRK 3.87 million. For provisions on a group basis in 2014 an amount was allocated of HRK 1.3 million (in 2013, the Bank decreased provisions on a portfolio basis in the amount of HRK 0.3 million).

In 2014, the realised net loss amounted to HRK 11.9 million (HRK 109.5 million in 2013).

## Risk management

The most significant financial risks the Bank is exposed to are credit risk, liquidity risk, market risk and operational risk. Market risk includes foreign exchange risk, interest rate risk and risk of market price changes in value of equity and debt financial instruments.

Integrated system of risk management is built and continuously improved at the Bank's level by introducing policies and procedures for assessment, control and managing of risks and by establishing limits to risks exposures in line with the regulations and the Bank's risk profile.

## Credit risk

The Bank is exposed to credit risk through activities including trading, granting of loans, investing and in cases where it acts for and on behalf of clients or third parties or when it issues guarantees. Risk of default present in financial instruments transactions with some counterparties is constantly monitored. With the aim of managing credit risk, the Bank tries to do business with clients with good credit ratings and to obtain good collateral to ensure the recoverability of receivables from two independent sources (cash flow and collateral).

Credit risk is managed in accordance with the Bank's policies. Credit exposure to the portfolio or separate groups is constantly questioned in accordance with the given limits. Usage of limits is communicated to the Bank's bodies responsible for their approval. Credit board approves all significant increases of credit exposures and makes all decisions regarding the credit risk.

## Liquidity risk

Liquidity risk occurs in financing activities of the Bank and the management of positions.

The Bank has access to different financing sources. Funds are collected through a large number of instruments including different types of deposits, loans and other liabilities, including deposits, loans and shareholders' equity. The Bank continuously works on defining procedures and business processes for effectively monitoring liquidity risk by establishing and supervising financing changes, with the aim of achieving business objectives in line with the Bank's overall business strategy.

The Bank adjusts its business activities relating to liquidity risk, in line with the regulation and internal policies for maintaining liquidity reserves, balancing of assets and liabilities, controlling limits and liquidity indicators and planning for unforeseen events. Treasury daily manages liquidity reserves and ensures fulfilment of the clients' needs.

## Market risk

Market risk management involves managing position risk and currency risk. In order to manage position risk, defined as the risk of loss arising from changes in the prices of financial instruments, a system of limits is set up by type of financial instrument and the issuer. The utilisation of limits is monitored on a daily basis.

The Bank manages the foreign currency risk, which is defined as a loss due to changes in foreign currency exchange rates as a result of the currency gap in the balance sheet, in accordance with the legal provisions related to the open currency position on a daily basis.

Interest rate risk represents the sensitivity of the Bank's financial position on interest rate movements. The Bank's operations are influenced by the interest rate changes to an extent in which interest bearing assets and liabilities mature or their interest rates change in different timing or amounts.

### Operational risk

Operational risk is present in all segments of the Bank's operations, requiring quality knowledge over and continuous monitoring of all business processes. Organisational model of the process of managing of operational risk is conceptualized on both centralized and decentralised function of managing operational risk and is performed in accordance with the regulations and Basel guidelines and internal acts (policies, procedures and methodology on managing of operational risk).

IT safety managing in the context of IT operational risk managing includes several periodical activities with the aim of reducing the Bank's IT operational risk, embedding control mechanisms, improving business processes and complying with the regulations with the aim of reducing potential damage to the Bank's IT system arising from the vulnerability.

With the aim of operational risk managing, the Bank has secured adequate IT system management and IT system risk management, externalisation risks management, compliance risk management, business continuity management and has secured adequate anti money laundering and financing of terrorism system.

The policies of financial risks management are described in detail in the Notes to the financial statements for 2014.

# Statement on the application of the Code of Corporate Governance

During December 2009, the Bank's Management and Supervisory Board have adopted the Code of Corporate Governance of Vaba d.d. banka Varaždin, which established high standards and methods of quality corporate governance (further: the Code). The Code is published on the Bank's official web site (www.vaba.hr).

In every matter that is not regulated by the Code, the Bank applies Code of Corporate Governance made by the Zagreb Stock Exchange and the Croatian Financial Services Supervisory Agency "CFSSA", to the extent applicable to the Bank.

In accordance with the Companies Act, Article 272p, the Management Board announces that the Bank has voluntarily applied the recommendations of both Codes during 2014, with the exception of certain sections (as explained in detail within the annual questionnaire in the Code delivered along with the annual report to the Zagreb Stock Exchange for the purpose of publication).

The Management Board governs the Bank and its assets. Accordingly, the Board is obliged and authorised to take any necessary actions and decisions required for successful management of the Bank, all within the valid framework of the Companies Act and the Credit Institutions Act.

In accordance with the Bank's Articles of Association, the Management Board consists of at least two members, i.e. of three members at most, and the Supervisory Board decides on the number of members of the Management Board. Currently, the Management Board consists of two members.

The Supervisory Board appoints the members and the president of the Management Board for the period of a maximum of 5 years, with the possibility of reappointment, upon the CNB's approval. In accordance with new legislation, in mid-2013 the Policy on the process of the evaluation of the appropriateness of the president and the members of the Board was adopted, which more closely defines the criteria and procedures for evaluation of the appropriateness of the Bank's Management Board members during their appointment to the function, as well as during their mandates.

The Supervisory Board can recall its decision on the appointment of the members or the president of the Bank's Management Board in case of a relevant reason in accordance with effective regulations.

Members of the Management Board who have performed their duty during 2014 were as follows:

- Mr. Stanko Kežman, President of the Management Board (until 12 November 2014)
- Ms. Natalija Jambrečić, Member of the Management Board (until 12 November 2014)
- Mr. Ivica Božan, President of the Management Board (from 12 November 2014)
- Ms. Monika Cereova, Member of the Management Board (from 15 July 2014)

As at 31 December 2014, the Supervisory Board had six members on a 4-year mandate in accordance with the Articles of Association, after which they can be reappointed. The Supervisory Board must have at least one independent member, and during 2014 this member was Mr. Željko Filipović. In accordance with the Companies Act, Article 256, Section 2, the shareholder J&T banka a.s. Varaždin has the right to appoint 2 (two) members of the Supervisory Board as long as it is an owner of at least 25% of the Bank's shares. During 2014, the shareholder did not use this right.

A person can be appointed as a member of the Supervisory Board only if this person's knowledge and experience in banking or economy or scientific work can guarantee that they will be able to properly and duly perform the duties of a Supervisory Board member. Moreover, a person cannot become a member of the Supervisory Board if there are legal reasons against such person's appointment as a Supervisory Board member of the Bank. Also, due to the entry into force of the new legislation, in September 2014 the Bank's General Assembly adopted the Policy on the evaluation of the appropriateness of the Supervisory Board members (adjusted with the new bylaw), which more closely defines the criteria and procedures for the evaluation of the appropriateness of the Supervisory Board members during their appointment to the function, as well as during their mandates.

The privileges of the Supervisory Board are governed by the Articles of Association in accordance with the relevant provisions of the Companies Act and the Credit Institutions Act.

During 2014, the Bank's Supervisory Board members were as follows:

- Mr. Julius Strapek, President of the Supervisory Board
- Mr. Željko Filipović
- Mr. Tomáš Hlaváč (until 12 May 2014)
- Mr. Zoran Zemlić (until 12 May 2014)
- Mr. Tomislav Marinac (until 23 January 2014)
- Ms. Irena Adžić-Jagodić (until 12 May 2014)
- Mr. Martin Pardupa (until 12 May 2014)
- Mr. Igor Kováč (from 12 May 2014)
- Mr. Ivo Enenkl (from 12 May 2014)
- Mr. Juraj Lalík (from 12 May 2014)
- Mr. Patrik Tkáč (from 12 May 2014)

Information on the composition and activities of the Management and the Supervisory Board and their sub-committees is provided within the Annual Questionnaire within the Code of Corporate Governance.

The procedure for amending the Articles of Association is defined in Article 57 of the Articles of Association. In accordance with law and these Articles of Association, amendments to the Articles of Association can be processed at the General Assembly, whereas the Supervisory Board is entitled to amend the Articles of Association in order to adapt or to refine content of the Articles of Association.

The Management Board is authorised to issue new shares of the Bank within the provisions of the so-called approved issued capital. With the consent of the Bank's Supervisory Board, within a period of 5 years calculating from the day of entering the amendments into the court register and based on the Decision of the General Assembly as of 12 May 2014, the Management Board is authorised to adopt one or more decisions about increase of the Bank's share capital by cash payment and by issuing new shares, with the total amount of such share capital increase not exceeding half of the nominal amount of the share capital on the date of the said decision on the amendments to the Articles of Association. With the consent of the Supervisory Board and in respect of the shares being issued on the basis of this provision, the Management Board is authorised to exclude the pre-emptive right to subscribe new shares. The Management Board decides on the rights arising from shares which are issued under this authority, as well as the conditions for the issuance of these shares with the consent of the Supervisory Board.

The Bank's main shareholders with a share capital exceeding 2% of the total share capital as at 31 December 2014 were as follows:

| Name and surname/Company name | Security ticker | Balance | Share capital % |
|---|---|---|---|
| J&T BANKA A.S. | BPBA-R-B | 7500000 | 58.327 |
| ALTERNATIVE | BPBA-R-B | 3571429 | 27.7748 |
| VALIDUS D.D. U STEČAJU | BPBA-R-A | 513477 | 3.9933 |

In February 2015, the Bank's share capital was increased on the basis of the provisions of the Articles of Association on the so-called approved capital by payment of the amount of HRK 37,500,000.00 by the Bank's majority shareholder J&T Banka a.s., so that the new share capital amounts to HRK 166,085,400.00, and the said shareholder holds a total of 11,250,000 shares, ticker BPBA-RB, i.e. an equity share of 67.74%.

During 2014, the Bank's Audit Committee comprised of the following members:

- Ms. Irena Adžić-Jagodić, President (until 6 May 2014)
- Mr. Zoran Zemlić, Member (until 12 May 2014)
- Mr. Tomas Hlavač, Member (until 12 May 2014)
- Mr. Mirsad Latović, President (from 1 September 2014 until 5 December 2014)
- Mr. Julius Strapek, Member (from 1 September 2014)
- Mr. Juraj Lalik, Member (from 1 September 2014)

Due to the missing third member upon termination of the mandate of Mr. Latović, on 19 February 2015, Mr. Branko Tomašković was appointed as a new member of the Audit Committee.

The Audit Committee assists the Supervisory Board in performing the function of business supervision, and especially in performing the following tasks:

– monitoring the financial reporting process,

– monitoring the effectiveness of internal control, internal audit and risk management system,

– supervising the audit of the annual financial and consolidated financial statements,

– monitoring the independence of the independent auditor or the audit company in charge of the audit, especially additional service agreements,

– making recommendations to the General Assembly regarding the selection of the independent auditor or audit company,

– discussing plans and the annual internal audit report and significant issues relating to this area.

In addition to the Audit Committee, the Supervisory Board in its function of controlling the Bank's operations, monitors and evaluates the effectiveness of internal audit and makes recommendations to improve the quality of work, as well as recommendations for the use of available resources, with the aim of establishing a sound system of internal control to timely identify the risks the Bank is exposed to, with the aim of effective risk management.

Ivica Božan, President of the Management Board

Monika Cereova, Member of the Management Board

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

The Management Board of the Bank is required to prepare financial statements which give a true and fair view of the financial position of the Bank and of the results of its 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. The Management Board has a general responsibility for taking such steps as are reasonably available to it to safeguard the assets of the Bank and to prevent and detect fraud and other irregularities.

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

The Management Board is obliged to submit to the Supervisory Board the Bank's Annual Report together with the annual financial statements for acceptance. If the Supervisory Board approves the annual financial statements they are deemed confirmed by the Management Board and Supervisory Board.

The financial statements set out on pages 20 to 79 were authorised by the Management Board on 24 April 2014 for issue to the Supervisory Board and are signed below to signify this.

For and on behalf of Vaba d.d. banka Varaždin:

Ivica Božan, President of the Management Board

Monika Cereova, Member of the Management Board

## *Independent Auditor's Report*

**To the Shareholders and Management of Vaba d.d. banka Varaždin**

We have audited the accompanying financial statements of Vaba d.d. banka Varaždin (the "Bank"), which comprise the balance sheet as at 31 December 2014 and the statements of income, changes in equity and cash flows for the year then ended, and notes comprising a summary of significant accounting policies and other explanatory information.

### Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting regulations applicable to banks in Croatia as set out in Note 1 - I 'Basis of preparation' to the financial statements and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

### Auditor's Responsibility

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

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

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

*PricewaterhouseCoopers d.o.o., Ulica kneza Ljudevita Posavskog 31, 10000 Zagreb, Croatia*
*T: +385 (1) 6328 888, F:+385 (1) 6111 556, www.pwc.hr*

**Opinion**

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Bank as at 31 December 2014, its financial performance and cash flows for the year then ended in accordance with accounting regulations applicable to banks in Croatia as set out in Note 1 - I 'Basis of preparation' to the financial statements.

PricewaterhouseCoopers d.o.o.
Zagreb, 24 April 2015

This version of our 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 our report takes precedence over this translation.

# Balance sheet as at 31 December 2014

| [HRK'000] BALANCE SHEET | Notes | 31/12/2013 | 31/12/2014 |
|---|---|---|---|
| **ASSETS** | | | |
| Cash and deposits with Croatian National Bank | 4 | 157,325 | 191,124 |
| Placements with other banks | 5 | 50,242 | 189,998 |
| Available-for-sale financial assets | 6 | 193,075 | 191,640 |
| Held-to-maturity financial assets | 7 | 55,959 | 30,032 |
| Loans and advances to customers | 8 | 675,689 | 654,038 |
| Property and equipment | 9 | 30,579 | 42,373 |
| Intangible assets | 10 | 17,472 | 17,675 |
| Other assets | 11 | 37,288 | 29,008 |
| **TOTAL ASSETS** | | **1,217,629** | **1,345,888** |
| **LIABILITIES** | | | |
| Deposits from customers | 12 | 987,513 | 1,145,526 |
| Borrowings | 13 | 151,072 | 37,894 |
| Hybrid instruments | 14 | 3,055 | 26,489 |
| Provisions for liabilities and charges | 15 | 1,039 | 970 |
| Other liabilities | 16 | 12,672 | 11,279 |
| **TOTAL LIABILITIES** | | **1,155,351** | **1,222,157** |
| **EQUITY** | | | |
| Share capital | 17.1 | 75,020 | 128,585 |
| Other reserves | 17.2 | 94,030 | 25,222 |
| Fair value reserve | 17.3 | 2,677 | 1,041 |
| Accumulated losses | 17.4 | (109,449) | (31,117) |
| **TOTAL EQUITY** | | **62,278** | **123,731** |
| **TOTAL LIABILITIES AND EQUITY** | | **1,217,629** | **1,345,888** |

The significant accounting policies and other notes on pages 24 to 79 form an integral part of these financial statements.

# Income statement for 2014

| [HRK'000] INCOME STATEMENT | Notes | 2013 | 2014 |
|---|---|---|---|
| Interest and similar income | 18 | 72,550 | 57,552 |
| Interest and similar expense | 19 | (42,076) | (42,753) |
| **Net interest income** | | **30,474** | **14,799** |
| Fee and commission income | 20 | 6,369 | 7,260 |
| Fee and commission expense | 21 | (1,757) | (1,882) |
| **Net fee and commission income** | | **4,612** | **5,378** |
| Gains less losses from available-for-sale financial assets | 22 | (6,468) | 6,833 |
| Gains less losses arising from foreign currencies | 23 | 3,388 | 2,827 |
| Other operating income | 24 | 1,032 | 1,677 |
| **Dealing and other income** | | **(2,049)** | **11,338** |
| **OPERATING INCOME** | | **33,037** | **31,515** |
| General and administrative expenses | 25 | (40,491) | (42,516) |
| Depreciation and amortisation | | (4,068) | (3,425) |
| Provisions for liabilities and charges | | (716) | (27) |
| **Operating expenses** | | **(45,275)** | **(45,968)** |
| **OPERATING RESULT BEFORE IMPAIRMENT OF ASSETS** | | **(12,238)** | **(14,453)** |
| Identified impairment losses | | (96,961) | 3,866 |
| Identified impairment losses on group basis | | (251) | (1,324) |
| **Total impairment losses** | 26 | **(97,211)** | **2,543** |
| **PROFIT/(LOSS) BEFORE TAX** | | **(109,449)** | **(11,911)** |
| Income tax | 27 | - | - |
| **PROFIT/(LOSS) FOR THE YEAR** | | **(109,449)** | **(11,911)** |

The significant accounting policies and other notes on pages 24 to 79 form an integral part of these financial statements.

## Statement of comprehensive income for 2014

| [HRK'000] | 2013 | 2014 |
|---|---|---|
| **Profit / (loss) for the year** | **(109,449)** | **(11,911)** |
| Net unrealised gains/losses from available-for-sale financial assets | (2,932) | (1,636) |
| **Other comprehensive income / (loss)** | **(2,932)** | **1,636** |
| **TOTAL COMPREHENSIVE INCOME / (LOSS)** | **(112,381)** | **(13,547)** |

The significant accounting policies and other notes on pages 24 to 79 form an integral part of these financial statements.

