

OTP BANKA d.d.

**ANNUAL REPORT
FOR THE YEAR ENDED
31 DECEMBER 2019**

This version of the auditor`s report is translation from the original, which was prepared in the Croatian language. All possible care has been taken to ensure that the translation is an accurate representation of the original. However, in all matters of interpretation of information, views or opinions, the original language version of the report takes precedence over this translation.

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Report of the Management Board on the Position of the Bank

Dear customers and business partners,

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The economic activity in Croatia intensified in 2019 compared to the preceding year, mainly owing to household and state consumption, and investments that increased in light of a better absorption of EU funds. The 2019 annual growth rate of the real GDP has been estimated at 3.0%, thus continuing a positive cycle in the domestic economy marked by a steady growth trend since the second half of 2014. Furthermore, a labour market upturn and a low inflation had a positive impact on the household consumption.

After a budget surplus of 0.8% and 0.3% in 2017 and 2018, respectively, the year 2019 ended in a budget deficit of 0.1% of GDP as the share of public debt dropped to 68.7% of GDP. In addition, positive trends were noticeable in the segment of external imbalance, as indicated by the surplus in the current account of the balance of payment, along with a decrease of the foreign debt. Such stable public finances and the decrease in the government debt continued throughout 2019, which resulted in an upgrade in the credit rating of the country to the investment grade level by two of the three most renowned credit rating agencies in the world – S&P and Fitch.

By sending a letter of intent to enter the European Exchange Rate Mechanism (ERM II) in July 2019, Croatia made the first formal step towards joining the ERM II, which precedes the introduction of the euro as a legal tender. In the letter it undertook to implement the total of 19 measures across six different areas over a period of 12 months after which it could enter the banking union and ERM II.

Regardless of the positive trends and general economic situation, the growth of the economy is still slower than in comparable economies, and the underlying reasons are the stagnation of the main export markets of Germany and Italy. In the observed year, the European economy successfully resisted global challenges, and consequently the growth rate of the real GDP in the EU members is expected to reach 1.5%. As the year neared its end, a slight improvement of the trade relations between USA and China became noticeable, but the future of the US trade policy remains highly uncertain and hindered the uplift in global business sentiment. It is expected that the heightened geopolitical tensions in the Middle East, the rising risk of escalation of the conflict between USA and Iran, the long-term uncertainty of the future trade relations between the European Union and the United Kingdom, and the imminent threat of the emergence and spreading of the coronavirus on the production and the state of the Chinese economy will limit the opportunities for any significant growth of the European and the Croatian economy over the years to follow. Under such circumstances, the estimated economic growth of the EU countries is 1.4% of GDP, whilst the Croatian GDP could grow by 2.6% in 2020. At the same time, economies of other comparable EU members have been growing, and are still expected to grow considerably faster, whilst Croatia remains almost at the bottom of the list of the EU members in terms of economic development (measured by GDP indicator adjusted by the purchase power parity per capita).

These projections do not include events after the balance sheet date, in particular events related to the corona virus.

Such a modest growth potential is a result of the long-term structural problems of the Croatian economy that have been further aggravated by the prevailing adverse demographic trends. Apart from the wider issue of an aging population, the main characteristic of the adverse demographic trends in Croatia is the exceptionally alarming migration trend, which resulted in a sharp downturn of the total population figures, and therefore a decline in the unemployment rate.

Since the beginning of 2014 the unemployment rate has been steadily declining, so in December 2019 the average registered unemployment rate reached 7.9% (fall from 8.9% recorded in December 2018), and in September 2019 the registered unemployment rate reached the all time low of 6.7%. This decrease in the unemployment rate was corroborated by a decrease in the Labour Force Survey employment rate, which averaged 5.7% in the third quarter of 2019, when the average Labour Force Survey employment rate in the EU members amounted to 6.1%. The lack of labour force in the domestic market during 2018 became even more prominent, with the same trend continuing through 2019, which stimulated a relatively strong rise in net salaries. Therefore, the average net salary was higher by 4.3% in nominal terms, and by 3.6% in real terms. The steadily growing personal consumption has remained the key component of the GDP growth, partly owing to tax reliefs in the form of a higher non-taxable income basis.

Having risen by 1.5% in 2018, consumer price growth in 2019 was slower and reached 0.8%. The HRK/EUR exchange rate was exceptionally stable in 2019, averaging HRK 7.41 to EUR 1, consistent with 2018. CNB pursued a rather expansive monetary policy, maintaining the stability of the HRK exchange rate, whilst the system liquidity remained rather high. Due to the aforementioned circumstances, supported by an accommodating international environment and stable public finances, the interest rates remained very low throughout 2019, which encouraged the growth on the side of retail lending, thus continuing the trend that began in September 2017. At the same time, however, such low interest rates failed to spark the growth of lending to entrepreneurs for a number of reasons, including their current high levels of indebtedness, low appetite for new geared investments and a lack of high-quality projects, but also, on the part of the bank, heightened caution was exercised, which is evident in the close scrutiny of clients' indebtedness, financial standing and quality of their projects.

At the end of the third quarter of 2019, there were 20 banks and 4 building societies operating in the local banking market. The total assets of these institutions totalled HRK 427 billion, which demonstrated a year-on-year increase of 4%. The assets are highly concentrated whereby the five largest banks hold as much as 80% of the market. The level of resilience of the local banking system to possible shocks is reasonably high owing to an exceptionally high level of capitalisation of banks, as illustrated by their average total capital rate that measured 22.89% at the end of September 2019.

Operations and activities of OTP banka in 2019

In December 2018 OTP banka finalised the formal acquisition of Splitska banka and created the fourth largest credit institution in terms of assets and performance in the Croatian banking system - the largest transaction of its kind in the financial sector of the Republic of Croatia to date. At that point, the total balance sheet of OTP banka grew by 114%, to HRK 42 billion. In addition, the total assets of the Bank grew during 2019 to HRK 44 billion by year-end. The Bank succeeded in maintaining its market position and remaining competitive, holding almost 13% of the market share in terms of loans advanced, and approximately 11% of the market share in terms of deposits held. In respect of lending to corporate customers, the Bank's market share in terms of loans advanced amounts to 10%, and it holds around 8% of the overall corporate deposits.

The total profit after tax in 2019 was HRK 579 million, bearing in mind that the business operations during this year were additionally burdened by the post-integration and business optimisation costs. If the 2019 operations were taken into account exclusive of the effects of extraordinary and one-off transactions, the Bank's profit after tax would have totalled HRK 679 million.

All the regulatory requirements were regularly attained, the liquidity levels were satisfactory, and the capital adequacy ratio was significantly above the set floor rate.

The auditor has reviewed the Bank's net profit for the period ended June 30, 2019 for the purpose of including net profit in regulatory capital.

OPT banka activities during 2019 were impacted by the comprehensive stress test assessment and AQR exercise of the European Central Bank. Namely, after the Croatian government sent a letter of intent for membership in the European Exchange Rate Mechanism (ERM II) in July 2019, OTP banka, together with four of the other largest banks in Croatia, was subjected to a comprehensive, intensive and very demanding process of stress testing and AQR. The process started in the summer of 2019 and the Bank has since required considerable human and technical resources across primarily all the segments of the Bank. The process is currently in its last phase, and the results are expected from ECB in April this year.

Corporate social responsibility

OTP Bank operates on the principles of corporate social responsibility, as evident in its accountability and transparency in business operations; from loan approval to savings and risk management, in addition to the projects designed to contribute to the development of local communities, specific to the regional characteristics, in which it operates.

Together with 22 other employers in the Republic of Croatia, the Bank signed the Employee Volunteering Charter in 2019.

OTP Bank has been contributing to better schooling conditions for students nationwide through its programme “Green light to knowledge” that has been running for ten consecutive years now. In the academic year 2019/2020, the project for granting scholarships to students of lower financial standing has been realised in partnership with the towns of Split, Zadar, Sisak and Čakovec, the municipalities of Župa dubrovačka, Bilje and Jakšić, the University of Zadar, and the charity of the Dubrovnik Diocese, which means that the Bank, as a partner, joined the existing grant programmes for this academic year. The grants have been awarded following the invitation to tenders, and the main criteria included financial and social standing of the applicants, and their academic performance.

Over the last ten years the Bank has set aside over six million kuna for this programme.

Wishing to foster excellence in sports, through its “Green light” programme OTP Bank has taken a step further in the academic year 2019/2020, that is, it has awarded additional grants to five full time students studying at universities in Croatia who, apart from their academic accomplishments, have also achieved noteworthy results in their chosen sport.

Upholding another tradition for the eighth year running, OTP Bank invited tenders for donations intended for projects across four different categories: youth, education and science; protection of cultural, historic and traditional heritage and environmental protection; humanitarian projects and sports. The Bank received just short of a thousand applications from all parts of Croatia, and 52 projects were chosen.

Over the last eight years OTP Bank has awarded a total of 3.2 million kuna for the projects initiated for improvement of quality of life in relevant communities.

Being environmentally conscious, OTP Bank supports projects aimed at development and use of renewable energy sources and reduction of the ecological footprint, and has therefore initiated the commencement of an electric cars charging station in Zadar as a part of its “Green light to...” programme. Further to the Cooperation Agreement entered into with the City of Zadar and HEP (national power supplier), regulating the infrastructure development project for charging of electric vehicles, a car charging station ELEN was installed at the public parking lot situated at the address Obala kneza Branimira, with two dedicated parking spaces.

Exercising responsibility in its business operations, and undertaking various activities, OTP Bank contributes to the development of positive values in society in the best interest of the domicile communities.

Plans for 2020

A stable growth of the portfolio across all business segments, and maintaining its quality and market share will remain a continued focus of our business operations in 2020.