# Statement of changes in equity for 2014

| [HRK'000] | Share capital | Share premium | Other reserves | Fair value reserve | Accumulated losses | Total |
|---|---|---|---|---|---|---|
| **At 1 January 2013** | 176,523 | 27,440 | 2,552 | 5,611 | (85,182) | 126,943 |
| Share capital increase | 50,306 | | | | | 50,306 |
| Share capital decrease | (151,810) | | | | | (151,810) |
| Transfer to reserves | | (27,440) | 91,478 | - | - | 64,038 |
| Coverage of loss from previous years | | | | | 85,182 | 85,182 |
| Profit/(loss) for the year | - | - | - | - | (109,449) | (109,449) |
| Net unrealised losses on available-for-sale financial assets | - | - | - | (2,932) | - | (2,934) |
| *Total comprehensive income* | | | | *(2,932)* | *(109,449)* | *(112,381)* |
| **At 31 December 2013** | **75,020** | **-** | **94,030** | **2,677** | **(109,449)** | **62,278** |
| Share capital increase | 75,000 | - | - | - | - | 75,000 |
| Share capital decrease | (21,434) | - | - | - | - | (21,434) |
| Transfer to reserves | - | - | (68,809) | - | - | (68,809) |
| Coverage of loss from previous years | - | - | - | - | 90,242 | 90,242 |
| Profit/(loss) for the year | - | - | - | - | (11,911) | (11,911) |
| Net unrealised losses on available-for-sale financial assets | - | - | - | (1,636) | - | (1,636) |
| *Total comprehensive income* | | | | *(1,636)* | *(11,911)* | *(13,547)* |
| **At 31 December 2014** | **128,586** | **-** | **25,221** | **1,041** | **(31,118)** | **123,731** |

The significant accounting policies and other notes on pages 24 to 79 form an integral part of these financial statements.

# Statement of cash flows for 2014

| [HRK'000] | 2013 | 2014 |
|---|---|---|
| **Cash flow from operating activities** | | |
| **Profit / (loss) before tax** | **(109,449)** | **(11,911)** |
| **Adjustments:** | **80,149** | **691** |
| - depreciation and amortisation | 4,068 | 3,425 |
| - foreign exchange (gains)/losses | (639) | (142) |
| - impairment losses on loans and advances to customers and other assets | 76,720 | (2,592) |
| - provisions for liabilities and charges | - | - |
| **Changes in operating assets and liabilities** | **104,340** | **180,443** |
| Net decrease/(increase) in placements with other banks | 3,382 | 3,661 |
| Net decrease/(increase) in loans and advances to customers | (29,772) | 37,198 |
| Net decrease/(increase) in other assets | 18,888 | (3135) |
| Net (decrease)/increase in deposits from banks | (6,546) | (2,720) |
| Obligatory reserves | 1,568 | (6,857) |
| Net (decrease)/increase in deposits from customers | 113,092 | 154,330 |
| Net (decrease)/increase in other liabilities | 3,728 | (2,034) |
| **Net cash inflow / (outflow) from operating activities** | **11,986** | **169,223** |
| **Cash flow from investing activities** | | |
| Purchase of property, equipment and intangible assets | (20,722) | (2,252) |
| Increase in available-for-sale financial assets | 2,158 | (2,071) |
| Maturity/(acquisition) of held-to-maturity financial assets | (40,252) | (26,462) |
| **Net cash inflow / (outflow) from investing activities** | **21,292** | **22,139** |
| **Cash flow from financing activities** | | |
| (Decrease)/increase in borrowings | (46,876) | (90,099) |
| Share capital (decrease)/increase | 50,306 | 75,000 |
| **Net cash inflow / (outflow) from financing activities** | **(32,025)** | **(15,099)** |
| Effect of foreign exchange rate changes on cash and cash equivalents | 801 | 1,428 |
| **NET INCREASE / (DECREASE) IN CASH AND CASH EQUIVALENTS** | **20,456** | **177,691** |
| **Cash and cash equivalents at beginning of year** | **89,620** | **110,076** |
| **Cash and cash equivalents at end of year** | **110,076** | **287,767** |

The significant accounting policies and other notes on pages 24 to 79 form an integral part of these financial statements.

# Notes to the financial statements for the year 2014

## 1. SIGNIFICANT ACCOUNTING POLICIES

### General information

Vaba d.d. banka Varaždin (hereinafter: the Bank) was established as Brodsko Posavska banka d.d., Slavonski Brod in 1994. On 27 December 2004, the Bank's name was changed to VABA d.d. banka Varaždin, and its registered office was relocated from Slavonski Brod to Varaždin, Anina 2. This change was a result of the changes in the ownership structure of the Bank, whose shareholder became Validus d.d. from Varaždin, with the consent of the Croatian National Bank provided that the Bank's operations would be secured in accordance with the law.

At the General Assembly held on 14 December 2006, the Bank issued a decision on increasing the share capital by issuing 292 thousand new shares, with a nominal value of HRK 100 per share through a private offer at a price of HRK 140 per share. At the General Assembly held on 18 April 2007, the Bank issued a decision on increasing the share capital by issuing 619 thousand new shares, with a nominal value of HRK 100 per share through a private offer to existing shareholders at a price of HRK 140 per share. In 2007, the share capital of the Bank was increased from HRK 62,226,400 to HRK 153,355,000 which was registered at the Commercial Court in Varaždin by the Court decision dated 17 August 2007.

Based on the Decision of the General Assembly dated 18 April 2007, the Bank's registered office was relocated to Aleja kralja Zvonimira 1, Varaždin.

On 6 March 2009, the General Assembly authorised a share capital increase from the amount of HRK 153,355,000 by the maximum amount of HRK 31,113,200 to the maximum amount of HRK 184,468,200. The Company's share capital was increased from HRK 23,167,800 to the amount of HRK 176,522,800 by payment in cash. The share capital is distributed among 1,765,228 ordinary shares, each with a nominal value of HRK 100.

As at 31 December 2013, the General Assembly authorised a simplified reduction of share capital to cover losses and transfer to capital reserves from the amount of HRK 176,522,800.00 to the amount of HRK 24,713,192.00. At the same meeting, the General Assembly decided to increase the share capital by the amount of HRK 50,000,006 to the amount of HRK 74,713,198.00 by payment in cash, whereby 3,571,429 new ordinary shares were issued in dematerialised form without nominal value.

Based on the Decision of the Management Board from 2 April 2013 adopted in accordance with Article 17 of the Articles of Association, with the prior approval of the Bank's Supervisory Board, the Bank's share capital was increased from the amount of HRK 74,713,198.00 by the amount of HRK 306,362.00 to the amount of HRK 75,019,560.00 (approved share capital). The share capital of the Bank was increased by issuing 21,883 ordinary shares in dematerialised form, without par value in cash each in the amount of HRK 14 per share.

On 12 May 2014, the General Assembly made a decision on decreasing share capital from the amount of HRK 75,019,560.00 by the amount of HRK 21,434,160.00 to the amount of HRK 53,585,400.00. The Bank's share capital was decreased in line with Article 342 of the Companies Act for the purpose of being included in the capital reserves of the entity without returning parts of this capital to shareholders, by reducing the amount of individual shares from the amount of HRK 75,019,560.00 by the amount of HRK 21,434,160.00 to the amount of HRK 53,585,400.00 and is divided among 5,358,540 ordinary shares, without par value.

On 12 May 2014, the General Assembly made a decision on increasing the share capital from the amount of HRK 53,585,400.00 by the amount of HRK 75,000,000.00 to the amount of HRK 128,585,400.00. The Bank's share capital was increased from the amount of HRK 53,585,400.00 by the amount of HRK 75,000,000.00 to the amount of HRK 128,585,400.00. The Bank's share capital was increased by payment in cash, by issuing 7,500,000 new ordinary shares in dematerialised form, without par value.

Based on the Decision of the Management Board from 17 December 2014 adopted in accordance with Article 17 of the Articles of Association, with the prior approval of the Bank's Supervisory Board, the Bank's share capital was increased from the amount of HRK 128,585,400.00 by the amount of HRK 37,500,000.00 to the amount of HRK 166,085,400.00 (approved share capital). The Bank's share capital was increased by issuing 3,750,000 new ordinary shares in dematerialised form, without par value. The share capital increase was performed on 28 January 2015 through a payment in cash by J&T bank, Prague, and it was entered into the Commercial Court Register on 9 February 2015.

These financial statements were approved by the Bank's Management Board on 24 April 2015 for submission to the Supervisory Board.

## I. Basis of presentation

### (a) Statement of compliance

The financial statements have been prepared in accordance with statutory accounting requirements for banks in Croatia. The Bank's operations in Croatia are subject to the Credit Institutions Act, in accordance with which the Bank's financial reporting is regulated by the Croatian National Bank ("the CNB") which is the central monitoring institution of the banking system in Croatia.

The principal accounting policies applied in the preparation of these financial statements are summarised below. Where specific accounting policies are aligned with accounting principles set out in International Financial Reporting Standards ("IFRS"), reference may be made to certain Standards in describing the accounting policies of the Bank; unless otherwise stated, these references are to Standards as adopted in the European Union at 31 December 2014.

The accounting regulations based on which these financial statements have been prepared differ from IFRS both in terms of presentation as well as in terms of recognition and measurement. We draw attention to the following differences between the accounting regulations of the CNB and the recognition and measurement requirements of IFRS:

- The CNB requires banks to recognise impairment losses, in the income statement, on assets not identified as impaired (including sovereign risk assets) at prescribed rates (excluding assets carried at fair value through profit or loss). In accordance with these requirements, the Bank has recognised portfolio-based provisions of HRK 9,574 thousand (2013: HRK 8,293 thousand) in the balance sheet and has recognised loss in the amount of HRK 1,282 thousand within impairment losses on loans to customers and other assets (2013: loss of HRK 302 thousand).
- Although the Bank calculates impairment losses on corporate lending as the present value of the expected future cash flows, discounted at the instrument's original effective interest rate, in accordance with IFRS, the CNB requires the amortisation of the calculated discount to be presented in the income statement within the movement in impairment losses on loans and advances to customers and other assets, rather than as interest income, as required by International Financial Reporting Standards.
- Additionally, the CNB prescribes minimum levels of impairment losses against certain specifically identified impaired exposures, which may be different from the impairment loss required to be recognised in accordance with IFRS.

### (b) Basis of preparation

The financial statements are prepared on a fair value basis for derivative financial instruments, financial assets and liabilities at fair value through profit or loss and available for sale assets, except those for which there is no reliable measure of fair value. Other financial assets and liabilities, and non-financial assets and liabilities, are stated at amortised or historical cost.

The financial statements are prepared in a format that is commonly used and internationally recognized by banks

In preparing the financial statements, management has made judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities and disclosure of commitments and contingencies at the reporting date, as well as amounts of income and expense for the period. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances and information available at the date of the preparation of the financial statements, the result of which form the basis for making the judgements about carrying amounts of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which they are incurred if affecting only that period or the period in which they are incurred and future periods if they impact current and future periods.

Judgements made by management in applying the appropriate standards that have significant effects on the financial statements and estimates with a significant risk of a possible material adjustment in the next year are discussed in Note 3.

### (c) Functional and presentation currency

The Bank's financial statements are presented using the currency of the primary economic environment in which the Bank operates (the "functional currency"), Croatian kuna ("HRK"). Amounts are rounded to the nearest thousand.

The exchange rates of currencies, in which the majority of the Bank's assets and liabilities are denominated, are used for the translation of the Bank's assets and liabilities and as at 31 December 2014 they were as follows: EUR 1 = HRK 7.661 (2013: EUR 1 = HRK 7.638) and USD 1 = HRK 6,302 (2013: USD 1 = HRK 5.549).

### (d) Changes in presentation or classification of items within the financial statements

Where necessary, comparative information has been reclassified to achieve consistency with amounts presented in the current financial year amounts and other disclosures.

## II. Specific accounting policies

### (a) Interest income and expense

Interest income and expense are recognised in the income statement as they accrue for all interest earning financial instruments, including those measured at amortised cost, at fair value through profit or loss and available for sale, using the straight-line method. Such income and expense is presented as interest and similar income or interest expense and similar charges in the income statement. Interest income and expense also includes fee and commission income and expense in respect of loans provided to customers or borrowings from other banks, premium or discount amortisation, and other differences between the initial carrying amount of an interest-earning financial instrument and its value at maturity, recognised on a linear basis. Income and expense on all assets and liabilities held for trading is recognised as interest income and expense.

### (b) Fee and commission income and expense

Fee and commission income and expense arise on financial services provided by the Bank and received by the Bank, and mainly comprise fees related to domestic and foreign payments, the issue of guarantees and letters of credit, credit card business and other services provided by the Bank. Fee and commission income and expense are recognised in the income statement when the related service is performed.

Loan commitment fees for loans that are likely to be drawn down are deferred linearly (together with related direct costs) and recognised as an adjustment to the interest rate on the loan. Commitment fees in relation to loans that are not likely to be drawn are recognised over the term of the commitment. Loan syndication fees are recognised as revenue when the syndication has been completed and the Bank has retained no part for itself, or has retained a part at the same interest rate as the other participants. Portfolio and other management advisory and service fees are recognised based on the applicable service contracts upon completion of the service.

Asset management fees related to investment fund management are recognised on an accrual basis over the period in which the service is provided. The same principle is applied for custody services that are continuously provided over an extended period of time.

### (c) Dividend income

Dividend income from equity securities is recognised in the income statement when the rights to receive the dividend are established.

### (d) Gains less losses from financial assets through profit and loss and investment securities

Gains less losses from financial instruments at fair value through profit or loss include unrealised and realised gains and losses arising from trading with derivative financial instruments, traded debt securities and other financial instruments designated at fair value through profit or loss.

Gains less losses arising from investment securities comprise realised gains and losses from available-for-sale financial instruments.

### (e) Gains less losses arising from dealing in foreign currencies

Gains less losses from dealing in foreign currencies include unrealised and realised gains and losses arising from spot and forward dealings in foreign currencies.

## (f) Foreign currencies

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the date of the transaction. Monetary assets and liabilities denominated in foreign currency at the reporting date are translated into HRK at the foreign exchange rate prevailing at that date.

Foreign currency differences arising on translation are recognised in the income statement. Non-monetary assets and liabilities denominated in foreign currency and measured at fair value are translated into HRK at the foreign exchange rate prevailing at the date their fair value was determined.

Non-monetary assets and items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction and are not retranslated.

Changes in the fair value of monetary securities denominated in foreign currency and classified as available-for-sale are analysed between translation differences resulting from changes in the amortised cost of the security and other changes in the carrying amount of the security. The translation differences are recognised in the income statement as part of the foreign exchange gains or losses on the revaluation of monetary assets and liabilities presented within general and administrative expenses in the income statement or other operating income. Translation differences on non-monetary financial assets, such as equity instruments classified as available for sale, are included in the fair value reserve in equity.

## (g) Financial instruments

i) Classification

The Bank classifies its financial instruments into the following categories: financial assets at fair value through profit or loss, loans and receivables, available for sale, held to maturity or financial liabilities. The classification depends on the purpose for which the financial instruments were acquired. The Management determines the classification of financial instruments at initial recognition.

*Financial assets and financial liabilities at fair value through profit or loss*

This category comprises two subcategories: financial instruments held for trading (including derivatives), and those designated by management as at fair value through profit or loss at inception. The Bank designates financial assets at fair value through profit or loss when:

- the assets and liabilities are managed, evaluated and reported internally on a fair value basis,
- the designation eliminates or significantly reduces an accounting mismatch which would otherwise arise, or
- the asset and liability contains an embedded derivative that significantly modifies the cash flows that would otherwise be required under the contract.

At 31 December 2014, the Bank had no financial assets and financial liabilities at fair value through profit or loss (2013: zero).

*Loans and receivables*

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the Bank provides money to a debtor with no intention of trading with the receivable and include loans and advances to banks, loans and advances to customers and the obligatory reserve with the Croatian National Bank.

*Held-to-maturity financial instruments*

Held-to-maturity financial instruments are non-derivative financial assets with fixed or determinable payments and fixed maturity that the Bank's Management has the positive intention and ability to hold to maturity. These include corporate bills of exchange.

*Available-for-sale financial assets*

This category comprises non-derivative financial assets which are defined as available for sale or are not included in loans and receivables or held-to-maturity investments, or classified as financial assets at fair value through profit or loss. Available-for-sale financial assets are intended to be held for an indefinite period of time, but may be sold in response to needs for liquidity or changes in interest rates, foreign exchange rates, or equity prices.

Available-for-sale financial assets include debt and equity securities, units in investment funds and units in a private equity fund.

*Other financial liabilities*

Other financial liabilities comprise all financial liabilities which are not held for trading or designated at fair value through profit or loss.

### ii) Recognition and derecognition

Purchases and sales of financial assets and financial liabilities at fair value through profit or loss, held-to-maturity financial assets and available-for-sale financial assets are recognised on the settlement date, that is, the date when the financial instrument is delivered to or transferred by the Bank. Loans and receivables and financial liabilities at amortised cost are recognised when advanced to borrowers or received from lenders.

The Bank derecognises financial instruments (in full or in part) when the contractual rights to receive cash flows from the financial instrument have expired or when it loses control over the contractual rights to such financial instrument. This occurs when the Bank transfers substantially all the risks and rewards of ownership to another business entity or when the rights are realised, surrendered or have expired. The Bank derecognises financial liabilities only when the financial liability ceases to exist, i.e. when it is discharged, cancelled or has expired. If the terms of a financial liability change, the Bank will cease recognising that liability and will instantaneously recognise a new financial liability, with new terms and conditions.
Realised gains and losses from the disposal of financial instruments are calculated by using the weighted average cost method.

### iii) Initial and subsequent measurement

Financial assets and liabilities are recognised initially at their fair value plus, in the case of a financial asset or financial liability not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability.

After initial recognition, the Bank measures financial instruments at fair value through profit or loss and available-for-sale financial assets at their fair value, without any deduction for selling costs. Instruments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured are measured at cost less impairment.

Loans and receivables and held-to-maturity investments and financial liabilities not designated at fair value through profit or loss are measured at amortised cost.

### iv) Gains and losses

Gains or losses arising from a change in the fair value of financial assets or financial liabilities at fair value through profit or loss are recognised in the income statement.

Gains or losses arising from a change in the fair value of available-for-sale monetary assets are recognised directly in a fair value reserve within equity and are disclosed in the statement of changes in equity. Impairment losses, foreign exchange gains and losses, interest income and amortisation of premium or discount on available-for-sale monetary assets are recognised in the income statement. Foreign exchange differences on equity instruments are part of the fair value of these instruments and are recognised in equity.

Dividend income is recognised in the income statement. Upon sale or other derecognition of available-for-sale financial assets, any cumulative gains or losses on the instrument are transferred to the income statement.

Gains or losses arising from financial assets and financial liabilities carried at amortised cost are recognised as interest in the income statement over the period of amortisation.

Gains or losses may also be recognised in the income statement when a financial instrument is derecognised or when its value is impaired.

### v) Determination of fair value of financial instruments

The fair values of quoted available-for-sale financial assets are based on closing prices at the reporting date. If there is no active market for the financial instrument, or if, due to any other reason, the fair value cannot be reliably measured based on the market price, the Bank uses an internal evaluation model for fair value estimation.

The fair value of non-exchange-traded derivatives is estimated at the amount that the Bank would receive or pay to terminate the contract on the reporting date taking into account current market conditions and the current creditworthiness of the counterparties.

### vi) Impairment of financial assets

#### *Impairment of assets identified as impaired*

Financial assets are reviewed at each reporting date to determine whether there is objective evidence of impairment. If any such indication exists, the asset's recoverable amount is estimated.

The Bank estimates and performs an impairment of all financial assets other than financial assets at fair value through profit or loss.

If any evidence of impairment exists for available-for-sale financial assets, the cumulative loss measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in profit or loss, is removed from equity and recognised in the income statement. A significant or prolonged decline in the fair value of investments in equity securities and investments in investment funds is considered an impairment. Impairment losses recognised in the income statement on equity instruments are not reversed through the income statement. If, in a subsequent period, the fair value of a debt instrument classified as available for sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss is reversed through the income statement.

The recoverable amount of financial assets measured at amortised cost is calculated as the present value of the expected future cash flows, discounted at the instrument's original interest rate. Short-term balances are not discounted. Provisions for uncollectibility are made against the carrying amount of loans and advances to customers that are identified as being impaired based on regular reviews of outstanding balances to reduce these loans and advances to their recoverable amounts (or lower amount if required by applicable CNB regulations). The expected cash flows for portfolios of similar assets are estimated based on previous experience and considering the credit rating of the underlying customers and late payments of interest or penalties. An increase in impairment losses is recognised in the income statement. When a loan is known to be uncollectable, all the necessary legal procedures have been completed, and the final loss has been determined, the loan is written off directly. If in a subsequent period the amount of impairment loss decreases and the decrease can be linked objectively to an event occurring after the write-off, the write-off amount or impairment loss is reversed through the income statement.

#### *Impairment of assets not identified as impaired*

In addition to the above described impairment losses on assets identified as impaired, the Bank recognises impairment losses in the income statement, in on- and off-balance-sheet credit risk exposures not identified as impaired at the rate of 1.00% in accordance with the accounting regulations of the CNB (Amendment to the Decision on the classification of placements and off-balance sheet contingent liabilities with effective from 31 August 2013 with respect to impairment of assets on a group basis).

Debt securities carried at fair value and classified as available for sale were excluded from the basis of such calculation at the reporting date.

## (h) Specific financial instruments

Cash and cash equivalents

Cash and cash equivalents comprise cash balances on hand, cash deposited with the Croatian National Bank, placements with other banks with original maturities of three months or less, and items in the course of collection.

Derivative financial instruments

The Bank uses derivative financial instruments to hedge economically its exposure to currency risk and interest rate risk arising from operating, financing and investing activities. In accordance with its investment policies, the Bank does not hold or issue derivative financial instruments for the purpose of speculative trading. Hedge accounting has not been applied. Consequently, all derivative agreements are classified as financial instruments at fair value through profit or loss.

Derivative financial instruments include foreign currency forward agreements and swaps and are initially recognised at fair value which is the value of the consideration paid to acquire the instrument less transaction costs. Subsequent to initial recognition, derivatives are measured at fair value. The fair value is determined based on the quoted market price or, if more appropriate, based on the discounted cash flow. All derivatives are carried as assets if their fair value is positive and as liabilities if their fair value is negative.

Hybrid contracts contain both a derivative and a non-derivative component. In such cases, the derivative component is considered to represent an embedded derivative. Except as required to the contrary by the CNB, when the economic characteristics and risks of embedded derivatives are not closely related to those of the host contract and when the hybrid contract is not itself carried at fair value through profit or loss, the embedded derivative is treated as a separate derivative and classified at fair value through profit or loss with all unrealised gains and losses recognised in the income statement, unless there is no reliable measure of their fair value.

Changes in the fair value of derivatives instruments are included in gains less losses arising from dealing with foreign currencies.

Treasury bills and debt securities

Treasury bills and debt securities that the Bank holds for short-term gain purposes are classified as available-for-sale assets, and are carried at fair value. The Bank uses treasury bills for liquidity purposes.

Equity securities and investments in open-ended investment and other funds

Equity securities and investments in open-ended and close-ended investment funds are classified as available-for-sale assets.

Placements with banks

Placements with banks are classified as loans and receivables and are carried at amortised cost less impairment losses.

Loans and advances to customers

Loans and advances to customers are classified as loans and receivables and are presented net of impairment allowances to reflect the estimated recoverable amounts.

Borrowings

Interest-bearing borrowings are recognised initially at fair value, less attributable transaction costs. Subsequent to initial recognition, interest-bearing borrowings are stated at amortised cost with any difference between proceeds (net of transaction costs) and redemption value being recognised in the income statement over the period of the borrowings as interest expense.

Repurchase agreements and linked transactions

The Bank enters into purchases/(sales) of investments under agreements to resell (repurchase) substantially identical investments or in a series of linked sales and buy-back transactions at a certain date in the future

at a fixed price. The amounts paid are recognised in loans and advances to either banks or customers. The receivables are shown as collateralised by the underlying security. Investments sold under repurchase agreements continue to be recognised in the balance sheet and are measured in accordance with the accounting policy for the relevant financial asset at amortised cost or at fair value as appropriate. The proceeds from the sale of the investments are reported as liabilities to either banks or customers.
The difference between the sale and repurchase consideration is recognised on an accrual basis over the period of the transaction and is included in interest income or expense.

### Offsetting of financial instruments

Financial assets and liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right to set off the recognised amounts and there is an intention to settle on a net basis or realise the asset and settle the liability simultaneously.

Income and expenses are presented on a net basis only when permitted by the accounting standards, or for gains and losses arising from a group of similar transactions such as in the Bank's trading activity.

### (i) Income tax

Income tax is based on taxable income for the year and comprises current and deferred tax. Income tax is recognised in the income statement except to the extent that it relates to items recognised directly in 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 the balance sheet date, and any adjustments to tax payable in respect of previous years.

Deferred tax is provided using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation 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 at the reporting date.

The measurement of deferred tax liabilities and deferred tax assets reflects the tax consequences that would arise from the manner in which the Bank expects, at the reporting date, 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 balance sheet. Deferred tax assets are recognised only to the extent that it is probable that sufficient taxable profits will be available against which the deferred tax assets can be utilised. At each balance sheet date, the Bank reassesses unrecognised potential deferred tax assets and the carrying amount of recognised deferred tax assets.

### (j) Property and equipment

Property and equipment are tangible items that are held for use in the supply of services or for administrative purposes.

Recognition and measurement

Property and equipment are stated at historical cost less accumulated depreciation and impairment losses. Historical cost includes the cost that is directly attributable to the acquisition of assets.

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Bank and the cost of the item can be measured reliably. All other repairs and maintenance are charged to the income statement during the financial period in which they are incurred.
Land and assets under construction are not depreciated. Depreciation of other assets is calculated using the straight-line method to allocate their cost over their estimated useful lives as follows:

| | 2014 | 2013 |
|---|---|---|
| **Buildings** | 33 years | 33 years |
| **IT equipment** | 5 years | 5 years |
| **Furniture and equipment** | 7-15 years | 7-15 years |
| **Motor vehicles** | 4 years | 4 years |
| **Other assets** | 10 years | 10 years |

Residual values are not taken into account. Depreciation methods and estimated useful lives are reassessed at the each reporting date. Gains and losses on disposals are determined by comparing proceeds with carrying amount, and are included in the income statement.

## (k) Intangible assets

Intangible assets are recorded at cost less accumulated depreciation and provision for impairment. Expenditure on development activities are capitalised if all of the requirements of IAS 38 "*Intangible Assets*" are met. Amortisation is provided on the straight-line basis over the estimated useful lives of intangible assets. Costs associated with maintaining intangible assets are recognised as an expense as incurred.

Intangible assets are amortised on a straight-line basis over their estimated useful economic lives as follows:

| | 2014 | 2013 |
|---|---|---|
| **Leasehold improvements** | 5 years | 5 years |
| **Software** | 5 years | 5 years |
| **Licences** | 5 years | 5 years |

## (l) Impairment of non-financial assets

The recoverable amount of property and equipment and intangible assets is the higher of the asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows ("cash-generating units"). In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset or cash-generating unit.

Non-financial assets that have suffered impairment are reviewed for possible reversal of the impairment at each reporting date. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount and to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation, if no impairment loss had been recognised.

## (m) Provisions for liabilities and charges

Provisions are recognised when the Bank has a present obligation as a result of past events, and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made, or as required by the law in the case of provisions for unidentified impairment of off-balance-sheet credit risk exposures, as previously referred to in Note II. (b) "Financial Instruments".

Provisions for liabilities and charges are maintained at a level which management believes is adequate to absorb probable future losses. Management determines the adequacy of the provision based upon reviews of individual items, recent loss experience, current economic conditions, the risk characteristics of the various categories of transactions and other relevant factors. Provisions are released only for such expenditure in respect of which provisions are recognised at inception. If an outflow of economic benefits to settle the obligations is no longer probable, the provision is reversed.

## (n) Operating lease

Leases where the Bank has substantially all the risks and rewards of ownership, are classified as finance leases. At the reporting date, the Bank did not have any financial leases neither as a lessee nor lessor. Other leases are operating leases. Rental income under operating leases is recognised in the income statement on a straight-line basis over the term of the lease. The Bank leases office space for conducting its business activities. Payments made under operating leases are recognised in profit or loss on a straight-line basis over the term of the lease.

## (o) Employee benefits

Pension obligations

The Bank pays contributions to state-owned institutions and obligatory pension funds managed by privately owned management companies, in accordance with legal requirements or by individual choice. The Bank has no further payment obligations once the contributions have been paid. Pension contributions are recognised as employee benefits in the income statement as they accrue.

Other employee benefits

Liabilities based on other long-term employee benefits, such as jubilee awards and statutory termination benefits, are recorded as the net present value of the liability for defined benefits at the reporting date. The projected discounted present value unit method is used for the calculation of the present value of the liability, using discount rates that, in opinion of the Bank's management, best represent the time value of money.

## (p) Share capital and reserves

Issued share capital represents the nominal value of paid-in ordinary shares classified as equity and is denominated in HRK.

Reserve for general banking risks

The Bank recognises a reserve for general banking risks, which represents a reserve for potential losses in excess of those expected and provided for through recognised impairment losses. The reserve is calculated in accordance with applicable regulations which require that a certain percentage of net profit for the year be set aside as a reserve within equity if the growth of risk assets on an annual basis exceeds a specific level. The reserve for general banking risk cannot be transferred to retained earnings or be otherwise distributed until the expiry of a consecutive three-year period in which the Bank has recorded annual growth not exceeding 15%.

Accumulated losses

Accumulated losses include losses from previous periods, the profit for the year and expenditures related to the acquisition of property in the prior period.

Earnings per share

The Bank presents earnings per share (EPS) data for its ordinary shares. EPS is calculated by dividing the net profit attributable to ordinary shareholders of the Bank by the weighted average number of ordinary shares outstanding during the period.

## (q) Off-balance-sheet commitments and contingent liabilities

In the ordinary course of business, the Bank enters into credit-related commitments which are recorded in off-balance-sheet records and primarily comprise guarantees, letters of credit and undrawn loan commitments. Such financial commitments are recorded in the Bank’s balance sheet if and when they become payable.

## (r) Funds management for and on behalf of third parties

The Bank manages funds for and on behalf of corporate and retail customers. Those amounts do not represent the Bank's assets and are excluded from the balance sheet. For the services rendered, the Bank charges a fee which is recognised in the income statement on an accruals basis. The Bank is not exposed to credit risk from these placements, nor does it guarantee for investments.

# 2. RISK MANAGEMENT

## 2.1. Internal assessment of risk of the Bank's operations

This section provides details of the Bank's exposure to risk and describes the methods used by management to identify, measure and manage risk in order to safeguard capital. The most significant types of financial risk to which the Bank is exposed are credit risk, liquidity risk, market risk and operational risk.

For the most significant risks, the Bank adopted a policy and management strategy which includes objectives and basic principles of risk assumption and management, it defined the risk profile and risk appetite and the compliance of the Bank's risk profile and the level of capital.

The Bank has established a risk management system appropriate to the nature, scope and complexity of the business, and risk profile of the Bank, which includes an adequate strategy, policy and other internal regulations for risk management, organizational structure with defined authorities and responsibilities for risk management, risk management process and an effective system of internal controls. The Bank regularly monitors and checks the risk management system and identifies and assesses the risks to which it is or expects to be exposed in its operations.

### 2.1.1. Credit risk

The Bank is subject to credit risk through its lending and investing activities and in cases where it acts as an intermediary on behalf of customers or other third parties. Credit risk can be defined as a risk of financial loss of the Bank by a counterparty failing to discharge its obligation.

To manage the level of credit risk, the Bank evaluates debtors' creditworthiness, and in order to minimise credit risk, obtains appropriate collateral. Also, the risk that counterparties to financial instruments might default on their obligations is monitored on an ongoing basis.

The Bank's primary exposure to credit risk arises from loans to and receivables from customers. The amount of credit exposure in this regard, and in respect of held-to-maturity securities recognised at amortised cost, is represented by the carrying amounts of the assets on the balance sheet. In addition, the Bank is exposed to credit risk arising from off-balance-sheet items, through commitments arising from unused facilities and guarantees issued.

The Bank manages its credit risk exposure in accordance with the legislative requirements and regulations of the Croatian National Bank, as well as in accordance with its internal procedures.

The Credit risk management policy and strategy is an umbrella document, i.e. a framework for managing credit risk, which is followed by procedures, instructions and other documents that define the following in more detail:

- tendency of taking credit risk,
- clear lines of authority and responsibility,
- way of assumption, overcoming and credit risk management,
- defining the credit process and establishing a system of control and reporting of credit risk exposure,
- methodology for determining credit worthiness, measurement and assessment of credit risk for the duration of the repayment / validity of risky product,
- procedures for controlling and monitoring credit risk, including the establishment of exposure limits,
- procedures and measures if there is a deviation from the application of existing policies, procedures and authority for approval of such deviations and
- stress testing as a preparation of the Bank for possible crisis situations.

The above stated creates a comprehensive credit risk management system.

## Credit risk assessment

The process of credit risk assessment of placements comprises the following:

- debtors' creditworthiness,
- debtors' timeliness in meeting their obligations,
- collateral quality.

Creditworthiness is assessed on each loan application, that is, as a minimum once a year subsequent to the delivery of the annual financial statements by the clients to which the Bank is exposed and who have not filed a loan request for a new risky product.

Creditworthiness implies the ability of a client to comply with credit terms or potential obligations and to ensure the fulfilment of the accepted obligation towards the Bank with its own funds, in the manner and within the period determined by the contract and that the client's operations comply with laws and regulations.

The creditworthiness of a corporate customer is assessed using at least the following criteria:

1. the nature of the debtor
2. the debtor's capital
3. creditworthiness of the debtor
4. liquidity and profitability
5. cash flow of the debtor
6. the general business terms and conditions and the outlook of the debtor
7. the debtor's exposure to currency indicated credit risk.

Monitoring of placements and contingent liabilities includes continuous assessment as to whether elements exist which would indicate a deterioration of the customer's financial position, the customer's exposure to currency risk or an increase in risk due to the decrease of collateral value.

Credit risk management during 2014 was complex and largely influenced by macroeconomic trends, as well as efforts to ensure the collection of receivables by implementing restructuring and/or rescheduling measures. By introducing the concept of pre-bankruptcy settlements as a new, legally acceptable and regulated modality for the restructuring of the debtor's liabilities towards all creditors was an additional challenge in the effort to reconcile the customers' ability to pay in accordance with prevailing market conditions by way of the overall restructuring of the debtors' operations or financial position. This will ultimately lead to a better settlement of liabilities to the Bank and improve the liquidity of customers in order to ensure business stability and sustainability over the long term.

## Classification of placements into risk categories

The process and criteria for the classification of placements into risk categories and calculation of impairment losses is defined by the By-law on the classification of placements and contingent liabilities of VABA d.d. banka, in accordance with the CNB's Decision on the Classification of Placements and Contingent Liabilities of Banks.

The Bank assesses the quality of placements and contingent liabilities continuously and classifies them based on the following general criteria:

a) creditworthiness of the debtor,
b) debtors' timeliness in meeting their obligations and
c) collateral quality.

The Bank uses all of the criteria in the process of classification of placements, in line with the best practices of credit risk management.