In respect of corporate banking, such growth should be supported by a larger contribution from the medium and small enterprises, in order to achieve a permanently sustainable diversification and stability in terms of the size of the client portfolio. To that end, our focus will remain on the export-oriented medium enterprises, tourism and market niches closely related to the propulsive tourist industry. In accordance with the increasingly demanding market and regulatory conditions, we will continue investing considerably into the digitalisation of our processes through technical innovations, permanently improving the quality of our products and services, and promptly reacting to the needs of our corporate clients.

As for the retail banking segment, the year 2020 will see continuation of the transformation programme carried out through a number of initiatives aimed at increasing the service level. The initiatives relate to a better user experience per all sales channels (mobile and Internet banking, contact centre, ATM network and branch network).

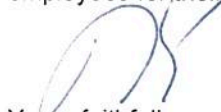
In addition, in accordance with the previously defined strategic guidelines, we will continue the branch network optimisation process that commenced upon the bank integration in December 2018. The branch network optimisation will be accompanied by a number of initiatives for improvement of the branch choreography that should result in a better time management for the sales staff in order to increase the level of service provided to clients. Along the same lines, the objective is to direct simple transactions to other channels, primarily mobile banking the improvement of which will be in the focus of the development plans for the year 2020.

Finally, it is important to mention several relevant events occurred during March that may affect the achievement of the 2020 plan. The emergence and spread of corona virus in the Republic of Croatia and the measures taken to stop the spread of the virus and suppress it will certainly have negative effects on the entire Croatian economy. In order to mitigate these effects, the Government of the Republic of Croatia presented a number of measures to support the economy.

However, given the recent events, the uncertainty over how long the measures will be in place and the fact that the elaboration of measures to support the economy is still ongoing, it is not possible to reliably estimate the effects at present.

For the Bank, the highest priority is currently ensuring business continuity and providing necessary services to all clients and monitoring the development of the economic situation.

On my own behalf and on behalf of the Board and the entire OTP Group, I would like to take this opportunity to extend thanks to our customers and business partners for the trust shown. Special thanks is due to our employees for their efforts, hard work and commitment over the past year.



Yours faithfully,
Balázs Békeffy
President of the Board

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

The Management Board of the Bank is required to prepare financial statements for each financial year 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 statutory accounting requirements for banks in Croatia, and is responsible for maintaining proper accounting records to enable the preparation of such financial statements at any time. It has a general responsibility for taking such steps as are reasonably available to it to safeguard the assets of the Bank and to prevent and detect fraud and other irregularities.

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

The Management Board is responsible for the submission to the Supervisory Board of its annual report on the Bank 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 Management Board is responsible for the preparation and content of Report of the Management Board on the Position of the Bank and the rest of other information, in accordance with the provisions of the Accounting Act (Official Gazette 78/15, 134/15, 120/16, 116/18).

Financial statements, as well as the Schedules prepared in accordance with the Decision of the Croatian National Bank on the Structure and Content of the Annual Financial Statements of Credit Institutions (Official Gazette 42/18), were authorised by the Management Board on 20 March 2020 and submitted to the Supervisory Board for acceptance. To confirm this, the financial statements have been signed by authorized persons, as follows.

For and on behalf of OTP banka d.d.:



Balazs Pal Bekeffy
President of the Management Board



Nikola Mikša
Member of the Management Board



Slaven Celić
Member of the Management Board



Zvonimir Akrap
Member of the Management Board



Bruno Biuk
Member of the Management Board



Ivan Šimičević
Procurator

INDEPENDENT AUDITOR'S REPORT

To the Shareholders of OTP banka d.d.

Report on the Audit of the Financial Statements

Opinion

We have audited the financial statements of OTP banka d.d. ("the Bank") which comprise unconsolidated statement of financial position as at 31 December 2019, unconsolidated statement of profit or loss, unconsolidated statement of other comprehensive income, unconsolidated statement of changes in shareholders' equity and unconsolidated statement of cash flow for the year then ended, including a summary of significant accounting policies and other explanatory information ("the financial statements").

In our opinion, the accompanying financial statements present fairly, in all material respects, the Bank's financial position as at 31 December 2019, and its financial performances and its cash flow for the year then ended in accordance with statutory accounting requirements for banks in Croatia.

Basis for Opinion

We conducted our audit in accordance with the Audit Act and International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Bank and the Group in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) and we have fulfilled our ethical responsibilities in accordance with the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Emphasis of Matter

We draw attention to Note 2.1 *Statement of compliance* to the financial statements, stating that the consolidated financial statements, which comprise the Bank and its subsidiaries, are not issued yet. The consolidated financial statements will be prepared in accordance with statutory accounting requirements for banks in Croatia and will be issued within the statutory deadline. Users should read consolidated financial statements together with these financial statements for a better understanding of the Group OTP banka d.d. as a whole. Our opinion is not modified in respect of this matter.

Key Audit Matters

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

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The company was registered at Zagreb Commercial Court: MBS 030022053; paid-in initial capital: Kn 44,900.00; Directors: Marina Tonžetić and Dražen Nimčević; Bank: Zagrebačka banka d.d., Trg bana Josipa Jelačića 10, 10 000 Zagreb, bank account no. 2360000-1101896313; SWIFT Code: ZABAHR2X IBAN: HR2723600001101896313; Privredna banka Zagreb d.d., Radnička cesta 50, 10 000 Zagreb, bank account no. 2340009-1110098294; SWIFT Code: PBZGHR2X IBAN: HR3823400091110098294; Raiffeisenbank Austria d.d., Petrinjska 59, 10 000 Zagreb, bank account no. 2484008-1100240905; SWIFT Code: RZBHHR2X IBAN: HR1024840081100240905.

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INDEPENDENT AUDITOR'S REPORT (continued)

Report on the Audit of the Financial Statements (continued)

Key Audit Matters (continued)

Impairment allowances for expected credit losses on loans and receivables from customers	How the matter was addressed in our audit
<p><i>For the accounting framework refer to Note 2, for accounting policies see Significant accounting policies Note 2.12 and 2.13, and Accounting estimates and judgements in applying accounting policies see Note 3. For the additional information regarding identified key audit matter, refer to Note 11, 17 and 35 to the financial statements.</i></p>	
<p>Credit risk represents one of the most important types of financial risks to which the Bank is exposed to. Determining appropriate methods and models by the Management to measure and manage credit risk is therefore one of the most important areas in safeguarding the Bank's capital. As part of the credit risk management process, appropriate determination impairment allowances for expected credit losses on loans and receivables from customers represent key considerations for the Management.</p> <p>In determining both the timing and the amount of impairment allowances for expected credit losses on loans and receivables from customers, the Management exercises significant judgement in relation to the following areas:</p> <ul style="list-style-type: none"> • Use of historic data in the process of determining risk parameters • Estimation of the credit risk related to the exposure • Assessment of stage allocation • Assessment on the significance of subsequent changes in credit risk of an exposure for the purposes of identifying whether significant increase in credit risk has occurred, leading to changes in stage allocation and the required measurement of lifetime expected credit losses • Expected future cash flows from operations • Valuation of collateral and assessment of realization period 	<p>In order to address the risks associated with impairment allowances for expected credit losses on loans and receivables from customers, identified as key audit matter, we have designed audit procedures that allowed us to obtain sufficient appropriate audit evidence for our conclusion.</p> <p>We performed following audit procedures with respect to area of loans and receivables from customers:</p> <ul style="list-style-type: none"> • Reviewing the methodology for recognizing impairment allowances for expected credit losses and comparing the reviewed methodology against the requirements of International Financial Reporting Standards, (IFRS) 9 within statutory reporting framework; • Obtaining understanding of the control environment and internal controls implemented by the Management within the process of measuring impairment allowance for expected credit losses; • Evaluating design and inspecting implementation of identified internal controls relevant to the process of measuring impairment allowance for expected credit losses; • Testing identified relevant controls for operating effectiveness; • Assessing quality of historical data used in determination of risk parameters and evaluating the appropriateness of IT elements and data processing; • Disaggregating loans and receivables from customers account balance based on stage allocation and relevant segments for the purposes of sample selection - for Stage 3, individually assessed loans and receivables, the criteria for selection included, but was not limited to, client's credit risk assessment, industry risk, days past due, etc.;

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INDEPENDENT AUDITOR'S REPORT (continued)

Report on the Audit of the Financial Statements (continued)

Key Audit Matters (continued)

<p>Since determination of appropriate impairment allowances for expected credit losses on loans and receivables requires use of complex models (generally dependent on IT elements) and significant judgement from the Management, process of measuring expected credit losses may be exposed to management bias. This fact led to the determination of impairment allowances for expected credit losses on loans and receivables from customers, recognized in accordance with the statutory reporting framework for banks in Republic of Croatia, as key audit matter in our audit of the financial statements for the year ended 31 December 2019.</p>	<ul style="list-style-type: none"> • Performing substantive tests over recognition and measurement of impairment allowance for expected credit losses on sample of loans and receivables allocated to Stage 1 and Stage 2, focusing on: <ol style="list-style-type: none"> i. models applied in stage allocation and transitions between stages; ii. assumptions used by the Management in the expected credit loss measurement models; iii. criteria used for determination of significant increase in credit risk; iv. assumptions applied to calculate probability of default; v. methods applied to calculate loss given default; vi. methods applied to incorporate forward-looking information; vii. mathematical accuracy of the minimal prescribed rate applied through independent recalculation; viii. re-performance calculation of expected credit losses on a selected sample. • Performing substantive tests over recognition and measurement of impairment allowance for expected credit losses on sample of individually assessed non-performing loans and receivables allocated to Stage 3, which included: <ol style="list-style-type: none"> i. assessment of borrower's financial position and performance following latest credit reports and available information; ii. critical assessment of judgements and assumptions applied in the calculation and measurement of expected future cash flows from operations taking into consideration borrower's financial status and performance; iii. reviewing and critically assessing estimated value of collateral and estimated realization period as well as associated legal agreements and supporting documentation to assess the legal right to and existence of collateral; iv. critical assessment of discount rates used in the estimation of the expected cash flows from operations and/or collateral; v. re-performing calculation of expected credit losses by challenging judgments and assumptions, based on our industry experience and professional skepticism, and comparing derived calculation with the one provided by the Management.
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INDEPENDENT AUDITOR'S REPORT (continued)