Exceptionally, in accordance with the CNB's Decision on the Classification of Placements and Contingent Liabilities of Banks, the Bank classifies placements from the "small loan portfolio" into risk categories based on the debtors' timeliness in meeting their obligations towards the Bank and/or their collateral quality with individually significant placements being classified based on the collateral quality if the key criteria for the approval of the placement was not the creditworthiness of the debtor, but the collateral quality (with obligatory assessments of fair value and marketability of the collateral).

Based on the criteria and the classification of the placements and contingent liabilities which are defined separately for the "small loan portfolio" (total exposure toward one counterparty or a group of related counterparties less than HRK 200,000 at the assessment date) and for individually significant exposures (total exposure toward one counterparty or a group of related counterparties more than HRK 200,000 at the assessment date), the Bank classifies all of its placements into risk categories with impairment losses as follows:

1. **Risk category A** – newly approved placements upon initial approval and placements that the Bank estimates are fully recoverable – with no impairment losses on individual basis (impairment losses for risk category A placements are calculated on the group basis).
2. **Risk category B** – partly recoverable placements – risk category B, which are classified into three subcategories, depending on the percentage of the impairment losses in relation to the initial amount of placements:

    **B1** – losses ranging from 1% to 29.99%,

    **B2** – losses ranging from 30.00% to 69.99%,

    **B3** – losses ranging from 70.00% to 99.99%.
3. **Risk category C** – non-recoverable placements with impairment losses of 100%.

Risk categories are classified at least on a quarterly basis. Risk categories for the "small loan portfolio" are applied systematically and controlled by the Risk Management Sector. The recoverability of placements which are not part of the "small loan portfolio" is assessed continuously and risk categories are updated at least on a quarterly basis as suggested by the Risk Management Sector.

As opposed to 2013, when value adjustments of the credit portfolio were significantly higher, primarily as a result of the deterioration of the loan portfolio due to the objective economic situation and unfavourable market conditions, initiating a large number of pre-bankruptcy settlements and adjustment due to changes in legal provisions regulating the classification of placements and off-balance sheet liabilities, in 2014 value adjustments were somewhat lower whereby additional provisions were decreased by releasing provisions for collection of the deposit at Centar banka d.d. in bankruptcy in the amount of HRK 9,5 million.

## Assets exposed to credit risk

Based on the applicable acts, the Bank uses the usual instruments as collaterals: bank guarantees, fiduciary right on real estate and movable assets, insurance policies, fiduciary rights on securities and shares in open-ended investment funds, cessions of receivables from companies and ministries (government) as well as bills of exchange and promissory notes. The valuation of property and movable assets is performed by certified valuers included in the list of the Bank's certified valuers. The collateral value is revised based on common business practices and market movements.

| [HRK'000] | Notes | 31/12/2013 | 31/12/2014 |
|---|---|---|---|
| Deposits with Croatian National Bank | 4 | 126,462 | 162,563 |
| Placements with other banks | 5 | 50,242 | 189,998 |
| Available-for-sale financial assets | 6 | 193,075 | 191,640 |
| Held-to-maturity financial assets | 7 | 55,959 | 30,032 |
| Loans and advances to customers | 8 | 675,690 | 654,038 |
| Other assets | 11 | 37,288 | 29,008 |
| Total assets exposed to credit risk | | 1,138,716 | 1,257,279 |
| Guarantees | | 35,916 | 23,264 |
| Letters of credit | | 653 | 2,977 |
| Credit lines | | 44,818 | 53,029 |
| Other off-balance sheet items | | 2,079 | - |
| Total off-balance sheet exposure to credit risk | 31 | 83,466 | 79,270 |
| **Total credit exposure** | | **1,222,182** | **1,336,549** |

## Uncollected due receivables

Uncollected due receivables include gross receivables based on maturity of both due and not due principal, on individual basis, including due but uncollected interest. The total amount of individual placement is allocated to the maturity class of the oldest uncollected receivable, relating to either principal or the interest.

During 2014 the share of assets past due over 90 days was reduced mainly due to an increase in the nominal amount of highly liquid assets and the collection of the overdue deposit in Centar banka (position Placements with other banks). Past due loans and advances to customers outstanding over 90 days recorded a slight increase during 2014 in the nominal and percentage amount as a result of the deterioration of the debtor's financial position arising from the general economic crisis, which inevitably affected the (in)ability to pay and the deterioration of the loan portfolio quality of companies. As opposed to 2013, when the outstanding debt grew for the most part as a result of initiating pre-bankruptcy settlements and realising rights to separate settlement secured by law in pre-bankruptcy settlement proceedings in which the Bank does not participate, the trend of significant growth of placements past due over 90 days was mitigated during 2014 by completing the pre-bankruptcy settlements in which the Bank participates and by restructuring debt.

| [HRK'000] | 31/12/2014 | | | | |
|---|---|---|---|---|---|
| | Gross | Not yet due and due up to 90 days | % | Past due beyond 90 days | % |
| **ASSETS** | | | | | |
| Deposits with Croatian National Bank | 162,563 | 162,563 | *100%* | - | *0%* |
| Placements with other banks | 189,998 | 189,998 | *100%* | - | *0%* |
| Held-to-maturity financial assets | 31,829 | 29,771 | *94%* | 2,058 | *6%* |
| Loans and advances to customers | 789,308 | 521,873 | *66%* | 267,435 | *34%* |
| Other assets | 56,651 | 29,235 | *52%* | 27,416 | *48%* |
| **TOTAL** | **1,230,349** | **933,439** | ***76%*** | **296,910** | ***24%*** |

| [HRK'000] | 31/12/2013 | | | | |
|---|---|---|---|---|---|
| | Gross | Not yet due and due up to 90 days | % | Past due beyond 90 days | % |
| **ASSETS** | | | | | |
| Deposits with Croatian National Bank | 126,462 | 126,462 | *100%* | - | - |
| Placements with other banks | 60,416 | 50,342 | *83%* | 10,074 | *17%* |
| Held-to-maturity financial assets | 57,935 | 56,648 | *98%* | 1,287 | *2%* |
| Loans and advances to customers | 803,671 | 541,153 | *67%* | 262,518 | *33%* |
| Other assets | 63,849 | 36,448 | *57%* | 27,401 | *43%* |
| **TOTAL** | **1,112,333** | **811,053** | ***73%*** | **301,280** | ***27%*** |

| [HRK'000] | 31/12/2014 Gross | % | Impairment loss for identified losses | Impairment loss for identified losses on group basis | Total impairment loss | Impairment loss / gross | Net | Collateral value | Collateral value / net |
|---|---|---|---|---|---|---|---|---|---|
| | 1 | 2 | 3 | 4 | 5 = 3 + 4 | 6 = 5 / 1 | 7 = 1 - 6 | 8 | 9 = 8 / 7 |
| **ASSETS** | | | | | | | | | |
| Deposits with Croatian National Bank | 162,563 | - | - | - | - | - | 162,563 | - | - |
| A | 162,563 | *100.00%* | - | - | - | - | 162,563 | - | - |
| Placements with other banks | 189,998 | - | - | - | - | - | 189,998 | - | - |
| A | 189,998 | *100.00%* | - | - | - | - | 189,998 | - | - |
| Held-to-maturity financial assets | 31,829 | - | 1,510 | 287 | 1,797 | *5.64%* | 30,032 | - | - |
| A | 28,594 | *89.84%* | - | 287 | 287 | *1.00%* | 28,308 | - | - |
| B, C | 3,235 | *10.16%* | 1,510 | - | 1,510 | *46.68%* | 1,725 | - | - |
| Loans and advances to customers | 789,308 | - | 126,776 | 8,494 | 135,271 | *17.14%* | 654,038 | 366,892 | *56.10%* |
| A | 494,660 | *62.67%* | - | 8,494 | 8,494 | *1.72%* | 486,165 | 201,767 | *41.50%* |
| B, C | 294,649 | *37.33%* | 126,776 | - | 126,776 | *43.03%* | 167,873 | 165,125 | *98.36%* |
| Retail | 166,089 | - | 33,587 | 1,984 | 35,572 | *21.42%* | 130,517 | 53,479 | *40.97%* |
| A | 115,555 | *69.57%* | - | 1,984 | 1,984 | *1.72%* | 113,571 | 38,516 | *33.91%* |
| B, C | 50,534 | *30.43%* | 33,587 | - | 33,587 | *66.47%* | 16,946 | 14,963 | *88.30%* |
| Corporate | 623,220 | - | 93,189 | 6,510 | 99,699 | *16.00%* | 523,521 | 313,413 | *59.87%* |
| A | 379,104 | *60.83%* | - | 6,510 | 6,510 | *1.72%* | 372,594 | 163,251 | *43.81%* |
| B, C | 244,115 | *39.17%* | 93,189 | - | 93,189 | *38.17%* | 150,926 | 150,162 | *99.49%* |
| Other assets | 56,651 | - | 27,642 | - | 27,642 | *48.79%* | 29,008 | - | - |
| A | - | - | - | - | - | - | - | - | - |
| B, C | - | - | 27,642 | - | 27,642 | - | (27,642) | - | - |
| **TOTAL** | **1,230,349** | | **155,929** | **8,781** | **164,710** | ***13.39%*** | **1,065,639** | **366,892** | ***34.43%*** |

| [HRK'000] | 31/12/2013 Gross | % | Impairment loss for identified losses | Impairment loss for identified losses on group basis | Total impairment loss | Impairment loss / gross | Net | Collateral value | Collateral value / net |
|---|---|---|---|---|---|---|---|---|---|
| | 1 | 2 | 3 | 4 | 5 = 3 + 4 | 6 = 5 / 1 | 7 = 1 - 6 | 8 | 9 = 8 / 7 |
| **ASSETS** | | | | | | | | | |
| Deposits with Croatian National Bank | 126,462 | - | - | - | - | - | 126,462 | - | - |
| A | 126,462 | *100.00%* | - | - | - | - | 126,462 | - | - |
| Placements with other banks | 60,416 | - | 10,174 | - | 10,174 | *16.84%* | 50,242 | - | - |
| A | 40,067 | *66.32%* | - | - | - | - | 40,067 | - | - |
| B, C | 10,174 | *16.84%* | 10,174 | - | 10,174 | *100.00%* | - | - | - |
| Held-to-maturity financial assets | 57,935 | - | 1,439 | 537 | 1,976 | *3.41%* | 55,959 | - | - |
| A | 53,650 | *92.60%* | - | 537 | 537 | *1.00%* | 53,113 | - | - |
| B, C | 4,285 | *7.40%* | 1,439 | - | 1,439 | *33.58%* | 2,846 | - | - |
| Loans and advances to customers | 803,671 | - | 121,060 | 6,921 | 127,981 | *15.92%* | 675,689 | 373,322 | *55.25%* |
| A | 516,120 | *64.22%* | - | 6,921 | 6,921 | *1.34%* | 509,199 | 206,251 | *40.50%* |
| B, C | 287,551 | *35.78%* | 121,060 | - | 121,060 | *42.10%* | 166,491 | 167,071 | *100.35%* |
| Retail | 162,267 | - | 31,133 | 1,539 | 32,672 | *20.13%* | 129,595 | 54,060 | *41.71%* |
| A | 114,767 | *70.73%* | - | 1,539 | 1,539 | *1.34%* | 113,228 | 39,680 | *35.04%* |
| B, C | 47,499 | *29.27%* | 31,133 | - | 31,133 | *65.54%* | 16,366 | 14,380 | *87.86%* |
| Corporate | 641,404 | - | 89,927 | 5,382 | 95,309 | *14.86%* | 546,095 | 319,262 | *58.46%* |
| A | 401,353 | *62.57%* | - | 5,382 | 5,382 | *1.34%* | 395,971 | 166,571 | *42.07%* |
| B, C | 240,051 | *37.43%* | 89,927 | - | 89,927 | *37.46%* | 150,124 | 152,691 | *101.71%* |
| Other assets | 63,849 | - | 26,561 | - | 26,561 | - | 37,288 | - | - |
| A | - | - | - | - | - | - | - | - | - |
| B, C | - | - | 26,561 | - | 26,561 | - | (26,561) | - | - |
| **TOTAL** | **1,112,333** | **-** | **159,234** | **7,457** | **166,692** | ***14.99%*** | **945,641** | **373,322** | ***39.48%*** |

## 2.1.2. Market risk

The exposure to market risk occurs in respect of positions recognised at fair value and refers to securities and other financial instruments held for trading, securities and other available-for-sale financial instruments and positions denominated in foreign currency.

### 2.1.2.1. Foreign exchange risk

Foreign exchange operations of the Bank are subject to risks due to changes in intercurrency relationships, as well as changes in foreign currency rates in relation to the domestic currency. The Bank monitors changes in the foreign currency sub-ledger on a daily basis by monitoring the relationship between the foreign currency receivables and liabilities, in accordance with the regulations of the CNB on the open foreign exchange position.

The Bank uses the open foreign exchange position (gap analysis) to measure and report exposure to currency risk in accordance with the methodology prescribed by the Croatian National Bank. The operational management of the foreign currency position within the prescribed limits is the responsibility of the Treasury Department, which has the ability to propose measures to eliminate the currency gap through a reduction or increase in loans and deposits with a currency clause, selling or buying the currency or through arbitration - selling one currency for another.

The Risk Management Sector controls the compliance with limits on a daily basis, and monthly reports to the Asset and Liability Management Committee on foreign exchange risk exposure.

**Foreign exchange risk analysis**

| [HRK'000] | 31/12/2014 | | | | |
|---|---|---|---|---|---|
| | HRK | HRK with FC clause | EUR | Other foreign currencies | **Total** |
| **ASSETS** | | | | | |
| Cash and deposits with Croatian National Bank | 164,515 | - | 10,916 | 15,693 | 191,124 |
| Placements with other banks | - | - | 179,976 | 10,022 | 189,998 |
| Available-for-sale financial assets | 52,511 | 62,564 | 76,565 | - | 191,640 |
| Held-to-maturity financial assets | 26,058 | 3,974 | - | - | 30,032 |
| Loans and advances to customers | 203,518 | 419,174 | 30,954 | 392 | 654,038 |
| Property and equipment | 42,372 | - | - | - | 42,372 |
| Intangible assets | 17,675 | - | - | - | 17,675 |
| Other assets | 27,425 | - | 1,583 | - | 29,008 |
| **TOTAL ASSETS** | **534,074** | **485,712** | **299,994** | **26,107** | **1,345,888** |
| **LIABILITIES** | | | | | |
| Deposits from banks | - | - | - | - | - |
| Deposits from customers | 361,511 | 54 | 758,020 | 25,941 | 1,145,526 |
| Borrowings | 20,973 | 9,853 | 7,068 | - | 37,894 |
| Hybrid instruments | - | - | 26,489 | - | 26,489 |
| Provisions for liabilities and charges | 970 | - | - | - | 970 |
| Other liabilities | 8,710 | 1,808 | 233 | 528 | 11,279 |
| **TOTAL LIABILITIES** | **392,164** | **11,715** | **791,810** | **26,469** | **1,222,157** |
| **EQUITY** | | | | | |
| Share capital | 128,585 | - | - | - | 128,585 |
| Share premium | - | - | - | - | - |
| Other reserves | 25,222 | - | - | - | 25,222 |
| Fair value reserve | 1,041 | - | - | - | 1,041 |
| Accumulated losses | (31,117) | - | - | - | (31,117) |
| **TOTAL EQUITY** | **123,731** | **-** | **-** | **-** | **123,731** |
| **TOTAL LIABILITIES AND EQUITY** | **515,895** | **11,715** | **791,810** | **26,469** | **1,345,888** |
| **CURRENCY GAP** | **18,179** | **473,997** | **(491,816)** | **(362)** | **-** |

| [HRK'000] | 31/12/2013 | | | | |
|---|---|---|---|---|---|
| | HRK | HRK with FC clause | EUR | Other foreign currencies | Total |
| **ASSETS** | | | | | |
| Cash and deposits with Croatian National Bank | 126,869 | - | 15,318 | 15,138 | 157,325 |
| Placements with other banks | - | - | 45,839 | 4,403 | 50,242 |
| Available-for-sale financial assets | 37,091 | 34,398 | 121,586 | - | 193,075 |
| Held-to-maturity financial assets | 55,959 | - | - | - | 55,959 |
| Loans and advances to customers | 181,325 | 450,658 | 43,402 | 305 | 675,690 |
| Property and equipment | 30,579 | - | - | - | 30,579 |
| Intangible assets | 17,472 | - | - | - | 17,472 |
| Other assets | 37,206 | - | 15 | 67 | 37,288 |
| **TOTAL ASSETS** | **486,501** | **485,056** | **226,160** | **19,913** | **1,217,629** |
| **LIABILITIES** | | | | | |
| Deposits from banks | | | | | 0 |
| Deposits from customers | 272,510 | 1,127 | 686,654 | 27,222 | 987,513 |
| Borrowings | 84,391 | 12,202 | 54,479 | - | 151,072 |
| Hybrid instruments | - | - | 3,055 | - | 3,055 |
| Provisions for liabilities and charges | 1,039 | - | - | - | 1,039 |
| Other liabilities | 5,642 | 6,785 | 245 | - | 12,672 |
| **TOTAL LIABILITIES** | **363,582** | **20,114** | **744,433** | **27,222** | **1,155,351** |
| **EQUITY** | | | | | |
| Share capital | 75,020 | - | - | - | 75,020 |
| Share premium | - | - | - | - | 0 |
| Other reserves | 94,030 | - | - | - | 94,030 |
| Fair value reserve | 2,677 | - | - | - | 2,677 |
| Accumulated losses | (109,449) | - | - | - | (109,449) |
| **TOTAL EQUITY** | **62,278** | **-** | **-** | **-** | **62,278** |
| **TOTAL LIABILITIES AND EQUITY** | **425,860** | **20,114** | **744,433** | **27,222** | **1,217,629** |
| **CURRENCY GAP** | **60,641** | **464,942** | **(518,273)** | **(7,309)** | **-** |

#### 2.1.2.2. Position risk

The exposure to position risk relates to risk arising from changes in value of a financial instrument or changes in underlying variable of derivatives.

Available-for-sale financial instruments are exposed to general position risk, which is the risk of loss due to price change of financial instruments which can occur due to interest rate changes, or more significant changes on capital markets not related to any specific characteristics of financial instruments. The stated instruments are also exposed to specific position risk which arises from price changes of individual financial instruments due to factors related to its issuer.

The Asset and Liability Management Committee of the Bank establishes limits to maximum exposures to available-for-sale financial assets. The Bank's Management Board makes a decision on the purchase/sale of a financial instrument and its classification into a category. The Treasury Division does the transaction, while the Risk Management Division controls the compliance with the internal acts and monitors fair values of the financial instruments on a daily basis, if available.

The Risk Management Division calculates: market risk exposure, usage of exposure to market risk limits and capital requirements for exposure to market risks.

In measuring market risk exposure, the Bank relies on regulations prescribed by the Croatian National Bank and monitors the following:

- capital requirements calculated by the standard method in accordance with the Croatian National Bank's Decision on capital adequacy,
- internal models of monitoring exposure to interest rate risk in the Bank’s records.

The Risk Management Division reports daily to the Treasury Division on the usage of market risk exposure limits and reports to the Asset and Liability Management Committee monthly.

#### 2.1.2.3. Interest rate risk

The Bank’s operations are subject to the risk of loss which arises from potential interest rate fluctuations which affects positions in the Bank’s records.

In line with cautious interest rate risk management, the Bank defines responsibilities in accordance with generally accepted standards and defined limits for maintaining an acceptable level of economic capital and achieving satisfactory financial results.

The majority of placements and deposits are initially contracted at variable interest rate in accordance with the Bank’s Decision, except when, for competitive reasons, fixed interest rates are contracted.

The Bank utilises the following measures for measurement of interest rate risk exposure:

1. repricing gap analysis,
2. standard interest shock on net interest income,
3. “what if” simulation, and
4. economic value of capital simulation (duration analysis).

Since 31 March 2010, based on the Decision on interest rate management in the Bank's records, the Risk Management Division reports on interest rate exposure on a quarterly basis in accordance with regulatory requirements. For each reporting period in 2014, the economic value of capital in relation to capital adequacy was in line with regulatory requirements.

### Measuring exposure to interest rate risk

The Bank measures the exposure to interest rate risk both from the profit perspective and the perspective of the economic value of capital.

*Profit perspective*

When calculating the effect of interest rate change on net interest income, the Bank uses the standard interest shock on net interest income for a 12-month period. The simulation is based on parallel movements in all interest rates, an increase/decrease by 2 percentage points for HRK and an increase/decrease by 1 percentage point for EUR and all other currencies.

| [HRK'000] | 2014 | 2013 |
|---|---|---|
| Potential decrease in net interest income | -674 | -643 |
| % of budgeted net interest income | -1.69% | -1.72% |

*Perspective of economic value of capital*

The perspective of the economic value of capital (duration analysis) represents a long-term measure of interest rate risk exposure in the balance sheet. The effect of interest rate changes on the economic value of capital is measured by the economic value of capital simulation. This model is based on the duration analysis and the hypothesis is that the economic value of capital is expressed as the difference between the present value of assets and the present value of liabilities. The calculation is based on balance sheet positions which are distributed according to repricing criteria.

The Bank calculates the market value of capital by discounting the balance sheet positions using a rate of 5%. The economic value of capital is expressed as the difference between the present value of assets and the present value of liabilities. The simulation of change in economic value of capital is based on a simultaneous parallel increase of interest rates by 1%.

The Risk Management Division reports the results of the interest rate risk exposure to the Bank's Asset and Liability Management Committee.

| [HRK'000] | 2014 | 2013 |
|---|---|---|
| Net book value of capital (HRK'000) | 129,620 | 62,278 |
| Economic value of capital (HRK'000) | 116,772 | 43,326 |
| Change in economic value of capital (HRK'000) | -10.69% | -7.46% |

### Interest rate risk stress test

The interest rate risk stress test is performed at least on a yearly basis. It represents a sensitivity analysis of net interest income and net interest margin on changes in interest rates based on the repricing of sensitive positions. The Risk Management Division selects at least two scenarios, informing the Asset and Liability Committee of the results.

## Interest rate gap analysis

The following table shows the Bank's exposure to interest rate risk, analysed on the basis of the contracted maturity, or, with the instruments whose interest rate changes before maturity (administrative interest rate), in the period until the next date of the interest rate change.

| [HRK'000] | 31/12/2014 0 - 30 days | 31 - 90 days | 91 - 360 days | 1 - 3 years | over 3 years | Interest free | Total | Fixed interest rate |
|---|---|---|---|---|---|---|---|---|
| **ASSETS** | | | | | | | | |
| Cash and deposits with Croatian National Bank | 72,673 | - | 80,624 | - | - | 37,828 | **191,124** | - |
| Placements with other banks | 187,798 | - | - | - | - | 2,200 | **189,998** | 435 |
| Available-for-sale financial assets | 30,694 | 30,653 | 124,455 | - | - | 5,838 | **191,640** | 185,802 |
| Held-to-maturity financial assets | 946 | 18,872 | 8,470 | 1,721 | - | 23 | **30,032** | 30,009 |
| Loans and advances to customers | 24,191 | 70,046 | 181,249 | 222,956 | 131,379 | 24,217 | **654,038** | 73,925 |
| Property and equipment | - | - | - | - | - | 42,372 | **42,372** | - |
| Intangible assets | - | - | - | - | - | 17,675 | **17,675** | - |
| Other assets | - | - | - | - | - | 29,008 | **29,008** | - |
| **TOTAL ASSETS** | **316,302** | **119,571** | **394,798** | **224,677** | **131,379** | **159,161** | **1,345,888** | **290,171** |
| **LIABILITIES** | | | | | | | | |
| Deposits from banks | - | - | - | - | - | - | **-** | - |
| Deposits from customers | 106,724 | 122,799 | 804,970 | 83,013 | 11,514 | 16,506 | **1,145,526** | 759,939 |
| Borrowings | 221 | 4,046 | 20,323 | 6,546 | 6,690 | 68 | **37,894** | 30,803 |
| Hybrid instruments | 3,065 | - | 22,984 | - | - | 440 | **26,489** | 3,065 |
| Provisions for liabilities and charges | - | - | - | - | - | 970 | **970** | - |
| Other liabilities | - | - | - | - | - | 11,279 | **11,279** | - |
| **TOTAL LIABILITIES** | **110,010** | **126,845** | **848,277** | **89,559** | **18,204** | **29,263** | **1,222,158** | **793,807** |
| **TOTAL EQUITY** | **-** | **-** | **-** | **-** | **-** | **123,731** | **123,731** | **-** |
| **TOTAL LIABILITIES AND EQUITY** | **110,010** | **126,845** | **848,277** | **89,559** | **18,204** | **152,994** | **1,345,888** | **793,807** |
| **INTEREST GAP** | **206,292** | **(7,274)** | **(453,479)** | **135,118** | **113,175** | **6,167** | **-** | **(503,636)** |

| [HRK'000] | 31/12/2013 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 0 - 30 days | 31 - 90 days | 91 - 360 days | 1 - 3 years | over 3 years | Interest free | **Total** | Fixed interest rate |
| **ASSETS** | | | | | | | | |
| Cash and deposits with Croatian National Bank | 14,322 | - | 72,278 | - | - | 70,725 | **157,325** | - |
| Placements with other banks | 48,049 | - | - | - | - | 2,193 | **50,242** | - |
| Available-for-sale financial assets | 7,638 | 15,275 | 157,151 | - | - | 13,011 | **193,075** | 180,064 |
| Held-to-maturity financial assets | 18,691 | 12,229 | 23,507 | 1,856 | - | (324) | **55,959** | 56,283 |
| Loans and advances to customers | 115,473 | 58,908 | 445,284 | 13,160 | 10,032 | 32,833 | **675,690** | 46,084 |
| Property and equipment | - | - | - | - | - | 30,579 | **30,579** | - |
| Intangible assets | - | - | - | - | - | 17,472 | **17,472** | - |
| Other assets | - | - | - | - | - | 37,288 | **37,288** | - |
| **TOTAL ASSETS** | **204,173** | **86,412** | **698,220** | **15,016** | **10,032** | **203,777** | **1,217,629** | **282,431** |
| **LIABILITIES** | | | | | | | | |
| Deposits from banks | - | - | - | - | - | - | **-** | - |
| Deposits from customers | 92,334 | 104,955 | 748,307 | 19,423 | 5,124 | 17,370 | **987,513** | 459,459 |
| Borrowings | 107,781 | 4,354 | 22,515 | 7,371 | 8,908 | 143 | **151,072** | 131,835 |
| Hybrid instruments | - | - | - | - | - | - | **3,055** | 3,055 |
| Provisions for liabilities and charges | - | - | - | - | - | 1,039 | **1,039** | - |
| Other liabilities | - | - | - | - | - | 12,672 | **12,672** | - |
| **TOTAL LIABILITIES** | **200,115** | **109,309** | **770,822** | **29,849** | **14,032** | **31,224** | **1,155,351** | **594,349** |
| **TOTAL EQUITY** | **-** | **-** | **-** | **-** | **-** | **62,278** | **62,278** | **-** |
| **TOTAL LIABILITIES AND EQUITY** | **200,115** | **109,309** | **770,822** | **29,849** | **14,032** | **93,502** | **1,217,629** | **594,349** |
| **INTEREST GAP** | **4,058** | **(22,897)** | **(72,602)** | **(14,833)** | **(4,000)** | **110,275** | **-** | **(311,918)** |

#### 2.1.2.4. Liquidity risk

Liquidity risk arises in the general funding of the Bank's activities and in the management of its positions. The main categories of liquidity risk to which the Bank is exposed are:

- inability to settle liabilities as a result of the maturity gap between cash inflow and outflow - structural liquidity risk, and
- risk of being unable to sell or acquire liquid instruments on the market in an appropriate time frame and at a reasonable price - liquidity risk of financial instruments.

The liquidity risk management is conducted in compliance with regulatory requirements and is defined by the following internal acts:

- liquidity risk management policy,
- liquidity stress test procedure,
- procedure for the Bank's liquidity management,
- liquidity risk (crisis) plan.

Internal acts are proposed by the Risk Management Division and approved by the Bank's Management Board. In accordance with changes, the Risk Management Division proposes revisions of internal acts.

The liquidity monitoring system is aimed at assessing the Bank's short-term liquidity and its ability to comply with future financing requirements. The Bank continuously aims its activities on improving the quality of the model and the entire process of liquidity management by upgrading the monitoring system, its related assumptions and by enhancing technical support in the procedural process.

The key purpose of the liquidity policy is to ensure that the Bank operates in a way to achieve an optimal balance between the Bank's safety and shareholders return on investment. The framework for appropriate liquidity risk management comprises of the following: liquidity management strategy approved by the Management Board within budget and strategic plans, efficient supervision by the Asset and Liability Management Committee and the Management Board, clearly defined responsibilities and operations in line with agreed limits, management of assets and liabilities by matching their maturities, an established evaluation system of all current and future inflows and outflows, liabilities structure management, specifically in monitoring the concentration of large deposits, sustained development of liquidity stress tests, assessment of access to financial markets and available funds under usual and stressed conditions and a crisis plan.

As part of its business activities the Bank monitors liquidity risk and complies with regulations, the following measures are part of liquidity risk management:

- prescribed ratio of current foreign currency receivables in relation to payables, which are monitored on a daily basis,
- reserve requirements - HRK,
- reserve requirements - foreign currency, and
- minimum liquidity ratio.

The purpose of management liquidity funds is the compliance with the regulatory minimum by maintaining the minimum cost of liquidity funds.

The Bank uses the following models for liquidity risk measurement:

- financial and structural indicators,
- deposit concentration,
- cash flow notice and projection system, and
- liquidity stress tests.

The Bank raises funds using a broad range of instruments including deposits, borrowings, subordinated loans and share capital. The Bank continuously assesses its liquidity risk by identifying and monitoring changes in the level of funding required to achieve business goals and strategic targets. Diverse funds enable flexibility, decrease dependence on a single source of funding and enable straightforward management of financing costs.

### Liquidity stress test

Liquidity stress tests are performed based on the analysis of different scenarios, i.e. the assessment of effects of simultaneous changes in several different factors of risk on the financial position of the Bank in clearly defined stress circumstances. In order to prepare for a possible impact on liquidity, the Bank performs liquidity stress tests adapted to business size and characteristics, strategic goals and plans, the internal Bank’s organization and its environment, to ensure sufficient liquidity funding. The aim of the liquidity stress test is to recognise a situation and to prepare the Bank's relevant function for a prompt reaction in the case of a liquidity crisis. The development of the liquidity stress test represents the Bank’s internal policy and is good practice for liquidity management. The stress test relates to the change in value of certain parameters that have an impact on the financial and liquidity position of the Bank and determining the effects of the impact of these parameters on the entire business.

The stress scenario is arbitrarily selected and approved by the Risk Management Division. Two scenarios are selected, at a minimum, one including the Bank's specific factors and the other including market factors. Different combinations of the factors are possible as well.

The selection of scenarios is usually affected by:

- current market movements;
- other movements historically significant for the Bank’s liquidity;
- future predictions based on available information significant for the Bank’s liquidity.

Upon selection of the stress scenario, the Treasury Division analyses the scenario or performs the sensitivity analysis, depending on whether one or more factors on the financial position of the Bank are analysed. The Risk Management Division and the Treasury Division report the results of the stress tests to the Asset and Liability Management Committee.

The following table provides information on the remaining maturity of the Bank's assets and liabilities.

## Maturity analysis

| [HRK'000] | 31/12/2014 | | | | | | |
|---|---|---|---|---|---|---|---|
| | 0 - 30 days | 31 - 90 days | 91 - 360 days | 1 - 3 years | over 3 years | Without maturity | **Total** |
| **ASSETS** | | | | | | | |
| Cash and deposits with Croatian National Bank | 191,124 | - | - | - | - | - | **191,124** |
| Placements with other banks | 189,998 | - | - | - | - | - | **189,998** |
| Available-for-sale financial assets | 31,082 | 30,653 | - | 39,657 | 90,248 | - | **191,640** |
| Held-to-maturity financial assets | 2,965 | 18,683 | 8,384 | - | - | - | **30,032** |
| Loans and advances to customers | 99,644 | 59,794 | 96,850 | 78,961 | 318,789 | - | **654,038** |
| Property and equipment | - | - | - | - | 42,372 | - | **42,372** |
| Intangible assets | - | - | - | - | 17,675 | - | **17,675** |
| Other assets | 5,051 | | 2,532 | 260 | 21,165 | - | **29,008** |
| **TOTAL ASSETS** | **519,864** | **109,130** | **107,766** | **118,878** | **490,249** | **-** | **1,345,888** |
| **LIABILITIES** | | | | | | | |
| Deposits from banks | - | - | - | - | - | - | **-** |
| Deposits from customers | 225,320 | 125,678 | 565,223 | 216,158 | 13,146 | - | **1,145,526** |
| Borrowings | - | 3,306 | 12,337 | 7,250 | 15,001 | - | **37,894** |
| Hybrid instruments | - | 3,065 | - | - | 23,424 | - | **26,489** |
| Provisions for liabilities and charges | 20 | - | 804 | - | 146 | - | **970** |
| Other liabilities | 5,899 | 718 | 4,147 | 515 | - | - | **11,279** |
| **TOTAL LIABILITIES** | **231,239** | **132,767** | **582,511** | **223,923** | **51,717** | **-** | **1,222,157** |
| **TOTAL EQUITY** | **-** | **-** | **-** | **-** | **-** | **123,731** | **123,731** |
| **TOTAL LIABILITIES AND EQUITY** | **231,239** | **132,767** | **582,511** | **223,923** | **51,717** | **123,731** | **1,345,888** |
| **MATURITY GAP** | **288,625** | **(23,637)** | **(474,746)** | **(105,045)** | **438,532** | **(123,731)** | **-** |

| [HRK'000] | 31/12/2013 | | | | | | |
|---|---|---|---|---|---|---|---|
| | 0 - 30 days | 31 - 90 days | 91 - 360 days | 1 - 3 years | over 3 years | Without maturity | **Total** |
| **ASSETS** | | | | | | | |
| Cash and deposits with Croatian National Bank | 150,779 | - | - | 6,546 | - | - | **157,325** |
| Placements with other banks | 48,638 | 1,604 | - | - | - | - | **50,242** |
| Available-for-sale financial assets | 36,507 | 16,312 | 61,135 | 644 | 78,477 | - | **193,075** |
| Held-to-maturity financial assets | 20,581 | 12,106 | 23,272 | - | - | - | **55,959** |
| Loans and advances to customers | 196,185 | 71,452 | 125,344 | 127,135 | 155,574 | - | **675,690** |
| Property and equipment | - | - | - | - | 30,579 | - | **30,579** |
| Intangible assets | - | - | - | - | 17,472 | - | **17,472** |
| Other assets | 2,435 | 295 | 426 | 283 | 33,849 | - | **37,288** |
| **TOTAL ASSETS** | **455,125** | **101,769** | **210,177** | **134,608** | **315,951** | **-** | **1,217,629** |
| **LIABILITIES** | | | | | | | |
| Deposits from banks | - | - | - | - | - | - | **-** |
| Deposits from customers | 177,363 | 106,382 | 600,401 | 96,475 | 6,892 | - | **987,513** |
| Borrowings | 105,569 | 702 | - | 25,963 | 18,838 | - | **151,072** |
| Hybrid instruments | - | - | - | 3,055 | - | - | **3,055** |
| Provisions for liabilities and charges | - | - | 1,039 | - | - | - | **1,039** |
| Other liabilities | 2,462 | 1,565 | 5,160 | - | 3,485 | - | **12,672** |
| **TOTAL LIABILITIES** | **285,394** | **108,649** | **606,600** | **125,493** | **29,215** | **-** | **1,155,351** |
| **TOTAL EQUITY** | **-** | **-** | **-** | **-** | **-** | **62,278** | **62,278** |
| **TOTAL LIABILITIES AND EQUITY** | **285,394** | **108,649** | **606,600** | **125,493** | **29,215** | **62,278** | **1,217,629** |
| **MATURITY GAP** | **169,731** | **(6,880)** | **(396,423)** | **9,115** | **286,736** | **(62,278)** | **-** |

### 2.1.3. Operational risk

Operational risk is defined as the risk of loss due to inadequate or incorrect internal processes, human or system errors or events caused by external factors (natural disasters, fire, flood, attack, changes of legislation, embezzlement).