Report on the Audit of the Financial Statements (continued)

Key Audit Matters (continued)

Litigation provisions	How the matter was addressed in our audit
<p><i>For the accounting policies refer to Accounting estimates and judgements in applying accounting policies (Note 3). For the additional information regarding identified key audit matter, refer to Note 11 and 29 to the financial statements.</i></p>	
<p>Banks are often exposed to various litigations or court cases, results of which may have adverse effects on their financial performance.</p> <p>In order to adequately reflect potential adverse effects, the Bank assess the requirement for provisions in accordance with IAS 37: <i>Provisions, Contingent Liabilities and Contingent Assets (IAS 37)</i>.</p> <p>The provision is recognized if, and only if a present, legal or constructive, obligation exist as a result of past events, if it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and if a reliable estimate of the obligation is determined.</p> <p>Due to the complexity involved in these litigation matters, Management's judgment regarding recognition and measurement of provisions for these legal proceedings is inherently uncertain and might change over time when the outcomes of the legal cases are determined and concluded.</p> <p>Therefore, the judgement over the existence of present obligation, the probability of payment being required to settle the court cases' obligation and a reliable estimate of such amount requires Management to consider risks and uncertainties that inevitably surround legal proceedings in order to ensure appropriate recording and disclosures in the financial statements.</p> <p>Considering the recent legal developments in Croatia and specific rulings of Croatian Courts in 2019, provisions for litigations have been determined as other key audit matter in our audit of the financial statements for the year ended 31 December 2019.</p>	<p>In order to address the risks associated with provisions for court cases, identified as another key audit matter, we have designed audit procedures that allowed us to obtain sufficient appropriate audit evidence for our conclusion.</p> <p>Our audit procedures included, among others, the following:</p> <ul style="list-style-type: none"> • Discussion with the Management to obtain understanding on the assumptions considered when determining requirement for recognition and measurement of provisions for litigations; • Obtaining and reviewing opinions and representations of external legal advisors in order to assess as to whether they sufficiently support Management's judgement over the assumptions considered and the amounts of provision recognised; • Reconciling opinions and representations of external legal advisors on initiated legal cases to the accounting records; • Obtaining and reviewing the calculation of the provisions for litigations and assessing whether the assumptions underpinning the valuation of these provisions are based on appropriate and available information from external parties and the market, thus representing Management's best estimate of the provision amount; • Assessing the mathematical accuracy of the provision calculation by performing a recalculation of the expected provisions for court cases; • Evaluating the appropriateness of related disclosures in accordance with IAS 37.

INDEPENDENT AUDITOR'S REPORT (continued)

Report on the Audit of the Financial Statements (continued)

Other Information

Management is responsible for the other information. The other information comprises the information included in the Annual Report, but does not include the financial statements and our auditor's report.

Our opinion on the financial statements does not cover the other information.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. With respect to the Report of the Management Board on the Position of the Bank which is included in the Annual Report, we have also performed the procedures prescribed by the Accounting Act. These procedures include examination of whether the Management Board Report include required disclosures as set out in the Articles 21 of the Accounting Act.

Based on the procedures performed during our audit, to the extent we are able to assess it, we report that:

- 1) Information included in the other information is, in all material respects, consistent with the attached financial statements of the Bank.
- 2) Report of the Management Board on the Position of the Bank has been prepared, in all material respects, in accordance with the Articles 21 of the Accounting Act.

Based on the knowledge and understanding of the Bank and its environment, which we gained during our audit of the financial statements, we have not identified material misstatements in the other information.

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

Management is responsible for the preparation and fair presentation of the financial statements in accordance with statutory accounting requirements for Banks in Croatia 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.

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

Those charged with governance are responsible for overseeing the Bank's financial reporting process.

INDEPENDENT AUDITOR'S REPORT (continued)

Report on the Audit of the Financial Statements (continued)

Auditor's Responsibilities for the Audit of the Financial Statements

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

As part of an audit in accordance with ISAs, we exercise professional judgement and maintain professional skepticism throughout the audit. We also:

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

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

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

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

INDEPENDENT AUDITOR'S REPORT (continued)

Report on Other Legal and Regulatory Requirements

We were appointed as the statutory auditor of the Bank by the shareholders on General Shareholders' Meeting held on 27 March 2019 to perform audit of accompanying financial statements. Our total uninterrupted engagement has lasted 4 years and covers period 1 January 2016 to 31 December 2019.

We confirm that:

- our audit opinion on the accompanying financial statements is consistent with the additional report issued to the Audit Committee of the Bank on 20 March 2020 in accordance with the Article 11 of Regulation (EU) No. 537/2014 of the European Parliament and the Council;
- no prohibited unaudit services referred to in the Article 5(1) of Regulation (EU) No. 537/2014 of the European Parliament and the Council were provided.

There are no services, in addition to the statutory audit, which we provided to the Bank and its controlled undertakings, and which have not been disclosed in the Annual Report.

Pursuant to the Decision of the Croatian National Bank on the structure and Content of Annual Financial Statements of Banks (Official Gazette No. 42/18; hereinafter: "the Decision"), Management has prepared the Supplementary schedules for CNB, as presented in the Appendix to these financial statements, which comprise Bank statement of financial position as at 31 December 2019, Bank statement of profit or loss, Bank statement of other comprehensive income, statement of changes in Bank's equity and Bank statement of cash flow for the year then ended, as well as the reconciliation to the accompanying financial statements. These forms and the reconciliation to the accompanying financial statements are the responsibility of the Management and do not represent components of the accompanying financial statements prepared in accordance with statutory accounting requirements for banks in Croatia, but rather a requirement specified by the Decision. The financial information provided in those forms has been derived from the accompanying financial statements.

Marina Tonžetić

Director

Tihana Bažant

Certified auditor

For signatures, please refer to the original Croatian auditor's report, which prevails.

Deloitte d.o.o.

20 March 2020

Radnička cesta 80,

10 000 Zagreb,

Croatia

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

Unconsolidated statement of profit or loss

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

	Note	2019	2018
Interest income	5	1,265	646
Interest expense	5	<u>(73)</u>	<u>(48)</u>
Neto prihod od kamata		<u>1,192</u>	<u>598</u>
Fee and commission income	6	493	197
Fee and commission expense	6	<u>(115)</u>	<u>(58)</u>
Net fee and commission income		<u>378</u>	<u>139</u>
Net (losses)/gains from valuation of financial instruments at fair value through profit or loss	7a	(135)	49
Net gains on financial instruments at fair value through other comprehensive income	7b	-	2
Net gains from trading and converting monetary assets and liabilities	7c	160	30
Other operating income	8	<u>49</u>	<u>22</u>
Net trading and other income		<u>74</u>	<u>103</u>
Income before value adjustment and operating expenses		<u>1,644</u>	<u>840</u>
Other operating expenses	9	(635)	(348)
Personnel expenses	10	(416)	(232)
Net gains/(losses) from impairment and provision charges	11	<u>121</u>	<u>(46)</u>
Profit before tax		<u>714</u>	<u>214</u>
Income tax	12	<u>(135)</u>	<u>(48)</u>
Profit for the year		<u>579</u>	<u>166</u>
Earnings per share	13	29,01	8,33

The significant accounting policies and notes form an integral part of these unconsolidated financial statements.

Unconsolidated statement of other comprehensive income

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

	Note	2019	2018
Profit for the year		579	166
Other comprehensive income:			
Items not reclassified subsequently to profit or loss:			
Net fair value changes of FVTOCI equity instruments	31	34	5
Net fair value changes of FVTOCI equity instruments – effect of Splitska banka d.d. merger	31	-	9
Total		34	14
Items transferred or transferable subsequently to profit or loss:			
Net fair value changes of FVTOCI debt securities	31	97	(11)
Net fair value changes of FVTOCI debt securities – effect of Splitska banka d.d. merger	31	-	53
Transferred to profit for the year – debt securities	7	-	2
Net changes in allowance for expected credit losses of FVTOCI financial assets		(5)	-
Net changes in allowance for expected credit losses of FVTOCI financial assets - effect of Splitska banka d.d. merger		-	7
Total		92	51
Deferred tax	12	(24)	(10)
Total other comprehensive income		102	55
Total comprehensive income		681	221

The significant accounting policies and notes form an integral part of these unconsolidated financial statements.

Unconsolidated statement of financial position

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

	Note	31.12.2019	31.12.2018
ASSETS			
Cash and balances with Croatian National Bank	14	7,935	8,368
Loans and receivables from banks	15	851	1,026
Financial assets at fair value through profit or loss	16	420	316
Loans and receivables from customers	17	26,971	25,548
Equity instruments at fair value through other comprehensive income	18a	111	78
Debt securities at fair value through other comprehensive income	18b	6,094	5,265
Financial asset measured at amortised cost	19	237	287
Investments in subsidiaries	20	365	323
Property and equipment	21	394	399
Assets classified under IFRS 16	21a	175	-
Investment property	22	63	64
Intangible assets	23	182	232
Deferred tax assets	12	29	-
Other Assets	24	135	126
Non-current assets held for sale	25	1	-
TOTAL ASSETS		43,963	42,032

The significant accounting policies and notes form an integral part of these unconsolidated financial statements.