Operational risk exists in every segment of the Bank's operations, requiring knowledge and continuous monitoring of all business processes. The organisational model of operational risk management is set up on the centralised and decentralised levels of operational risk management.

The operational risk management is conducted in compliance with regulatory requirements and is defined by the following internal acts:

- policy on operational risk management
- procedure on operational risk management
- methodology for operational risk management
- directive on reporting of operational losses and operational risks

When measuring operational risk exposure, based on the consequences of a risk event, the Bank distinguishes the following:
*Loss from operational risk*, which represents operational losses affecting the balance sheet and assuming the known amount of losses in the Bank's records.
*Significant operational risk*, which is present in business processes and has not resulted in operational losses, but there is a possibility of future operational losses resulting from it.

Self Risk Assessment is performed for every business process of the Bank. Self Risk Assessment is performed on a yearly basis based on the questionnaires prepared in accordance with Basel guidelines. Based on the collected data, each reported event which could result in operational risk is quantified and classified into a risk category. For events for which risks are high and very high, the business processes owners, in coordination with the Risk Management Division, propose action for reducing exposure to operational risk using methods for reduction of effects, i.e. damages and the probability of occurrence or transferring the risk to a counterparty. The Risk Management Division reports the results of the Self Risk Assessment to the Management Board once a year.

The Risk Management Division reports to the Management Board quarterly on recorded operational losses, i.e. events which resulted in losses recorded in the Bank's records due to exposure to operational risk. Report on operational losses contains, at a minimum, data on amounts of losses, recovered amounts, unrecovered amounts, operational losses per type of event and cause and share of different organisational parts of the Bank in operational losses.

For operational risk management, the Bank has secured the following:

- adequate IT system management by using the following internal acts: Safety policy and Bylaw on adequate use of IT systems
- adequate risk management related to externalisation by using the following internal acts: Bylaw on externalisation, Procedure for externalisation and Bylaw on the minimum content of the contract provisions on the matter of contracts on externalisation and other procurement or provision of services
- adequate compliance risk management by using the following internal acts: Bylaw on compliance monitoring and implementation and Methodology for controls of organisational compliance of processes with internal and external processes
- adequate business continuity management by using the following internal acts: Business continuity strategy, Business continuity management procedure and Business continuity plan
- adequate system for the prevention of money laundering and terrorism financing by using the following internal acts: Policies and procedures for the prevention of money laundering and terrorism financing.

### 2.1.4. Concentration risk

Risk of concentration is every individual, direct or indirect exposure toward one counterparty or group of related parties or group of exposures connected by common risk factors such as industry, geographical area, operations or goods, i.e. application of techniques for credit risk reduction, which can cause such losses which could jeopardise the Bank's going concern.
The Bank analyses and reports on concentration risk present both on the asset side of the balance sheet, i.e. loan portfolio, as well as on the capital and liability side of the balance sheet.

The Bank analyses concentration risk on the basis of each individual, direct or indirect exposure toward one counterparty or group of related parties and has regulated the identification of related parties by internal acts, determining the following:

1) control, i.e. relationship between the parent company and its subsidiary or similar relationship between any entity or individual and
2) economical and financial ties.

Relationship is established mainly on the basis of information/data received from the client, but also by checking other available sources. Groups of related parties are formed and reported by the Credit Risk Management Department within the Risk Management Division. Groups of related parties are entered into Registry of related parties, comprehensive database.

The identification and measurement of concentration relates to a group of exposures connected by common risk factors such as common industry, geographical area or similar operations.

In order to maintain a diversified and stable base of financing and to avoid overdependence on only certain sources, concentration is monitored for the following:

- clients or groups of related parties whose deposits comprise more than 2% of the Bank's total liabilities on both an individual and group basis
- deposits from companies and other financial institutions: 10 biggest deponents in relation to total deposits from companies and financial institutions; 10 biggest deponents in relation to total deposits
- retail deposits: 10 and 100 biggest deponents from retail sector as a percentage of total retail deposits as a percentage of total deposits.

The Risk Management Division reports the concentration risk to the Asset and Liability Management Committee on a monthly basis.

Concentration risk is also monitored on a sector basis, as shown in the following table:

| [HRK' 000] Gross exposure | 2013 | % | 2014 | % |
|---|---|---|---|---|
| Retail | 151,787 | *13%* | 159,146 | *12%* |
| Agriculture and mining | 56,612 | *5%* | 51,499 | *4%* |
| Processing industry | 256,946 | *22%* | 240,500 | *19%* |
| Construction industry | 104,509 | *9%* | 84,226 | *7%* |
| Wholesale and retail | 161,730 | *14%* | 137,628 | *11%* |
| Financial and insurance activities | 239,580 | *21%* | 408,160 | *32%* |
| Scientific and technical services | 72,888 | *6%* | 82,278 | *6%* |
| Health and social welfare services | 11,504 | *1%* | 8,168 | *1%* |
| Other | 101,994 | *9%* | 111,183 | *9%* |
| | **1,157,549** | **100%** | **1,282,788** | **100%** |

### 2.1.5. Business continuity management

The Bank has adopted internal acts regulating the plan for business continuity management for the main business processes. The plan contains data on key personnel contacts, alternative locations in case of operations discontinuity, descriptions of key processes and strategies for their emergency recovery and documentation to be prepared in the case of operations discontinuity.

## 2.2. The Bank's general acts

### 2.2.1. General acts regulating credit policy

General acts regulating credit policy and asset and liability management are given as follows:

#### 2.2.1.1. Credit policy objective

The credit policy objective includes the following:

- establishment of an adequate credit risk management environment
- operations in accordance with the generally accepted loan approval procedure
- maintenance of adequate procedures for administration, measurement and monitoring of loans
- maintenance of adequate controls over credit risk
- maintenance of adequate assessment of the quality of assets
- recognition of adequate impairment allowances for identified and unidentified losses.

#### 2.2.1.2. General articles of credit policy

The Bank's credit policy is based on applicable legislation and mission, vision and business policy of the Bank. It includes all important factors needed for ensuring development and reputation of the Bank, realisation of profit and maintenance of real value of capital based on safety, liquidity and profitability principles.

#### 2.2.1.3. Definitions, principles and standards

The intention of the credit policy is the establishment of basic principles for approving loans and other placements, relating to the implementation of segregation of responsibilities for execution and for control of activities in the credit process.

The basic principles of the credit policy are:

- safety of placements through realistic insight into the client's operations, assessment of its business capacity and its capability of servicing liabilities to the Bank,
- stable liquidity through assessment of repayments of placements in the scheduled time frame and expected inclusion of the debtor's funds into the Bank's deposit system as well as usage of the Bank's other services,
- profitability, i.e. satisfying the investors interests and enhancing self-financing of sales activities,
- quality service and satisfied customer,
- cross selling and enhancing deposit bases through private and corporate banking,
- capital adequacy maintenance through adequate rating of primary credit risk and reduction of the need for capital coverage through collaterals for loans.

#### 2.2.1.4. Approving placements

The Bank has established a formal procedure for rating and approval of placements with the objective of maintaining a quality loan portfolio. Approvals are given in accordance with internal acts and are given by an appropriate organisational level. Each placement's approval procedure and the level of approval is properly documented. The segregation of duties of recommendations, approval and execution of a risk product ensures the adequacy of the approval process.

#### 2.2.1.5. Monitoring placements

The process of monitoring placements includes assessing the creditworthiness of a debtor, a group of related parties and the quality of collateral during the lifespan of the legal relationship representing the exposure. The adequate system for monitoring placements includes the following measures:

- ensuring the Bank's understanding of the current financial position of the debtor
- assessing the current collateral coverage in relation to the debtor's current position
- identifying overdue payments

Internal acts define the organisational units and responsible personnel ensuring all necessary information for undertaking corrective actions as well as deadlines in which to act, considering potential conflicts of interest.

#### 2.2.1.6. Loan portfolio analysis and credit risk monitoring process

The Bank has established a system for monitoring the entire structure and quality of the loan portfolio. The Credit Committee, the Supervisory Board and the Audit Committee are regularly informed of the quality of the portfolio. The analysis of the loan portfolio includes, at a minimum, an analysis of risk categories, overdue days and the total exposure. The loan portfolio report is prepared by the Risk Management Division / Credit Risk Management Department. Based on the analysis results, decisions are made on the Bank's strategy toward the counterparty, group of related parties, certain industry or economic sector, geographical region, certain type of collateral etc.

#### 2.2.1.7. Non-performing loans

Continuous monitoring of collection is an integral part of the loan process. If the borrower does not pay its liabilities before the due date, overdue liability exists. The Bank has internally defined actions and procedures for collection of overdue receivables. The primary goal is swift action and the objective is maximum collection with establishing the optimal solution for the Bank. Within the process of non-performing loans management, the Bank's objectives are improving its loan portfolio, timely reaction to identified collection issues, limiting impairment losses to the minimum and loan portfolio management.

#### 2.2.1.8. Credit risk control and stress test

Credit risk control is one of the Bank's functions organised as a separate organisational part, functionally and organisationally separated from other organisational parts of the Bank and is directly responsible to the Bank's Management Board.

The objective of establishing credit risk control is maintaining the Bank's exposure to credit risk within the parameters established by the Management Board. Credit risk control assists in ensuring the credit risk stays within the limits acceptable to the Bank.

Credit risk control ensures an independent, continuous check of the application and effectiveness of the credit risk management methods and procedures. Also, credit risk control includes establishing measurement and assessment of credit risk to which the Bank is or could be exposed, and making recommendations for adequate credit risk management.

In order to function effectively, the credit risk control has the authorization for unlimited and permanent access to all documents, evidences and personnel of the Bank, with strict confidentiality.

The credit risk control function keeps evidence on performed work and reports the results of each separate review to the Management Board.

### Stress test

The Risk Management Division / Credit Risk Management Division tests the effects of two different factors, at a minimum. The stress situation simulated in a test is usually determined by indicators on the market or within the Bank which point to a possibility of occurrence of significant changes in the loan portfolio, resulting in changes to the financial results of the Bank and to the regulatory indicators.

The Risk Management Division reports the results of the stress tests to the Credit Committee and recommends the risk management strategy to be maintained or changed, depending on the stress test results.

## 3. SIGNIFICANT ACCOUNTING ESTIMATES AND JUDGEMENTS

The Bank makes estimates and assumptions about uncertain events, including estimates and assumptions about the future. Such accounting assumptions and estimates are regularly evaluated, and are based on historical experience and other factors. Key sources of estimation uncertainty are described below.

### Impairment losses on loans and receivables

The Bank monitors the creditworthiness of its customers on an ongoing basis. In accordance with the CNB regulations, the need for impairment of the Bank's on and off-balance-sheet credit risk exposure is assessed at least quarterly. Impairment losses are made mainly against the carrying value of loans and advances to corporate and retail customers as described in Note 2.1.1. "Credit risk", while provisions for liabilities and charges arise from off-balance-sheet risk exposure to customers, mainly in the form of guarantees, documentary credits and undrawn loan commitments.

### Financial assets carried at amortised cost

Financial assets carried at amortised cost include financial investments held to maturity and loans and advances to customers.

The Bank initially assesses whether objective evidence of impairment exists. Assets assessed individually as unimpaired are then included in groups of assets with similar credit risk characteristics. These portfolios are then assessed collectively for impairment.

The Bank estimates impairment losses in cases where it judges that the observable data indicates the likelihood of a measurable decrease in the estimated future cash flows of the asset or portfolio of assets.

The Bank also seeks to recognise impairment losses which are known to exist at the reporting date, but which have not yet been specifically identified. In estimating unidentified impairment losses existing in collectively assessed portfolios, and in the absence of reliable data on historical loss rates and the emergence period for the identification of these impairment losses, the Bank considers the range of impairment loss rates at 1% prescribed by the CNB to be calculated on all credit risk exposures except those carried at fair value, including off-balance-sheet amounts and Croatian sovereign risk. Amounts assessed as impaired on an individual basis are excluded from this calculation.

### Fair value of financial instruments quoted in an active market

In estimating the fair value of quoted financial instruments, the Bank uses closing prices at the date of estimation. If the market for a financial asset is not active (and for unlisted securities), or if, for any other reason, the fair value cannot be reliably measured by market price, the Bank establishes fair value by using valuation techniques.

### Legal disputes

The Bank conducts individual assessments of all legal disputes initiated against the Bank. If the market for a financial asset is not active (and for unlisted securities), or if, for any other reason, the fair value cannot be reliably measured by market prices, the Bank establishes fair value by using valuation techniques. As at 31 December 2014, the Bank is defendant in a total of 7 legal disputes, all of which are civil proceedings. In 3 proceedings, the Bank obtained first-instance rulings in its favour. 6 proceedings have been classified in risk group A and 1 has been classified in risk group C. As at 31 December 2014, total provisions for legal disputes were made in the amount of HRK 146,319.65.

### Regulatory requirements

The CNB is entitled to carry out regulatory inspections of the Bank's operations and to request changes to the carrying values of assets and liabilities, in accordance with the underlying regulations.

## 4. CASH AND DEPOSITS WITH CROATIAN NATIONAL BANK

| [HRK'000] CASH AND DEPOSITS WITH CROATIAN NATIONAL BANK | 31/12/2013 | 31/12/2014 |
|---|---|---|
| **Cash in hand** | **30,862** | **28,562** |
| in HRK | 14,728 | 16,618 |
| in foreign currency | 16,134 | 11,944 |
| **Current accounts with CNB** | **33,316** | **58,008** |
| in HRK | 33,316 | 58,008 |
| in foreign currency | - | - |
| **Obligatory reserve with CNB** | **86,600** | **95,289** |
| in HRK | 72,278 | 80,624 |
| in foreign currency | 14,322 | 14,665 |
| **Treasury bills with CNB** | **6,546** | **9,266** |
| in HRK | 6,546 | 9,266 |
| in foreign currency | - | - |
| **Accrued interest** | **-** | **-** |
| past due | - | - |
| not past due | - | - |
| **TOTAL** | **157,325** | **191,124** |

Based on the Decision on obligatory reserve requirements, the Croatian National Bank prescribes the calculation, maintenance and allocation of obligatory reserve requirements for banks and other credit institutions. In line with the stated Decision, the rate of obligatory reserve as at 31 December 2014 is set at 12%.

Of the calculated part of the foreign currency obligatory reserve, 75% is included in the part of the obligatory reserve in HRK and is executed in HRK.

Of the calculated part of obligatory reserve requirement, banks are required to allocate a certain percentage to the accounts of the CNB. For the HRK reserve requirement, the percentage is set at 70%, while for the foreign currency reserve requirement the percentage is set at 60%.

Banks maintain the remaining amount of the obligatory reserve by average daily balances of liquid claims in the maintenance period. The HRK part is maintained by average daily balances on the settlement account and in the account to cover the negative balance in the settlement account in the National Clearing System. The foreign currency part is maintained by an average daily balance of liquid foreign currency claims and average daily balances of foreign currency cash and foreign currency cheques.

The Croatian National Bank does not pay any fees on the obligatory reserve funds.

## 5. PLACEMENTS WITH OTHER BANKS

| [HRK'000] PLACEMENTS WITH OTHER BANKS | 31/12/2013 | 31/12/2014 |
|---|---|---|
| **Short-term** | **58,106** | **187,798** |
| with foreign banks | 40,481 | 121,089 |
| with domestic banks | 17,625 | 66,709 |
| **Long-term** | **2,193** | **2,200** |
| with foreign banks | 2,193 | 2,200 |
| with domestic banks | - | - |
| **Accrued interest** | **117** | **-** |
| past due | 116 | - |
| not past due | - | - |
| **Provisions for impairment** | **(10,174)** | **-** |
| identified losses - domestic banks in bankruptcy | (10,058) | - |
| identified losses - accrued interest | (116) | - |
| **TOTAL** | **50,242** | **189,998** |

Out of total placements with other banks at 31 December 2014, the Bank had net deposits in the amount of HRK 189,998 thousand (2013: HRK 50,242 thousand).