Unconsolidated statement of financial position (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

	Note	31.12.2019	31.12.2018
LIABILITIES			
Amounts due to other banks	26	1,809	653
Amounts due to customers	27	33,551	33,060
Other borrowed funds	28	1,112	1,328
Financial liabilities at fair value through profit or loss	16	31	13
Provisions for liabilities and charges	29	484	539
Deferred tax liabilities	12	-	34
Income tax payable	12	145	36
Lease liabilities classified under IFRS 16	21a	179	-
Other liabilities	30	455	434
Total liabilities		37,766	36,097
SHAREHOLDERS' EQUITY AND RESERVES			
Share capital		3,994	3,994
Share premium		171	171
Statutory and legal reserves		399	87
Fair Value Reserves		210	108
Other reserves		109	109
Retained earnings		1,314	1,466
Total shareholders' equity and reserves	31	6,197	5,935
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY AND RESERVES		43,963	42,032

The significant accounting policies and notes form an integral part of these unconsolidated financial statements.

Unconsolidated statement of changes in shareholders' equity

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

	Share capital	Share premium	Legal and statutory reserves	Fair value reserves	Other reserves	Retained earnings	Total
Balance at 1 January 2018	3,994	171	82	53	109	574	4,983
Changes in equity in 2018							
Effect of Splitska banka d.d. merger	-	-	-	-	-	803	803
Tax effect of Splitska banka d.d. merger	-	-	-	-	-	(72)	(72)
Other comprehensive income – debt securities	-	-	-	(8)	-	-	(8)
Other comprehensive income – equity instruments	-	-	-	4	-	-	4
Other comprehensive income from merger of Splitska banka d.d.:							
- Debt securities (Note 31)	-	-	-	44	-	-	44
- Equity instruments (Note 31)	-	-	-	8	-	-	8
- Expected credit losses of FVTOCI financial assets (Notes 18 and 31)	-	-	-	7	-	-	7
Profit for the year	-	-	-	-	-	166	166
Total comprehensive income	-	-	-	55	-	166	221
Transfer of profit to reserves	-	-	5	-	-	(5)	-
Balance at 31 December 2018	3,994	171	87	108	109	1,466	5,935
Balance at 1 January 2019	3,994	171	87	108	109	1,466	5,935
Changes in equity in 2019							
Other comprehensive income	-	-	-	-	-	-	-
- Debt securities (Note 31)	-	-	-	79	-	-	79
- Equity instruments (Note 31)	-	-	-	28	-	-	28
- Expected credit losses of FVTOCI financial assets (Notes 18 and 31)	-	-	-	(5)	-	-	(5)
Profit for the year	-	-	-	-	-	579	579
Total comprehensive income	-	-	-	102	-	579	681
Transfer of profit to reserves	-	-	312	-	-	(312)	-
Dividends	-	-	-	-	-	(491)	(491)
Reversal of tax effect of Splitska banka merger (Note 12c)	-	-	-	-	-	72	72
Balance at 31 December 2019	3,994	171	399	210	109	1,314	6,197

The significant accounting policies and notes form an integral part of these unconsolidated financial statements.

Unconsolidated statement of cash flows

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

	Note	2019	2018
CASH FLOWS FROM OPERATING ACTIVITIES			
Profit before tax		714	214
Adjustments to reconcile profit before taxes to net cash from operating activities			
Impairment losses	11	(168)	28
Net gains on financial assets measured at fair value through profit or loss	7a	183	3
Impairment of investments in subsidiaries	9	8	-
Provisions for legal actions and off-balance sheet items	11	47	18
Other provisions	10	4	(5)
Depreciation and amortisation	9	171	49
Losses/(gains) on disposal and write-off of property and equipment	8	21	6
Interest income	5,7,8	(1,277)	(652)
Interest expense	5,7	78	48
Goodwill write off		-	43
Revenue from cancellation of accrued expenses	8	(18)	-
Other non-cash items, other income and expenses	8,9	7	-
Exchange rate differences		20	36
Operating income before changes in operating assets and liabilities		(210)	(212)
<i>(Increase)/decrease in operating assets:</i>			
Obligatory reserves with the CNB		(5)	(40)
Loans and receivables from banks		-	(17)
Loans and receivables from customers		(1,479)	(375)
Other assets		(38)	(28)
<i>Increase/(decrease) in operating liabilities:</i>			
Amounts due to other banks		1,156	465
Amounts due to customers		378	1,074
Other liabilities		40	94
Payments from provisions for liabilities and charges		(106)	(5)
Net cash flow from operating activities before interest and income taxes paid		(264)	956
Income taxes paid		(40)	(37)
Interest received		1,290	678
Interest paid		(102)	(67)
Net cash from operating activities		884	1,530
CASH FLOWS FROM INVESTING ACTIVITIES			
Financial assets and liabilities at fair value through profit or loss		38	(134)
Securities at fair value through other comprehensive income		(711)	172
Purchases of tangible and intangible assets		(101)	(88)
Proceeds from sale of repossessed real estate		4	-
Increase of investments in related parties		(51)	-
Decrease of investments at amortised cost		16	2
Net cash from investing activities		(805)	(48)

Unconsolidated statement of cash flows (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

	Note	2019	2018
CASH FLOWS FROM FINANCING ACTIVITIES			
Lease payments (IFRS 16)		(31)	-
Decrease of other borrowed funds		(221)	(330)
Dividends paid		(491)	-
Net cash from financing activities		(743)	(330)
Net (decrease) / increase in cash and cash equivalents		(664)	1,152
Cash and cash equivalents at the beginning of the year		6,896	2,359
The impact of changes in exchange rates on cash and cash equivalents		49	(33)
Cash and cash equivalents acquired with merger of Splitska banka d.d.		-	3,418
Cash and cash equivalents at the end of the year	33	6,281	6,896

The significant accounting policies and notes form an integral part of these unconsolidated financial statements.

Notes to the financial statements

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

1. GENERAL INFORMATION

The registered seat of the Bank is in Split, Domovinskog rata 61. The Bank is incorporated in the Republic of Croatia as a joint stock company and provides retail and corporate banking services. The Bank is registered at the Commercial Court in Split, with the registered share capital in the amount of HRK 3,993,754,800 as of 31 December 2019 (31 December 2018: HRK 3,993,754,800).

OTP banka d.d. (the Bank) is an authorized commercial bank operating in the Republic of Croatia and is the parent company of the OTP banka Group (the Group) in the Republic of Croatia.

The Bank provides a full range of banking services.

OTP banka Group is a group that provides a wide range of financial services that include insurance, leasing, fund management and other services, the most important of which are real estate management services.

The Bank's main areas of operation are as follows:

1. Acceptance of all types of deposits
2. Approval of loans and loans
3. Repurchase of receivables
4. Financial lease
5. Issuing guarantees
6. Trading for own account or client's account
7. Payment services
8. Services related to lending activities
9. Issuing and managing other payment instruments
10. Rental of safes
11. Mediation on the money market
12. Issue of electronic money
13. Conducting business related to the sale of insurance policies
14. Consulting legal entities on the structure of capital, business strategy, and provision of services related to business combinations and acquisition of shares and business interests
15. Investment related services and activities
16. Investment consulting
17. Services connected with realization of the offer or sale of financial instruments.

Governance and Management

Shareholders' Assembly

Viktor Siništaj, President

Supervisory Board as of 31 December 2019:

Antal László Pongracz	President from 31 March 2017
Anna Mitkova Florova	Vice president until 5 February 2019
Péter Csányi	Vice president from 5 February 2019
	Member from 30 May 2018 until 5 February 2019
Branko Mikša	Member from 31 March 2017 until 5 September 2019
Zlatko Mateša	Member from 15 October 2019
Zsolt Barna	Member from 5 February 2019 until 31 December 2019
László Kecskés	Member from 31 March 2017
Balázs Létay	Member from 25 January 2017 until 1 April 2019

Notes to the financial statements

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

1. GENERAL INFORMATION (CONTINUED)

Management Board as of 31 December 2019:

Balazs Pal Bekeffy	President from 25 September 2017
Slaven Celić	Member from 1 December 2018
Zvonimir Akrap	Member from 1 December 2018
Nikola Mikša	Member from 5 September 2019
Bruno Biuk	Member from 1 December 2018
Nera Šunjić	Member from 1 December 2018 until 1 June 2019
Zorislav Vidović	Member from 16 December 2017 until 4 September 2019
Helena Banjad	Member until 11 September 2018
Ivan Šimićević	Procurator from 1 June 2019

Audit Committee as of 31 December 2019:

Péter Csányi	President from 30 May 2018
László Kecskés	Member from 31 March 2017
Zlatko Mateša	Member from 1 December 2018
Branko Mikša	Member from 31 March 2017 until 5 September 2019

Ownership structure

The ownership structure and shareholders of the Bank are specified below:

	31 December 2019		31 December 2018	
	Share capital	Ownership interest in %	Share capital	Ownership interest in %
OTP bank Nyrt Hungary	3,994	100.00	3,994	100.00
Total	3,994	100.00	3,994	100.00

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

1. GENERAL INFORMATION (CONTINUED)

SUBSIDIARIES

Investments in subsidiaries are presented in Note 20

31.12.2019	Headquarter	Percentage of ownership	Industry	Investment (acquisition cost after impairment)
OTP Nekretnine d.o.o.	Zagreb	100%	Organization of project implementation for buildings	260
OTP Invest d.o.o.	Zagreb	74.33%	Fund management activities	1
Aventin d.o.o. in liquidation	Zadar	100%	Renting and operating of own or leased real estate (leasing)	-
OTP Savjetovanje d.o.o.	Zagreb	100%	Business and management consultancy	2
OTP Osiguranje d.d.	Zagreb	100%	Life insurance	54
OTP Leasing d.d.	Zagreb	60%	Finance and operating lease	48
Total subsidiaries:				365

Cresco d.o.o. (Real estate business) is 100% owned by OTP Nekretnine d.o.o.

SB Leasing d.o.o. in liquidation (Finance and operating leasing business) is 100% owned by OTP Leasing d.d.

On 28 September 2018, the Bank signed a contract for the sale of a 50% share in OTP Leasing d.d. with Mercantil Bank Zrt. from Budapest for the price of HRK 47 million. On 1 April 2019, the Bank became the majority shareholder of OTP Leasing d.d. with a share of 60%.

The Management Board of the Bank d.d. issued a decision on 5 November 2019 to merge SB Zgrada d.o.o. with OTP Nekretnine d.o.o. The Commercial Court in Zagreb has adopted a decision on the merger of SB Zgrada d.o.o. with OTP Nekretnine and this merger was registered in the Court Register on 23 December 2019. The merger was carried out as a restructuring within the Group in the Republic of Croatia at book value.

The Management Board of the Bank d.d. issued a decision on 3 September 2019 to initiate the liquidation of the company OTP Aventin d.o.o. The Commercial Court in Zadar adopted a decision on the liquidation and a decision on the name change to Aventin d.o.o. in liquidation on 25 October 2019.

In February 2019, the Bank conducted the capital increase of OTP Savjetovanje d.o.o. in the amount of HRK 3 million. The plan is to merge OTP Savjetovanje d.o.o. to OTP Invest d.o.o. at the beginning of 2020.

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

1. GENERAL INFORMATION (CONTINUED)

SUBSIDIARIES (CONTINUED)

31.12.2018	Headquarter	Percentage of ownership	Industry	Investment (acquisition cost after impairment)
OTP Nekretnine d.o.o.	Zagreb	100%	Organization of project implementation for buildings	52
OTP Invest d.o.o.	Zagreb	74.33%	Fund management activities	8
OTP Aventin d.o.o.	Zadar	100%	Renting and operating of own or leased real estate (leasing)	-
OTP Savjetovanje d.o.o.	Zagreb	100%	Business and management consultancy	1
SB Zgrada d.o.o.	Split	100%	Real estate business	208
OTP Osiguranje d.d.	Zagreb	100%	Life insurance	54
Total subsidiaries:				323

Cresco d.o.o. (Real estate business) is 100% owned by OTP Nekretnine d.o.o.

In 2018, SB Nekretnine changed its name to OTP Savjetovanje d.o.o. and at the same time it changed its headquarters and business in accordance with the decision of the Bank's Management Board on the restructuring of the existing company into an advisory services company, and taking into account that SB Nekretnine business was taken over by an equivalent company within the OTP Group, OTP Nekretnine d.o.o. Using the existing registered entity SB Nekretnine d.o.o., name changes were made to OTP Savjetovanje d.o.o., as well as the changes to the headquarters, business and bodies of the Company.

The business transaction of the merger of Splitska banka was initiated on 1 December 2018. The Bank changed the status of the merger of Splitska banka by entering it into the court register of the Commercial Court in Split, by which action the status change became final.

All relevant disclosures regarding the acquisition of Splitska banka have been published in the Annual Financial Statements for the year ended 31 December 2018 together with the report of the independent auditor.

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

2. ACCOUNTING POLICIES

The principal accounting policies applied in the preparation of these financial statements are summarised below.

2.1 Statement of compliance

Separate financial statements are prepared in accordance with the legal accounting requirements for banks in Croatia.

These separate financial statements represent the annual financial statements of the Bank, the parent company of OTP banka d.d. group (the "Group") consisting of the Bank and its subsidiaries (Note 20). The consolidated financial statements, which include the Bank and its subsidiaries (Note 20), will be prepared in accordance with the statutory accounting requirements of banks in the Republic of Croatia and have not been published yet. Note 1 *General information*, this Note and Note 2.20 *Investments in subsidiaries* describe how the consolidated financial statements will be disclosed within the statutory deadline, and accounting policies for recognition and measurement and other disclosures in respect of unconsolidated subsidiaries.

The banking operations in Croatia are subject to the Credit Institutions Act (OG 159/13, 19/15 102/15 and 15/18) pursuant to which the Bank's financial reporting is regulated by the Croatian National Bank ("the CNB") which is the central banking system oversight institution in Croatia. These financial statements have been prepared in accordance with the above-mentioned banking regulations.

The accounting regulations of the CNB rely on International Financial Reporting Standards (IFRS) adopted by the European Union (EU). Key differences between the accounting regulations of the CNB and the recognition and measurement requirements under International Financial Reporting Standards (IFRS) are as follows:

- Since 1 January 2018 (introduction of IFRS 9) by the Decision on Classification of Exposure to Risk Groups and the Method of Determining Credit Losses (OG 114/17), the Croatian National Bank prescribed that the total impairment at exposures classified in Stage 1 and Stage 2 cannot be less than 0.8% of the gross carrying amount of these exposures. For the purpose of calculating impairment, the Bank uses an internal model in accordance with IFRS 9 using PD (probability of default status), LGD (loss due to default) and EAD (risk exposure), and after applying the internal model, it adjusts the total amount of provisions for exposures classified in Stage 1 and Stage 2 to a minimum of 0.8%. Balance of impairment for exposures classified in Stage 1 and Stage 2 (presented in notes 17, 18, 19, 24 i 32) on 31 December 2019 amounted to HRK 379 million (2018: HRK 365 million), of which HRK 106 million refers to the additional amount of harmonization between the internal model and the legally the prescribed minimum amount of 0.8% (in 2018: HRK 27 million).
- Determining of impairment losses by discounting the expected cash flows at the original effective interest rate of the impaired assets - unlike IFRSs, national regulations require that such discounting be recognized as reversal of impairment losses rather than as interest income.
- CNB prescribes minimum levels of impairment losses for certain exposures for which impairment has been determined, which may be different from the impairment losses calculated in accordance with IFRSs.
- Provisions for passive litigations - Pursuant to the Decision on the obligation to make provisions for legal proceedings against a credit institution, the Bank is required to provide funds for legal cases for which there is no risk of loss or estimated cash outflows is less than 10% of the total amount if the total amount of the litigation exceeds 0.1% of the credit institution's assets according to the audited financial statements for the previous year. The provision is made in the amount of estimated cash outflows, and at least in the amount of 1% of the total amount of the litigation, while according to IFRS in such a situation the provisions need not be recognized

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

2. ACCOUNTING POLICIES (CONTINUED)

2.2 Basis of preparation

The financial statements are prepared on the amortised or historical cost basis, except for financial instruments which are carried at fair value. Historical cost is generally based on the fair value of the consideration given in exchange for assets.

In preparing the financial statements management makes judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, the disclosure of commitments and contingencies at the reporting date, as well as the amounts of income and expenses 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 the information available as of the date of preparation of the financial statements, the results of which form the basis for making the judgments about the carrying amounts of assets and liabilities that are not readily apparent from other sources. Actual results may differ from those estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period or in the period of revision and future periods if the revision affects both the current and future periods. Judgments made by management in the application of appropriate standards that have a significant effect on the financial statements and estimates with a significant risk of material adjustment in the next year are described in Note 3.

The accounting policies outlined below, including changes resulting from the entry into force of new standards and amendments to the existing and interpretations that came into force (and adopted by the European Union), were applied to the periods in which they were in force.

2.2.1 Effective standards, amendments to the existing standards and implementations – adopted in 2019

The Bank has adopted the following new standards and amendments to existing standards and new interpretations published by the International Accounting Standards Board (“IASB”) and adopted in the European Union and which have become effective for annual periods beginning on or after 1 January 2019.

The adoption of new standards (other than IFRS 16), amendments to existing standards and interpretations of standards are not material to the Bank’s operations and have no material impact on the financial statements.

- **IFRS 16: Leases** - the standard is effective for annual periods beginning on or after 1 January 2019 and has been adopted in the European Union in October 2017. IFRS 16 establishes the principles for the recognition, measurement, presentation and disclosure of leases, for both contractual parties, for the user (“lessee”) and for the service provider (“lessor”). Until 31.12.2018 the Bank was applying IAS 17 a from 01.01.2019 applies IFRS 16. The effects of the transition from IAS 17 to IFRS 16 are presented in Note 4.
- **Amendments to IFRS 9 “Financial Instruments”** - Prepayments with negative compensation, adopted in the European Union on 22 March 2018 (effective for annual periods beginning on or after January 1, 2019),
- **Amendments to IAS 19 “Employee Benefits“** - Amendments, restriction of entitlements, or payments from benefits plans, adopted in the European Union on 13 March 2019 (effective for annual periods beginning on or after 1 January 2019),
- **Amendments to IAS 28 “Investments in Associates and Joint Ventures”** - Long-term investments in Associates and Joint Ventures, adopted in the European Union on 8 February 2019 (effective for annual periods beginning on or after 1 January 2019),

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

2. ACCOUNTING POLICIES (CONTINUED)

2.2.1 Effective standards, amendments to the existing standards and implementations – adopted in 2019 (continued)

- **Amendments to various standards resulting from the "IFRS 2015 to 2017 revisions"**, arising from the IFRS annual improvement project (IFRS 3, IFRS 11, IAS 12 and IAS 23), primarily to eliminate inconsistencies and clarify text, adopted in the European Union on 14 March 2019 (effective for annual periods beginning on or after 1 January 2019),
- **IFRIC 23 "Uncertainty over Income Tax Treatment"** - Adopted in the European Union on 23 October 2018 (effective for annual periods beginning on or after 1 January 2019).

2.2.2 Standards, amendments to existing standards and interpretations issued but not yet effective

The standards, amendments to existing standards and interpretations that have been published by IASB and adopted by the European Union, but are not yet effective until the date of the financial statements are set out below. Where applicable, the Bank intends to adopt these standards at the time of entry into force. The Bank does not expect that the adoption of standards or interpretations will affect the financial statements or the result of the Bank.