## 6. AVAILABLE-FOR-SALE FINANCIAL ASSETS

| [HRK'000] AVAILABLE-FOR-SALE FINANCIAL ASSETS | 31/12/2013 | 31/12/2014 |
|---|---|---|
| **Debt securities** | **185,014** | **185,802** |
| Croatian MoF bonds | 99,838 | 139,493 |
| Croatian MoF treasury bills | - | - |
| Foreign government bonds | 15,407 | - |
| Foreign government treasury bills | 68,687 | 30,653 |
| Corporate bonds | 1,082 | 1,100 |
| Foreign corporate bonds | - | 14,557 |
| **Shares in investment funds** | **4,477** | **4,306** |
| **Equity securities** | **-** | **-** |
| **Accrued interest** | **3,584** | **1,532** |
| past due | - | - |
| not past due | 3,584 | 1,532 |
| **TOTAL** | **193,075** | **191,640** |

The Bank recognises available-for-sale financial assets at fair value with changes in fair value recognised in a fair value reserve in equity, i.e. in the other comprehensive income. Of the total value of available-for-sale financial assets, as at 31 December 2014 the Bank had collaterals for repurchase agreements in the total amount of HRK 12,109 thousand (2013: HRK 123,815 thousand).

Pursuant to Article 3 of the Decision on Classification of Placements and Contingent Liabilities of Credit Institutions, the Bank classifies its “loans and receivables” and “held to maturity” placements in accordance with IAS 39 under the scope of the Decision. Pursuant to Article 4 of the Decision, financial assets classified as “at fair value through profit or loss” and “available-for-sale financial assets” in accordance with IAS 39 do not fall under the scope of the Decision. In accordance with the Decision, no impairment losses on the group basis are calculated for financial assets classified as “available for sale”.

## 7. HELD-TO-MATURITY FINANCIAL ASSETS

| [HRK'000] HELD-TO-MATURITY FINANCIAL ASSETS | 31/12/2013 | 31/12/2014 |
|---|---|---|
| **Debt securities** | **56,595** | **30,653** |
| Bills of exchange | 56,595 | 30,653 |
| **Accrued interest** | **1,340** | **1,176** |
| past due | 1,340 | 1,176 |
| not past due | - | - |
| **Provisions for impairment** | **(1,976)** | **(1,797)** |
| identified losses - bills of exchange | (103) | (337) |
| identified losses - accrued interest | (1,336) | (1,173) |
| identified losses on group basis | (537) | (287) |
| **TOTAL** | **55,959** | **30,032** |

Held-to-maturity financial assets consist of discounted bills of exchange from companies. Discounted bills of exchange represent a short-term financial instrument in terms of acceptance of credit risk that perceives the recourse guarantee and represents acceptable exposure for the Bank.

## 8. LOANS AND ADVANCES TO CUSTOMERS

| [HRK'000] LOANS AND ADVANCES TO CUSTOMERS | 31/12/2013 | 31/12/2014 |
|---|---|---|
| **Gross loans** | **767,678** | **752,605** |
| retail | 157,269 | 160,418 |
| corporate | 610,409 | 592,187 |
| **Accrued interest** | **35,992** | **36,703** |
| past due | 32,005 | 33,935 |
| not past due | 3,987 | 2,768 |
| **Provisions for impairment** | **(127,981)** | **(135,271)** |
| identified losses - gross loans | (93,687) | (98,841) |
| identified losses - accrued interest | (27,373) | (27,935) |
| identified losses on group basis | (6,921) | (8,494) |
| **TOTAL** | **675,689** | **654,038** |

| [HRK'000] MOVEMENTS IN IMPAIRMENT ALLOWANCE LOANS AND ADVANCES TO CUSTOMERS | 2014 | | |
|---|---|---|---|
| | Identified losses | Identified losses on group basis | TOTAL |
| **Movement in impairment allowances** | | | |
| At 1 January | **121,060** | **6,921** | **127,981** |
| (Decrease)/increase in impairment losses | 7,731 | 1,573 | **9,304** |
| Write-offs | (1,916) | - | **(1,916)** |
| Collected impaired interest | - | - | **-** |
| Net foreign exchange losses/(gains) | (99) | - | **(99)** |
| **At 31/12/2014** | **126,776** | **8,494** | **135,271** |

| [HRK'000] MOVEMENTS IN IMPAIRMENT ALLOWANCE LOANS AND ADVANCES TO CUSTOMERS | 2013 | | |
|---|---|---|---|
| | Identified losses | Identified losses on group basis | TOTAL |
| **Movement in impairment allowances** | | | |
| At 1 January | 46,508 | 7,072 | **53,580** |
| (Decrease)/increase in impairment losses | 75,942 | (151) | **75,791** |
| Write-offs | (1,118) | - | **(1,118)** |
| Collected impaired interest | - | - | **-** |
| Net foreign exchange losses/(gains) | (272) | - | **(272)** |
| **At 31/12/2013** | **121,060** | **6,921** | **127,981** |

The Bank applies the rate of 1% on balance sheet and off-balance sheet exposures which are subject to the credit risk and for which no identified impairment losses have been recognised.

## 9. PROPERTY AND EQUIPMENT

| 2014<br>[HRK'000] | Land and buildings | IT equipment | Office furniture and equipment | Motor vehicles and other | Assets under construction | Total |
|---|---|---|---|---|---|---|
| **Cost** | | | | | | |
| **At 1 January 2014** | **29,969** | **9,016** | **11,106** | **1,944** | **58** | **52,092** |
| Additions | - | - | - | - | - | - |
| Purchase | - | - | - | - | 220 | 220 |
| Write-offs | - | (121) | (77) | (4) | - | (202) |
| Disposals | (978) | - | - | (445) | - | (1,423) |
| Transfers | 14,912 | 228 | 33 | 7 | (269) | 14,911 |
| **At 31 December 2014** | **43,903** | **9,123** | **11,062** | **1,502** | **9** | **65,598** |
| | | | | | | |
| **Accumulated depreciation** | | | | | | |
| At 1 January 2014 | **4,334** | **7,264** | **8,474** | **1,442** | **-** | **21,514** |
| Charge for the year | 811 | 677 | 813 | 90 | - | 2,391 |
| Write-offs | (32) | (121) | (77) | (4) | - | (234) |
| Disposals | - | - | - | (445) | - | (445) |
| **At 31 December 2014** | **5,113** | **7,820** | **9,210** | **1,083** | **-** | **23,226** |
| | | | | | | |
| **Net book amount** | **38,790** | **1,303** | **1,852** | **419** | **9** | **42,373** |

| 2013<br>[HRK'000] | Land and buildings | IT equipment | Office furniture and equipment | Motor vehicles and other | Assets under construction | Total |
|---|---|---|---|---|---|---|
| **Cost** | | | | | | |
| **At 1 January 2013** | **27,788** | **8,722** | **11,196** | **1,849** | **56** | **49,611** |
| Additions | 52 | - | - | - | 483 | 535 |
| Purchase | 2,122 | - | - | - | - | 2,122 |
| Write-offs | - | (56) | (166) | (8) | - | (230) |
| Transfers | 7 | 350 | 76 | 103 | (481) | 55 |
| **At 31 December 2013** | **29,969** | **9,016** | **11,106** | **1,944** | **58** | **52,092** |
| | | | | | | |
| **Accumulated depreciation** | | | | | | |
| At 1 January 2013 | 3,564 | 6,533 | 7,612 | 1,364 | - | 19,073 |
| Charge for the year | 770 | 787 | 1,017 | 83 | - | 2,657 |
| Write-offs | - | (56) | (155) | (5) | - | (216) |
| **At 31 December 2013** | **4,334** | **7,264** | **8,474** | **1,442** | **-** | **21,514** |
| | | | | | | |
| **Net book amount** | **25,635** | **1,752** | **2,632** | **502** | **58** | **30,579** |

Additions in land and buildings in 2014 are set out in Note 11.

## 10. INTANGIBLE ASSETS

| 2014 [HRK'000] | Software | Leasehold improvements | Licences | Assets under construction | Total |
|---|---|---|---|---|---|
| **Cost** | | | | | |
| At 1 January 2014 | **3,607** | **9,614** | **5,438** | **14,060** | **32,722** |
| Additions | - | - | - | 955 | 955 |
| Purchase | - | - | - | 282 | 282 |
| Transfers | - | - | 99 | (99) | - |
| **At 31 December 2014** | **3,607** | **9,614** | **5,521** | **15,198** | **33,940** |
| **Accumulated amortisation** | | | | | |
| At 1 January 2013 | **1,765** | **8,816** | **4,667** | **-** | **15,248** |
| Charge for the year | 462 | 274 | 297 | - | 1033 |
| Write-offs | - | - | (16) | - | (16) |
| **At 31 December 2014** | **2,227** | **9,090** | **4,948** | **-** | **16,265** |
| **Net book amount** | **1,380** | **524** | **573** | **15,198** | **17,675** |

| 2013 [HRK'000] | Software | Leasehold improvements | Licences | Assets under construction | Total |
|---|---|---|---|---|---|
| **Cost** | | | | | |
| At 1 January 2013 | 3,607 | 8,895 | 5,144 | 13,142 | 30,788 |
| Additions | - | - | - | 1,965 | 1,965 |
| Transfers | - | 719 | 328 | (1,047) | - |
| Write-offs | - | - | (34) | - | (34) |
| **At 31 December 2013** | **3,607** | **9,614** | **5,438** | **14,060** | **32,719** |
| **Accumulated amortisation** | | | | | |
| At 1 January 2013 | 1,284 | 8,418 | 4,115 | - | 13,817 |
| Charge for the year | 481 | 398 | 552 | - | 1,431 |
| **At 31 December 2013** | **1,765** | **8,816** | **4,667** | **-** | **15,248** |
| **Net book amount** | **1,842** | **798** | **771** | **14,060** | **17,472** |

## 11. OTHER ASSETS

| [HRK'000] OTHER ASSETS | 31/12/2013 | 31/12/2014 |
|---|---|---|
| **Other assets** | **63,849** | **56,650** |
| Fees receivable | 964 | 2,868 |
| Prepaid expenses | 442 | 422 |
| Repossessed assets | 33,422 | 20,556 |
| Inventories | 427 | 326 |
| Other receivables | 28,594 | 32,478 |
| **Provisions for impairment** | **(26,561)** | **(27,642)** |
| **TOTAL** | **37,288** | **29,008** |

During 2014 the Bank repossessed assets in the total amount of HRK 1,485 thousand (2013: HRK 18,509 thousand) of which HRK 0 thousand relates to land (2013: HRK 399 thousand), HRK 997 thousand relates to buildings (2013: HRK 18,110 thousand) and HRK 488 thousand relates to flats (2013: HRK 0 thousand).

During 2014, repossessed assets sold in lieu of uncollected receivables amounted to HRK 978 thousand.

Although the Bank actively works on selling repossessed assets, during 2014 assets in the amount of HRK 14,913 thousand (2013: HRK 2,118 thousand) were reclassified to property and equipment due to a time period of 2 years passing from the repossession. In such cases the Bank starts recognising depreciation of such assets (Note 9).

Movements in provisions for impairment of other assets are as follows:

| [HRK'000] MOVEMENT IN IMPAIRMENT ALLOWANCES FOR OTHER ASSETS | 2013 | 2014 |
|---|---|---|
| **At 1 January** | **18,611** | **26,561** |
| Increase/decrease | 9,207 | 303 |
| Write-offs | (1,257) | 1,081 |
| **At 31 December** | **26,561** | **27,945** |

## 12. DEPOSITS FROM CUSTOMERS

| [HRK'000] DEPOSITS FROM CUSTOMERS | 31/12/2013 | 31/12/2014 |
|---|---|---|
| **Demand deposits** | **78,649** | **115,768** |
| retail | 18,785 | 33,872 |
| *in HRK* | *12,235* | *20,650* |
| *in foreign currency* | *6,550* | *13,222* |
| corporate | 59,864 | 81,896 |
| *in HRK* | *53,407* | *76,805* |
| *in foreign currency* | *6,458* | *5,090* |
| **Restricted deposits** | **705** | **292** |
| **Term deposits** | **891,494** | **1,013,251** |
| retail | 839,102 | 942,841 |
| *in HRK* | *179,851* | *220,477* |
| *in foreign currency* | *659,250* | *722,364* |
| corporate | 52,392 | 70,410 |
| *in HRK* | *23,482* | *39,354* |
| *in foreign currency* | *28,910* | *31,056* |
| **Accrued interest** | **16,666** | **16,214** |
| past due | 51 | 86 |
| not past due | 16,615 | 16,128 |
| **TOTAL** | **987,513** | **1,145,526** |

## 13. BORROWINGS

| [HRK'000] BORROWINGS | 31/12/2013 | 31/12/2014 |
|---|---|---|
| **Short-term** | **130,400** | **20,723** |
| from banks | 98,306 | 13,700 |
| *in HRK* | *63,050* | *13,700* |
| *in foreign currency* | *35,256* | - |
| from other financial institutions | 32,094 | 7,023 |
| *in HRK* | *13,000* | - |
| *in foreign currency* | *19,094* | *7,023* |
| from other | - | - |
| *in HRK* | - | - |
| *in foreign currency* | - | - |
| **Long-term** | **20,530** | **17,103** |
| from banks | 20,530 | 17,103 |
| *in HRK* | *20,530* | *17,103* |
| *in foreign currency* | | |
| **Accrued interest** | **142** | **68** |
| past due | - | - |
| not past due | 142 | 68 |
| **TOTAL** | **151,072** | **37,894** |

Borrowings include repurchase agreements in the total amount of HRK 10,700 thousand (2013: HRK 111,306 thousand).

Borrowings also include a loan from the EIF (European Investment Fund) in the amount of HRK 7,023 thousand (2013: HRK 19,094 thousand). These funds relate to a credit line for financing of small entrepreneurship.

## 14. HYBRID INSTRUMENTS

| [HRK'000] HYBRID INSTRUMENTS | 31/12/2013 | 31/12/2014 |
|---|---|---|
| **Hybrid instruments** | **3,055** | **26,049** |
| in HRK | 3,055 | 3,065 |
| in foreign currency | - | 22,984 |
| **Accrued interest** | **-** | **440** |
| past due | - | 440 |
| **TOTAL** | **3,055** | **26,489** |

In July 2009, the Bank received a hybrid instrument with a maturity of 5.5 years and a fixed interest rate of 7.75%. The hybrid instrument is included in the Bank’s supplementary capital.

Furthermore, in July 2014, an Agreement on subordinated debt was signed based on which J&T Banka, Prague, made a payment in the amount of EUR 3 million at an interest rate of 7.488%. This instrument is included in the Bank’s supplementary capital.

## 15. PROVISIONS FOR LIABILITIES AND CHARGES

| [HRK'000] PROVISIONS FOR LIABILITIES AND CHARGES | 31/12/2013 | 31/12/2014 |
|---|---|---|
| Provisions for legal disputes | 138 | 146 |
| Provisions for pensions and other liabilities to employees | 62 | 20 |
| Provision for contingent and other liabilities | 839 | 803 |
| **TOTAL** | **1,039** | **970** |

The movement in provisions for liabilities and charges is presented below:

| [HRK'000] MOVEMENT IN PROVISIONS FOR LIABILITIES AND CHARGES | 2013 | 2014 |
|---|---|---|
| **At 1 January** | **889** | **1,039** |
| Increase/decrease | 720 | 808 |
| Used during the year | (570) | (967) |
| **At 31 December** | **1,039** | **880** |

## 16. OTHER LIABILITIES

| [HRK'000] OTHER LIABILITIES | 31/12/2013 | 31/12/2014 |
|---|---|---|
| Trade payables | 224 | 1,027 |
| Liabilities for salaries, deductions from salaries, taxes and contributions | 1,723 | 1,892 |
| Deferred fee income | 3,485 | 3,433 |
| Other liabilities | 7,239 | 4,928 |
| **TOTAL** | **12,672** | **11,279** |

# 17. EQUITY

## 17.1. Share capital

| 31/12/2014 | Number of shares | Ownership share (%) |
|---|---|---|
| J&T BANKA A.S. | 7,500,000 | 58.33 |
| ALTERNATIVE d.o.o. | 3,571,429 | 27.77 |
| VALIDUS D.D. U STEČAJU | 513,477 | 3.30 |
| RAIFFIESENBANK AUSTRIA D.D. - custodian account | 199,444 | 1.55 |
| PLURIS D.D. U STEČAJU | 158,694 | 1.23 |
| Other shareholders | 915,496 | 7.12 |
| **TOTAL** | **12,858,540** | **100.00** |

| 31/12/2013 | Number of shares | Ownership share (%) |
|---|---|---|
| ALTERNATIVE D.O.O. | 3,571,429 | 66.65 |
| VALIDUS D.D. U STEČAJU | 513,477 | 9.58 |
| RAIFFEISENBANK AUSTRIA D.D. - custodian account | 283,944 | 5.30 |
| Other shareholders | 989,690 | 18.47 |
| **TOTAL** | **5,358,540** | **100.00** |

## 17.2. Other reserves

| [HRK'000] | 2013 | 2014 |
|---|---|---|
| **Reserves for own shares** | 2,522 | 2,552 |
| **Legal reserves** | 1,235 | 1,235 |
| **Other capital reserves** | 90,273 | 21,435 |
| | **94,030** | **25,222** |

## 17.3. Fair value reserve

The fair value reserve includes unrealised gains and losses on changes in the fair value of available-for-sale financial assets.

## 17.4. Accumulated loss

Accumulated loss comprise previous year accumulated losses and property acquisition cost related to capitalised costs incurred during sale and repurchase transactions of property owned by the Bank in prior years.

## 17.5. Legal reserve

The Bank is required to create a legal reserve by allocating 5% of its net profit for the year, until the reserve reaches 5% of the share capital. The legal reserve can be used to cover losses from previous years if the losses are not covered by current year profits or if other reserves are not available.

## 17.6. Reserves for general banking risks

The reserve for general banking risks represents a reserve for potential losses in excess of planned and already established allowances for identified losses.

In accordance with the regulations of the Croatian National Bank, the Bank is required to create a reserve for general banking risks, if the growth in the Bank's balance-sheet and off-balance-sheet exposure exceeds 15% of the balance-sheet and off-balance-sheet exposure at the previous year-end.