- **Amendments to IAS 1 "Presentation of Financial Statements" and IAS 8 "Accounting Policies, Changes in Accounting Estimates of Errors"** - definition of significance (effective for annual periods beginning on or after 1 January 2020),
- **Amendments to the Conceptual Framework guidance in IFRSs** (effective for annual periods beginning on or after January 1, 2020),
- **Amendments to IFRS 9 "Financial Instruments", IAS 39 "Financial Instruments: Recognition and Measurement" and IFRS 7 "Financial Instruments: Disclosure"** - Reform of reference interest rates, adopted in the European Union on 15 November 2020 (effective for annual periods beginning on or after 1 January 2020).

IBOR transition

Comprehensive benchmark reform is underway following concerns raised in recent years about the integrity and reliability of major benchmarks for the financial market. In this regard, on 15 January 2020, the European Commission approved amendments to the Reform of Interest Rates IFRS 9, IAS 39 and IFRS 7 ("Amendments") for use in the European Union. The amendment addresses the potential source of uncertainty about the effects of interbank rate reform (IBOR) on existing hedge accounting relationships that are affected by the IBOR reform, clarifying that the reform does not require termination of hedge accounting of this kind.

The effective date of the beginning of the change is the year period beginning on 1 January 2020 or later.

The amendments to the standards have no effect on the financial statements, since the Bank only had active fair value hedge accounting contracts related to EURIBOR at the end of 2019.

In addition, the Bank did not have significant amounts of financial instruments contracted at interest rates other than EURIBOR risk-free interest rate.

In order to closely monitor developments related to IBOR and properly manage transitional impacts, the Bank continuously monitors the market, attends European working groups, industry working groups (eg the International Swaps and Derivatives Association - ISDA) and participates in relevant public consultations.

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

2. ACCOUNTING POLICIES (CONTINUED)

2.2.3 Standards, amendments to existing standards and interpretations issued but not yet adopted in the European Union

IFRSs currently adopted in the European Union are not significantly different from those adopted by the International Accounting Standards Board (IASB), except for the following standards and amendments to existing standards, the adoption of which has not yet been decided by the European Union (the effective dates set out below apply to IFRSs issued by IASB):

- **IFRS 14 “Regulatory Deferral Accounts”** (effective for annual periods beginning on or after 1 January 2016) - the European Commission has decided to postpone the process of transposing this transitional standard until its final version is published,
- **IFRS 17 “Insurance Contracts”** (effective for annual periods beginning on or after 1 January 2021),
- **Amendments to IFRS 3 “Business Combinations”** - Definition of Business (effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 January 2020 and on the acquisition of assets that occur on or after the start of that period),
- **Amendments to IFRS 10 “Consolidated Financial Statements” and IAS 28 “Investments in Associates and Joint Ventures”** - “Sale or deposit of assets between an investor and his associate or joint venture” and further amendments (the original date of entry into the force was postponed until the completion of the research project on the application of the equity method),

The Bank expects that the adoption of these new standards and amendments to existing standards will not result in significant changes in the financial statements of the Company in the period of initial application of the standards.

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

2. ACCOUNTING POLICIES (CONTINUED)

2.3 Functional and presentation currency

Items included in the financial statements are presented in the currency of the primary economic environment in which the Bank operates (its functional currency). The financial statements are presented in the Croatian kuna, which is both the functional and reporting currency of the Bank. The amounts are rounded to the nearest thousand (unless otherwise stated).

The principal exchange rates set by the Croatian National Bank and used in the conversion of the Bank's monetary assets and liabilities at the date of the statement of financial position were as follows:

31 December 2019	1 EUR = 7.442580 kn	1 CHF = 6.838721 kn	1 USD = 6.649911 kn
31 December 2018	1 EUR = 7.417575 kn	1 CHF = 6.588129 kn	1 USD = 6.469192 kn

2.4 Foreign currency translation

Transactions in foreign currencies are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the retranslation of monetary assets and liabilities denominated in foreign currencies at the year-end rates are recognised in profit and loss.

Foreign currency denominated non-monetary assets and items that are measured in terms of historical cost are translated at the exchange rates in effect on the transaction dates and are not retranslated at the reporting date. Changes in fair value of debt securities denominated in a foreign currency, which are, in line with IFRS 9, measured at fair value through other comprehensive income are recognised through other comprehensive income. Foreign exchange differences and expected credit losses for these securities are recognised through profit or loss. Changes in fair value and foreign exchange differences of equity securities denominated in a foreign currency are recognised through other comprehensive income – option of fair value through other comprehensive income. The Bank has a portion of assets and liabilities originally denominated in Croatian kunas, which are linked to a foreign currency with a one-way currency clause.

The clause provides the Bank the option to remeasure relevant assets by the higher of the foreign exchange rate valid as of the date of maturity and foreign exchange rate valid as of the date of origination of the financial instrument. In case of a liability linked to this clause, the counterparty has this option. Due to the specifics of the market in the Republic of Croatia the fair value of this option cannot be calculated, as forward rates for the Croatian kuna for periods over 6 months are not available. The Bank therefore estimates the values its assets and liabilities governed by such clauses at the higher of the middle spot rate of the Croatian National Bank valid at the reporting date and the contractually agreed foreign exchange rate for the option (valid at the date of the contract).

2.5 Leases

IFRS 16: Leases - The standard is effective for annual periods beginning on 1 January 2019. IFRS 16 establishes the principles for the recognition, measurement, presentation and disclosure of leases, for both parties, for the user ("lessee") and for the service provider ("lessor").

It replaces the current IAS 17 standard - Leases, interpretation 4 of the International Financial Reporting Interpretations Committee - Determining whether an Arrangement contains a Lease, interpretation 15 of the Standard Interpretations Committee - Operating leases – Incentives, and interpretation 27 of the Standard Interpretations Committee – Evaluating the Substance of Transactions Involving the Legal Form of a Lease.

The purpose of the new standard is to ease the comparability of the financial statements, presenting both financial and operating leases in the statement of financial position, and providing corresponding information to the users of the financial statements about the risks associated with the agreements. The new standard discontinues the differentiation between operating and finance leases in the lessee's books, and requires to recognise a right-of-use asset and lease liability regarding all of the lessee's lease agreements.

Pursuant to IFRS 16, an agreement is a lease or contains a lease if it transfers the rights to control the use of an identified asset for a given period in exchange for compensation.

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

2. ACCOUNTING POLICIES (CONTINUED)

2.5 Leases (continued)

The essential element differentiating the definition of a lease from IAS 17 and from IFRS 16 is the requirement to have control over the used, specific asset, indicated directly or indirectly in the agreement.

Expenses related to the use of lease assets, the majority of which were previously recognised in external services costs, will be currently classified as depreciation/amortisation and interest costs. Usufruct rights are depreciated using a straight line method, while lease liabilities are settled using an effective discount rate.

In the cash flow statement cash flows from the principal of the lease liability are classified as cash flows from financing activities, while lease payments for short-term leases, lease payments for leases of low-value assets and variable lease payments not included in the measurement of the lease liability are classified as cash-flows from operating activities. The interest payments regarding the lease liability are classified according to the IFRS 16.

The lessee applies IAS 36 – Impairment of Assets standard to determine whether the right-to-use asset is impaired, and to recognise impairment, if it is necessary.

For the lessors the recognition and measurement requirements of IFRS 16 are similar, as they were stated in IAS 17. The leases shall be classified as finance and operating leases according to IFRS 16 as well. Compared to IAS 17, IFRS 16 requires the lessors to disclose more information about than earlier, however the main characteristics of the accounting treatment is unchanged.

a) Recognition of a lease liability

Following the adoption of IFRS 16, the Bank recognizes lease liabilities that relate to leases previously classified as 'operating leases' in accordance with IAS 17 Leases. These liabilities are measured at the present value of the lease payments receivable as of the date of commencement of the application of IFRS 16. Lease payments are discounted at the interest rate rate implicit in the lease or, if that rate can not be readily determined, the incremental borrowing rate. At the date of initial recognition, lease payments included in the measurement of the lease liability include the following types of payments for the right to use the underlying asset for the life of the lease:

- fixed lease payments less all lease incentives,
- variable lease payments which are dependent on market indices,
- amounts expected to be payable by the lessee under residual value guarantees,
- the exercise price of the purchase option, if it is reasonably certain that the option will be exercised, and
- payment of contractual penalties for terminating the lease, if the lease period reflects that the lessee used the option of terminating the lease.

b) Recognition of right-to-use assets

Right-to-use assets are initially measured at cost.

The cost of a right-of-use asset comprises:

- the initial estimate of lease liabilities (excluding VAT),
- all lease payments paid at the commencement date or earlier, less any lease incentives receivable,
- initial costs directly incurred by the lessee as a result of entering into a lease agreement,
- estimates of costs which are to be incurred by the lessee as a result of an obligation to disassemble and remove an underlying asset or to carry out renovation/restoration.

The Bank uses expedients related to short-term leases (less than 12 months) as well as in the case of leases where the related assets are of low value (less than USD 5,000 converted to the functional currency at the middle exchange rate on the contract date), for which contracts no financial liabilities nor the right-of-use assets will be recognized. These types of payments will be recognized as expenses using the linear method over the life of the lease. The impact of the transition to IFRS 16 is presented in note 4.

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

2. ACCOUNTING POLICIES (CONTINUED)

2.6 Interest income and expense

Interest income is accrued on a time basis, by reference to the principal outstanding and at the effective interest rate applicable, which is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset to that asset's net carrying amount.

Interest income includes coupons earned on fixed income investments and securities as well as accrued discount and premium on treasury bills and other discounted instruments.

One-off loan origination fees for loans which are probable of being drawn down, are deferred (together with related direct costs) and recognized as an adjustment to the effective yield of the loan and as such adjust the interest income.

Interest income on financial assets classified as Stage 3 financial asset is recognized in the statement of profit or loss when collected.

Penalty interests for financial assets and financial liabilities are recognised in other operating income or other operating costs.

2.7 Fee and commission income and expense

The fees and commissions calculated and charged to clients by the Bank for the provision of financial services consist mainly of fees for domestic and foreign payment services and credit guarantee services, account management services, card services, asset management services and other similar financial services provided by the Bank in accordance with the registration. Fees included in the calculation of the effective interest rate are recognized as interest income and expense. Fee and commission income and expense are recognized in the profit and loss account under the service contract in question at the time the particular service is provided. Fees and commissions that are paid and charged in advance are deferred over the period of providing the service for services provided continuously over a longer period of time.

2.8 Employee benefits

Short-term benefits

Obligations for contributions to defined contribution pension plans and other short-term benefits are recognised as an expense in the statement of comprehensive income for the period in which they are incurred.

Bonus obligations/liabilities

A liability is recognised for the amount expected to be paid under short-term cash bonus plans if the Bank has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee and the obligation can be estimated reliably.

Retirement benefits

The Bank awards one-time compensation to employees whose retirement is legally required. The amount of the liability is estimated annually by an independent qualified assessor. Actuarial gains and losses arising from changes in actuarial assumptions are debited or credited to equity in other comprehensive income in the period in which they arise. Past service cost is recognized in the profit and loss account. The amount of the liability is shown in the Provisions for liabilities and charges.

Jubilee awards

The Bank awards jubilee awards to employees. The amount of the liability is estimated annually by an independent qualified assessor. The amount of the liability is recognized in the profit and loss account. The liability is shown in the Provisions for liabilities and charges.

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

2. ACCOUNTING POLICIES (CONTINUED)

2.9 Taxation

Income tax expense is based on taxable income for the year and represents the sum of the tax currently payable and deferred tax.

Current tax

The tax currently payable is based on taxable profit for the year. Taxable profit differs from the profit reported in the statement of comprehensive income because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Bank's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the end of the reporting period.

Deferred tax

Deferred tax is recognised on temporary differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit. Deferred tax liabilities are generally recognised for all taxable temporary differences, and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. Deferred tax assets and liabilities are not recognised if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

Deferred tax liabilities are recognised for all taxable temporary differences associated with investments in subsidiaries and associates, and interests in joint ventures, except where the Bank is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future. Deferred tax assets arising from deductible temporary differences associated with such investments and interests are only recognised to the extent that it is probable that there will be sufficient taxable profits that will allow the utilisation of the benefits arising from the temporary differences and the temporary differences are expected to reverse in the foreseeable future.

The carrying amount of deferred tax assets is reviewed at the end of each reporting period and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or a part of the tax assets to be recovered.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the period in which the liability is settled or the asset realised, based on tax rates and tax laws that have been enacted or substantively enacted by the end of the reporting period. The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from the manner in which the Bank expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when they relate to income taxes levied by the same taxation authority and the Bank intends to settle its current tax assets and liabilities on a net basis.

Current and deferred tax for the period

Current and deferred taxes are recognised as an expense or income in profit or loss, except when they relate to items presented directly in equity, in which case the tax is also recognised in equity, or where they arise from the initial accounting for a business combination, in which case the tax effect is taken into account in accounting for the business combination.

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

2. ACCOUNTING POLICIES (CONTINUED)

2.10 Cash and cash equivalents

For the purpose of reporting cash flows, cash and cash equivalents comprise cash, balances with the Croatian National Bank (CNB), accounts with other banks and term deposits with other banks with contractual maturities of up to three months.

Cash and cash equivalents exclude the obligatory reserves with the CNB, as these funds are not available for the Bank's day-to-day operations.

2.11 Financial instruments

Classification

The Bank applies IFRS 9 and, depending on business model for management of financial assets and contractual cash flow characteristics, classifies financial assets into following measurement categories: financial assets at amortised cost; financial assets at fair value through other comprehensive income (FVTOCI); financial assets designated at fair value through other comprehensive income (FVTOCI option); financial assets at fair value through profit or loss (FVTPL).

Financial assets at amortised cost

Financial asset is measured at amortised cost if both of following conditions are met:

- (a) the financial asset is held within a business model whose objective is to hold financial assets in order to collect contractual cash flows and
- (b) the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

Financial assets at fair value through other comprehensive income

Financial asset is measured at fair value through other comprehensive income if both of following conditions are met:

- (a) the financial asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets and
- (b) the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

Financial assets designated at fair value through other comprehensive income (option)

For investments in equity instruments that are not held for trading, the Bank may make an irrevocable election to present in other comprehensive income subsequent changes in the fair value.

If Bank chooses this option (fair value measurement), it is valid until maturity date of instrument.

Gain/loss on disposal of equity instruments designated at fair value through other comprehensive income is never recycled to profit and loss account; unrealised gains/losses are recognized within other comprehensive income. Only dividends are recognized within profit and loss account.

Financial assets at fair value through profit or loss

Financial asset is measured at fair value through profit or loss, if not classified held to collect or held to collect and sell, unless irrevocable choice has been elected and in cases of SPPI test fail.

Derivatives, units in investment funds and securities held for trading are an examples of instruments that shall be classified in this category since payments do not represent solely payments of principal and interest on unpaid principal.

The Bank reclassifies debt instruments when and only when business model for managing financial assets is changed.

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

2. ACCOUNTING POLICIES (CONTINUED)

2.11 Financial instruments (continued)

Classification (continued)

Business model assessment

Business model is based on activities conducted by the Bank to achieve objectives in accordance with Bank's strategy and how Bank manages its' financial assets with aim of generating profits.

Types of business models considering cash flow generation are described in following paragraphs:

- Business model held to collect

Objective of this model is to hold assets in order to collect contractual cash flows. Sale is not integral part of this business model within assets are measured at amortised cost, but sales could be consistent with this business model provided: a) sale is frequent, but insignificant (not more than 5% assets within homogeneous group occurred in observed period), b) sale is infrequent, but significant, c) sale is close to maturity or d) sale due to increase in credit risk (e.g. interest rate increase, sale of NPL portfolio). Sale in stress liquidity situations could also be classified within this model.

During 2019, the Bank sold only NPL portfolio.

- Business model held to collect and sell

Objective is achieved by collecting contractual cash flows and by sale of financial assets. It is not required to observe frequency, value and reason of sale, but typically this business model involves greater frequency and value of sales.

- Other models (other strategies)

Objective is to achieve short term profit on disposal of financial assets and this business model includes assets held for trading. All other business models are allocated in measurement category fair value through profit or loss.

Business model is determined by Bank's key management personnel. Key management personnel includes Bank's Management Board. Every Management Board member has an authority to determine business model for financial assets portfolio within his competence.

SPPI test (Solely Payment of Principal and Interest)

SPPI test is conducted to assess contractual cash flow characteristics of particular financial instruments, i.e. to assess if contractual cash flows represent solely payments of principal and interest on unpaid principal in accordance with basic lending arrangement (without specific modifications related to prepayment fee, index linked payments, mismatch between interest rate and reference interest rate etc.).

For the purpose of this test, principal is defined as fair value of financial assets at initial recognition. Interest consists of consideration for the time value of money, for the credit risk associated with the principal amount outstanding during a particular period of time and for other basic lending risks and costs, as well as a profit margin.

In cases where the SPPI test indicates the existence of modification of the time value of money, an additional assessment is conducted to determine whether the modification is significant (the benchmark test). Benchmark test is conducted by comparing undiscounted contractual cash flows and undiscounted cash flows that would arise if the time value of money element was not modified (reference or benchmark cash flows).

Relevant comparable benchmark instrument is instrument with identical contractual terms and the identical credit risk, either existing or hypothetical instrument (it is not required for instrument to exist on the market).

If based on conducted assessments, result is significant difference between contractual cash flows and reference/benchmark cash flows, financial asset fails SPPI test and shall be allocated to measurement category fair value through profit or loss.

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

2. ACCOUNTING POLICIES (CONTINUED)

2.11 Financial instruments (continued)

SPPI test (Solely Payment of Principal and Interest) (continued)

OTP Bank Nyrta has defined an SPPI test (questionnaire) that is conducted at the level of a product portfolio with the same or similar characteristics, the so-called homogeneous product groups. In specific cases of financing that cannot be attributed to a specific homogeneous product group, the SPPI test is conducted on an individual basis. This test was applied at the initial application of IFRS 9 (transition from IAS 39 to IFRS 9).

Below are listed the basic homogeneous groups of products for which the SPPI test was conducted. The Bank further elaborates listed homogeneous groups taking into account the currency, interest rate type, certain types of funding programs, and other specific features and characteristics of the product.

1. Corporate clients products:

- Long term loans to financial institutions which are not members of the Group, with fixed interest rate
- Long term loans to financial institutions which are not members of the Group, with administrative interest rate
- Investment loans with administrative interest rate
- Investment loans with fixed interest rate
- Investment loans with variable interest rate
- Working capital loans with administrative interest rate
- Working capital loans with fixed interest rate
- Other loans with administrative interest rate
- Other loans with fixed interest rate
- Other loans with variable interest rate
- Overdrafts on giro account
- Refinancing loans with administrative interest rate
- Refinancing loans with fixed interest rate
- Refinancing loans with variable interest rate
- Guarantees as a liability of the group

2. Retail clients products:

- Housing loans with fixed interest rate
- Housing loans with variable interest rate
- Housing loans with combination of fixed and variable interest rate
- Subsidized housing loans
- Cash loans with fixed interest rate
- Cash loans with variable interest rate
- Cash loans with combination of fixed and variable interest rate
- Lombard loans
- Express loans
- Consumer loans
- Mortgage loans
- Tourism loans
- Car loans
- Housing loans without mortgage
- Overdraft loans
- Credit card loans - revolving
- Credit card loans - charge
- Credit card loans - instalment

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

2. ACCOUNTING POLICIES (CONTINUED)

2.11 Financial instruments (continued)

Modifications

The modification applies to all financial assets within the scope of IFRS 9. Any change in a contractual provision is considered a modification. The Bank defines the significance of the modification. In case of significant modification, the Bank derecognizes the existing instrument and carries out initial recognition of the new instrument. Upon initial recognition of a new instrument, the Bank implements all necessary requirements defined in IFRS 9 for the initial recognition of financial assets.