The Bank did not recognise a reserve for general banking risks.

## 17.7. Proposed dividends

Dividends payable are not recognized until they are approved at the General Assembly. The Management Board will not propose a dividend payment for 2014 (2013: nil).

## 17.8. Capital adequacy

The basic parameters of the capital management policy are given by the Credit Institutions Act and the Regulation (EU) no. 575.2013.

The basic objectives of capital management are ensuring the following:

- the going concern assumption and
- meeting the regulatory and capital adequacy requirements

The regulatory capital adequacy rate as at 31 December 2013 was set at a minimum of 8%, while based on the CNB Decision for the Bank this amount was increased by an additional 2%, while keeping a protective layer for the preservation of the ordinary capital in the amount of 2.5% and a protective layer for structural system risk of 1.5%.

Total capital is determined as a category of capital that is managed by the Bank, and must be at least at a level that ensures the adequacy of capital sufficient to cover the capital requirements for operational risks and to ensure minimum prescribed capital adequacy ratio. Regulatory capital is calculated in accordance with the prescribed subordinate acts of the CNB and the Regulation (EU) no. 575.2013.

| [HRK'000] CAPITAL ADEQUACY | 31/12/2013 | 31/12/2014 |
|---|---|---|
| BASIC CAPITAL | 55,883 | 104,515 |
| Regular basic capital | 55,883 | 104,515 |
| Additional basic capital | - | - |
| Supplementary capital | 3,055 | 23,034 |
| **REGULATORY CAPITAL** | **58,938** | **127,550** |
| **CAPITAL REQUIREMENTS** | **108,793** | **72,229** |
| **CAPITAL ADEQUACY RATIO** | **6.50%** | **14.13%** |

During 2014, J&T Banka provided sufficient capital which secured and met all legal criteria required for the further development of the Bank. The stated was implemented in 2 steps:

1. Based on a transaction of increasing the basic capital by payment in cash in the amount of HRK 75 million by J&T Banka. The share capital increase was entered into the register of the Commercial Court on 26 June 2014, and based on the Decision EROFF-27-020/14-ŽJ-BV from 7 July 2014 the CNB approved the allocation into the basic capital instrument as of 30 June 2014.

2. In addition, based on the signed Agreement on subordinated debt dated 24 July 2014, J&T Banka made a payment in cash into the supplementary capital in the amount of EUR 3 million.

## 18. INTEREST AND SIMILAR INCOME

| [HRK'000] INTEREST AND SIMILAR INCOME | 2013 | 2014 |
|---|---|---|
| **Analysis by product** | **72,550** | **57,552** |
| Loans and advances to customers | 62,202 | 48,883 |
| *retail* | *12,754* | *10,524* |
| *corporate* | *49,448* | *38,360* |
| Deposits | 338 | 27 |
| Debt securities | 9,772 | 8,773 |
| Other | 239 | (131) |
| **Analysis by source** | **72,550** | **57,552** |
| Retail | 12,754 | 10,524 |
| Corporate | 49,386 | 38,961 |
| State and public sector | 6,290 | 5,836 |
| Financial institutions | 1,427 | 502 |
| Other | 2,694 | 1,729 |

## 19. INTEREST AND SIMILAR EXPENSE

| [HRK'000] INTEREST AND SIMILAR EXPENSE | 2013 | 2014 |
|---|---|---|
| **Analysis by product** | **42,076** | **42,753** |
| Deposits from customers | 39,666 | 39,555 |
| *retail* | *35,789* | *37,793* |
| *financial institutions* | *448* | *36* |
| *corporate* | *3,429* | *1,725* |
| Borrowings | 2,152 | 1,709 |
| Hybrid instruments | 207 | 973 |
| Other | 51 | 516 |
| **Analysis by source** | **42,076** | **42,753** |
| Retail | 35,996 | 38,022 |
| Corporate | 1,878 | 1,434 |
| State and public sector | 424 | 297 |
| Financial institutions | 2,600 | 2,458 |
| Other | 1,178 | 542 |

## 20. FEE AND COMMISSION INCOME

| [HRK'000] FEE AND COMMISSION INCOME | 2013 | 2014 |
|---|---|---|
| **Payment transaction fees** | **3,927** | **4,017** |
| **Letters of credit and guarantee fees** | **1,680** | **1,059** |
| **Impairment losses** | **(79)** | **16** |
| **Other** | **841** | **2,168** |
| **TOTAL** | **6,369** | **7,260** |

## 21. FEE AND COMMISSION EXPENSE

| [HRK'000] FEE AND COMMISSION EXPENSE | 2013 | 2014 |
|---|---|---|
| Payment transaction fees | 1,311 | 1,298 |
| Other | 447 | 585 |
| TOTAL | 1,757 | 1,882 |

## 22. GAINS LESS LOSSES FROM AVAILABLE-FOR-SALE FINANCIAL ASSETS

| [HRK'000] GAINS LESS LOSSES FROM AVAILABLE-FOR-SALE FINANCIAL ASSETS | 2013 | 2014 |
|---|---|---|
| **Realised** | **1,205** | **6,833** |
| Shares | - | - |
| Bonds | 1,205 | 6,839 |
| Treasury bills | - | (6) |
| Investment funds | - | - |
| **Impairment of available-for-sale financial assets - investment funds** | **(7,674)** | **-** |
| TOTAL | (6,468) | 6,833 |

## 23. GAINS LESS LOSSES FROM FOREIGN CURRENCIES

| [HRK'000] GAINS LESS LOSSES FROM FOREIGN CURRENCIES | 2013 | 2014 |
|---|---|---|
| Net gains / (losses) from translation of monetary assets and liabilities | 522 | 365 |
| Net gains / (losses) from dealing in foreign currencies | 2,866 | 2,463 |
| TOTAL | 3,388 | 2,827 |

## 24. OTHER INCOME

| [HRK'000] OTHER OPERATING INCOME | 2013 | 2014 |
|---|---|---|
| Other income | 1,032 | 1,677 |
| TOTAL | 1,032 | 1,677 |

## 25. GENERAL AND ADMINISTRATIVE EXPENSES

| [HRK'000] GENERAL AND ADMINISTRATIVE EXPENSES | 2013 | 2014 |
|---|---|---|
| Staff costs | 22,302 | 21,698 |
| Saving deposits insurance charge | 2,391 | 2,851 |
| Other expenses | 15,798 | 17,967 |
| TOTAL | 40,491 | 42,516 |

At 31 December 2014, the Bank had 143 employees (31 December 2013: 142 employees).

## 26. IMPAIRMENT LOSSES

| [HRK'000] IMPAIRMENT LOSSES | 2013 | 2014 |
|---|---|---|
| **Identified losses** | **96,961** | **(3,866)** |
| Available-for-sale financial assets | 1,108 | (27) |
| Held-to-maturity financial assets | 29 | 234 |
| Loans and advances to customers | 63,658 | (4,308) |
| Interest receivable | 22,959 | 235 |
| Other receivables | 9,207 | - |
| **Identified losses on group basis** | **251** | **1,324** |
| Assets | 251 | 1,324 |
| TOTAL | 97,211 | (2,543) |

## 27. INCOME TAX

Income tax expense recognised in the income statement:

| [HRK'000] INCOME TAX | 2013 | 2014 |
|---|---|---|
| **Profit before tax** | **(109,449)** | **(11,911)** |
| **Income tax at 20%** | **(21,890)** | **(2,382)** |
| Expenses not deductible for tax purposes | 2,420 | 3,055 |
| Income not subject to tax | (1,635) | (2,192) |
| **Utilised tax loss from previous years** | **(21,104)** | **(1,519)** |
| | | |

In previous years the Bank incurred tax losses. Such tax losses can be carried forward over the following five years in which they are incurred. Tax losses and their expiry dates at 31 December 2014 and 2013 were as follows:

| [HRK'000] TAX LOSSES | | 2013 | | 2014 | |
|---|---|---|---|---|---|
| Incurred | Year of expiry | Gross tax losses | Tax effect at a rate of 20% | Gross tax losses | Tax effect at a rate of 20% |
| 2008 | 2013 | 23,653 | 4,731 | | |
| 2010 | 2015 | 7,303 | 1,461 | 7,303 | 1,461 |
| 2011 | 2016 | 8,312 | 1,662 | 8,312 | 1,662 |
| 2012 | 2017 | 8,137 | 1,627 | 8,137 | 1,627 |
| 2013 | 2018 | 105,520 | 21,104 | 105,520 | 21,104 |
| 2014 | 2019 | | | 7,597 | 1,519 |
| **TOTAL** | | **152,925** | **30,585** | **136,869** | **27,373** |

The Bank has not recognised deferred tax assets since their utilisation in future periods is uncertain.

## 28. BASIC AND DILUTED EARNINGS PER SHARE

For the purpose of calculating earnings per share, earnings are calculated as the profit for the period attributable to shareholders of the Bank. The number of ordinary shares is the weighted average number of ordinary shares in circulation during the year after deducting the number of ordinary treasury shares.

Since there is no effect of options, convertible bonds or similar effects, the weighted average number of ordinary shares used to calculate diluted earnings per share was the same as the one used to calculate basic earnings per share. The bank has no preference shares.

| | 2013 | 2014 |
|---|---|---|
| **Profit/(loss) for the year [HRK'000]** | **(109,449)** | **(11,911)** |
| **Weighted average number of shares** | **5,358,540** | **12,858,540** |
| **BASIC AND DILUTED EARNINGS PER SHARE** | **(20.43)** | **(0.93)** |

## 29. CONCENTRATION OF ASSETS AND LIABILITIES

| [HRK'000] | 31/12/2013 | 31/12/2014 |
|---|---|---|
| Giro account with CNB | 33,316 | 58,008 |
| Obligatory reserve with CNB | 86,600 | 95,289 |
| Bonds issued by the Ministry of Finance | 67,044 | 139,493 |
| Borrowings from CBRD | (46,380) | (20,103) |
| **TOTAL** | **140,581** | **272,687** |

The Bank's exposure towards local government and state institutions not directly funded from the State Budget (excluding companies owned by the state) is presented below:

| [HRK'000] | 31/12/2013 | 31/12/2014 |
|---|---|---|
| Loans | 4,962 | 4,697 |
| Deposits | (18,384) | (19,118) |
| **TOTAL** | **(13,422)** | **(14,421)** |

## 30. CASH AND CASH EQUIVALENTS

| [HRK'000] | 31/12/2013 | 31/12/2014 |
|---|---|---|
| Cash and amounts due from banks | 110,076 | 273,932 |
| Placements to banks with original maturity up to 90 days | - | 13,835 |
| **TOTAL** | **110,076** | **287,767** |

## 31. CONTINGENCIES

| [HRK'000] COMMITMENTS AND CONTINGENCIES | 31/12/2013 | 31/12/2014 |
|---|---|---|
| **Guarantees** | **35,916** | **23,264** |
| in HRK | 32,844 | 22,589 |
| in foreign currency | 3,072 | 675 |
| **Letters of credit** | **653** | **2,977** |
| in foreign currency | 653 | 2,977 |
| **Unused loan commitments** | **44,818** | **53,028** |
| in HRK | 44,761 | 53,017 |
| in foreign currency | 57 | 11 |
| **Other off-balance sheet items** | **2,079** | **-** |
| in foreign currency | 2,079 | - |
| **TOTAL** | **83,466** | **79,270** |

At 31 December 2014, the Bank recognised unidentified impairment losses for off-balance-sheet risks arising from the issue of guarantees, letters of credit and undrawn lending commitments in the amount of HRK 793 thousand (2013: HRK 835 thousand).

## 32. RELATED PARTY TRANSACTIONS

The key shareholders of the Bank are J&T Banka A.S., Alternative d.o.o. and Validus d.d. in bankruptcy which together at the year-end owned 90.10% of the Bank's shares. The remaining 9.90% of the shares are publicly traded. The Bank considers that it has an immediate related party relationship with its key shareholders; the Supervisory and Management Board members and other executive management (together “key management personnel”); close family members of key management personnel; and entities controlled, jointly controlled or significantly influenced by key management personnel and their close family members, in accordance with the definitions contained in International Accounting Standard 24 “Related Party Disclosures” (“IAS 24”).

### 32.1. Key transactions with immediate related parties

At 31 December 2014, the Bank has no high-risk product exposure towards its key shareholders (2013: nil). All transactions with key shareholders during the year were generated from deposit, lending activities and key management compensation. The gross exposure to key shareholders at 31 December 2013 as well as 31 December 2012 is nil.

As at 31 December 2014, the Bank has no obligation to key shareholders concerning demand deposits with the Bank.

Except for salaries, there was no other compensation to the key management in 2014 and 2013. The Bank had no Reward policy for in 2014 and 2013.

| [HRK'000] RELATED PARTY TRANSACTIONS | 2013 | | | | 2014 | | | |
|---|---|---|---|---|---|---|---|---|
| | exposure | liabilities | revenue | expenses | exposure | liabilities | revenue | expenses |
| **Key shareholders** | | | | **15** | | | **420** | **1,323** |
| **Key management** | **-** | **23** | **-** | **2,262** | **1,302** | **-** | **-** | **2,816** |
| Compensation paid | - | 23 | - | 2,260 | - | - | - | 2,816 |
| Loans granted | - | - | - | 2 | 1,302 | - | - | - |
| **TOTAL** | **-** | **23** | **-** | **2,277** | **1,302** | **-** | **420** | **4,139** |

## 33. MANAGED FUNDS FOR AND ON BEHALF OF CORPORATE AND RETAIL CUSTOMERS

The Bank manages funds for and on behalf of corporate and retail customers, whereby it holds and manages assets or invests funds received in various financial instruments at the direction of the customer. For providing these services, the Bank receives fee income. These assets do not represent the Bank's assets and are not recognised in the balance sheet. The Bank is not exposed to any credit risks from these placements, nor does it guarantee for investments.

Furthermore, the Bank manages credit exposure of third parties as follows:

| [HRK'000] MANAGED FUNDS FOR AND ON BEHALF OF CORPORATE AND RETAIL CUSTOMERS | 2013 | 2014 |
|---|---|---|
| **Assets** | **98,628** | **98,670** |
| Corporate | 66,254 | 63,594 |
| Retail | 32,369 | 35,071 |
| Giro account | 5 | 5 |
| **Liabilities** | **98,628** | **98,670** |
| Companies | 60,848 | 62,436 |
| CBRD | 27,659 | 24,689 |
| Local authorities | 1,227 | 1,641 |
| Retail | 8,894 | 9,904 |

## 34. AVERAGE INTEREST RATES

Average interest rates calculated based on the weighted average for each category of interest-earning assets and interest-bearing liabilities, are presented below:

| [HRK'000] | 2013 | 2014 |
|---|---|---|
| **Assets** | | |
| Obligatory reserve with CNB | - | - |
| Placements with and loans to other banks | 1.97% | 0.37% |
| Available-for-sale financial assets | 3.24% | 3.27% |
| Held-to-maturity financial investments | 10.77% | 8.10% |
| Loans and advances to customers | 8.65% | 7.47% |
| **Liabilities** | | |
| Deposits | 4.27% | 3.76% |
| Borrowings | 1.49% | 2.01% |
| Hybrid instruments | 6.85% | 7.50% |

## 35. OPERATING LEASE COMMITMENTS

| [HRK'000] OPERATING LEASE COMMITMENTS | 31/12/2013 | 31/12/2014 |
|---|---|---|
| Up to 1 year | 4,510 | 3,862 |
| From 1 to 5 years | 9,959 | 11,993 |
| Over 5 years | - | 2,383 |
| | 14,469 | 18,238 |

## 36. FAIR VALUE OF FINANCIAL ASSETS

Fair value represents the amount at which an asset could be exchanged or a liability settled on an arm's length basis.

The Management Board believes that the fair value of financial assets and liabilities are not significantly different from their carrying values recorded in the balance sheet as at 31 December 2014.

The following methods were used to estimate the fair value of financial instruments of the Bank:

**Cash and amounts due from banks, amounts held with the CNB**

The carrying values of cash, amounts due from banks, amounts held with the CNB generally approximate their fair values.

**Placements with and loans to other banks**

Estimated fair value of placements and loans to other banks represents a discounted value of future cash flows.

**Available-for-sale financial assets**

The fair value of available-for-sale financial assets is based on their market prices. Financial instruments not quoted on active markets are evaluated through discounted cash flows method or by an alternative method used for fair value estimation.

**Loans and advances to customers**

The fair value of loans and advances to customers is based on the analysis of discounted cash flows of loans by applying current interest rates for loans with similar conditions or characteristics. The fair value of non-performing loans to customers is estimated using a discounted cash flow analysis or the appraised value of the underlying collateral. Considering that insignificant part of loans and advances to customers is contracted at a fixed interest rate or at a rate deviating from the market rate, the Bank considers the fair value of loans and advances to customers to approximate their carrying value.

**Deposits from banks and customers**

The fair value of term deposits payable on demand represents the carrying value of amounts payable on demand as at the balance sheet date. The fair value of term deposits at variable interest rates approximates their carrying values as at the balance sheet date. The fair value of deposits at fixed interest rates is estimated by discounting their future cash flows using rates currently offered for deposits of similar remaining maturities. Most of the customers' deposits with a fixed interest rate become due within one year and therefore their fair value does not significantly differ from their carrying value.

## 37. EVENTS AFTER THE REPORTING PERIOD

Based on the decision of the Management Board and the approval of the Supervisory Board dated 28 January 2015, the Bank's share capital was further increased by a payment made by the majority owner J&T Banka, Prague, in the amount of HRK 37.5 million, which was registered at the Commercial Court on 9 February 2015. After entering this share capital increase into the court register, the total share capital amounts to HRK 166.09 million, and J&T Banka, Prague has an ownership interest of 67.74%.