If the modification is insignificant, the gain or loss is recognized in the profit and loss statement. The most common form of modification relates to restructuring, where in almost all cases the Bank derecognizes an existing instrument and recognizes a new instrument.

Recognition and derecognition

Financial assets and liabilities are initially recognized at fair value, increased or decreased by transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability. The fair value of a financial instrument on initial recognition is usually the purchase price of the transaction.

After initial measurement, the Bank measures financial assets at amortized cost or at fair value (through other comprehensive income or at fair value through profit or loss), depending on the Bank's financial asset management model and contractual cash flow characteristics.

Write-offs

The Bank writes off financial assets in cases where it is not possible to collect, or when all payment possibilities have been exhausted, or when the collection costs exceed the amount of possible collection.

The Bank writes off financial assets that are completely impaired or whose fair value is equal or approximately zero.

The Bank primarily seeks to sell such financial assets in the market. If there is no market demand for financial assets, they are written off and transferred to off-balance sheet records.

In case of financial assets recorded in off-balance sheet records, for which certain collection procedures of mostly formal nature have not yet been completed, the Bank continues to monitor them and collect wherever possible. These financial assets are finally written off only when there is no longer any reason for the Bank to continue collection, or when there is no possibility of partial collection in the future.

Discharge of debt (permanent write-off of financial assets without transfer to off-balance sheet records) is done by the Bank in case of sale of receivables or if the receivables are written off in line with court decisions in accordance with applicable legal regulations or in other specific cases defined in the Bank's internal policies. In case of financial assets that are not fully written off, the remaining assets are not recognised as an existing instrument at the time of writing-off, and a new instruments is recognised in accordance with IFRS 9.

Gains and losses

Gains and losses from financial assets and financial liabilities measured at fair value through profit or loss are recognized in profit and loss account.

Gains or losses from financial assets measured at amortised cost and is not part of a hedging relationship shall be recognised in profit or loss when the financial asset is derecognised or reclassified through the amortisation process or in order to recognise impairment gains or losses.

For debt instruments measured at fair value through other comprehensive income, gain or loss arising from change in fair value is recognized in other comprehensive income. Foreign exchange gain or loss is recognized through profit or loss in profit and loss account. When the financial asset is derecognised the cumulative gain or loss previously recognised in other comprehensive income is reclassified from equity to profit or loss as a reclassification adjustment. Interest calculated using the effective interest method is recognised in profit or loss.

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

2. ACCOUNTING POLICIES (CONTINUED)

2.11 Financial instruments (continued)

Gains and losses (continued)

Gains or losses arising from change in fair value and foreign exchange gain or loss for equity instruments designated at fair value through other comprehensive income are recognised in other comprehensive income. Gain/loss resulting from disposal of equity instruments classified as fair value through other comprehensive income option is never disclosed within profit and loss account; accumulated gains/losses are recognized in other comprehensive income. Only dividends are recognized as gain in relevant reporting period.

Fair value measurement principles

The fair values of quoted securities are based on current closing bid prices. 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 determines the fair value using valuation techniques. These include the use of prices achieved in recent arm's length transactions between knowledgeable and willing parties, reference to other instruments that are substantially the same, discounted cash flow analysis, and option pricing models, making maximum use of market inputs and relying as little as possible on entity-specific inputs. Where discounted cash flow techniques are used, estimated future cash flows are based on management's best estimates and the discount rate used is a market rate. The fair value of non-traded derivatives is estimated at the amount that the Bank would receive or pay to terminate the contract at the statement of financial position date, taking into account current market conditions and the current creditworthiness of the counterparties.

Valuation techniques and assumptions for the purposes of measuring fair value

The fair values of financial assets and financial liabilities are determined as follows:

- The fair values of financial assets and financial liabilities with standard terms and conditions and traded on active liquid markets are determined by reference to quoted market prices (includes listed redeemable notes, bills of exchange, debentures and perpetual notes).
- The fair values of other financial assets and financial liabilities (excluding derivative instruments) are determined in accordance with generally accepted pricing models based on discounted cash flow analysis using prices from observable current market transactions and dealer quotes for similar instruments;
- The fair values of derivative instruments are calculated using quoted prices. Where such prices are not available, a discounted cash flow analysis is performed using the applicable yield curve for the duration of the instruments for non-optional derivatives, and option pricing models for optional derivatives. Foreign currency forward contracts are measured using quoted forward exchange rates and yield curves derived from quoted interest rates matching maturities of the contracts. Interest rate swaps are measured at the present value of future cash flows estimated and discounted based on the applicable yield curves derived from quoted interest rates.

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

2. ACCOUNTING POLICIES (CONTINUED)

2.12 Impairment of financial assets (continued)

Impairment of financial assets measured at amortised cost

Definition and calculation method of expected credit losses for each stage

Expected credit loss calculation methodology depends on type of portfolio and risk stage of portfolio subject to assessment. Portfolio classified into lower risk stages (Stage 1 and Stage 2) is assessed collectively.

Bank recognizes relevant impairment every month for exposure in amount equal to:

- 1) 12 month expected credit loss for Stage 1 risk subcategory;
- 2) lifetime expected credit loss for Stage 2 risk subcategory

Portfolio classified into Stage 3 is assessed collectively with lifetime expected credit loss recognized in cases of retail portfolio and individually in cases of corporate portfolio. Exceptionally, in case of corporate portfolio, for clients with group exposure below HRK 3,000,000, collective assessment is applied in expected credit loss calculation.

For individual method, expected credit losses are calculated as difference between gross carrying amount of individual exposure and present value of expected future cash flows discounted at effective interest rate. At least two scenarios are projected for expected cash flow assessment. Weights are applied to each scenario based on probability of occurrence. The present value calculated as the weighted average of the individual scenarios is used to calculate the transaction impairment. In calculation of individual expected credit losses the following information is taken into account: expected operating cash flow, expected cash from the sale of collateral (real estate), the effective interest rate, and the estimated collateral realisation period.

In case of collective assessment, the Bank uses internal model in accordance with IFRS 9 for calculation of expected credit losses, applying PD (probability of default), LGD (loss given default) and EAD (exposure at default; for off-balance exposures CCF of 100% is applied) as impairment parameters. Bank also applies 5 different macroeconomic scenarios that reflect forecasts. Macroeconomic scenarios and its probabilities are based on regional macroeconomic forecasts. Expected loss (EL) is calculated separately for each scenario and final expected loss (EL) assessment is weighted average of expected loss in cases of multiple scenarios. Model calculation is performed monthly. Basic assumption in the model is credit segmentation based on client type (sovereign, banks, corporate, retail). Retail segment is further subdivided by product type into the sub-segment of housing, mortgage, cash, car and other loans and the sub-segments of overdrafts and credit cards. Each segment is also divided according to the years on book criterion and to the categories defined by the number of days past due (0-30 S1, 0-30 S2, 31-60, 61-90, 0-90 S3, 91-120, 121- 150, 151-180, 181-360, above 360, restructured which has a 2-year follow-up period). For the purposes of capturing the LGD parameter, the ECL calculation model also uses a breakdown of secured and unsecured exposures, currencies, and number of quarters since entering the default status.

The Bank uses the aggregate method to calculate the expected loss of exposures classified in Stage 3 in the case of Retail portfolio (included in Note 17 Loans and receivables from customers), and to calculate the expected loss of exposures classified in Stage 1 and Stage 2, and for assets carried at amortized cost which is included in notes 14 Cash and balances with Croatian National Bank, 15 Loans and receivables from banks, 17 Loans and receivables from customers, 19 Financial assets measured at amortized cost, and 24 Other financial assets subject to impairment.

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

2. ACCOUNTING POLICIES (CONTINUED)

2.12 Impairment of financial assets (continued)

Impairment of financial assets measured at amortised cost (continued)

Definition and calculation method of expected credit losses for each stage (continued)

After initial recognition and on every reporting date, financial assets are allocated into one of three stages:

- 1) Stage 1 - performing,
- 2) Stage 2 - performing, but for which significant increase in credit risk was observed since initial recognition,
- 3) Stage 3 - default and other non performing exposures

Performing assets (Stage 1) include all financial assets for which events and criteria valid for Stage 2 and Stage 3 do not exist on reporting date.

Financial asset shows significant increase in credit risk (Stage 2) if any of following indicators exist on reporting date and non-performing criteria had not been met (Stage 3):

- the payment delay exceeds 30 days,
- it is classified as performing forborne,
- based on individual decision, its currency suffered a significant "shock" (significant increase in the exchange rate for loans with currency clause in Swiss Franc CHF) since the disbursement of the loan and no hedge position exists in respect thereof,
- the transaction/client rating exceeds a predefined value or falls into a determined range (for cash loans and corporate portfolio internal rating 8 or 9; for housing loans internal rating 7, 8 and 9), or compared to the historic value it deteriorates to a predefined degree,
- delay in payment more than 10 days in the last 6 months for loans in which the classification according to the rating is not possible (rating not available)
- in case of housing mortgage loans, the loan-to-value ratio (LTV) exceeds a predefined rate (at present 125%),
- default on another loan of the individual client (retail portfolio), if no cross-default exists,

- the monitoring classification of a non-retail exposure above the threshold in Watchlist 2 (during the monitoring process it is classified as an exposure that shows a significant increase in credit risk or is placed on Watch List 2 based on subjective assessment).

Above mentioned stipulations do not apply sovereign exposures or to exposures for which Bank could prove that more than 30 days past due is not relevant indicator.

Financial asset is considered defaulted (Stage 3) if any of following criteria have been met:

- objective criteria: more than 90 days past due on significant obligation;
- probability analysis resulting in conclusion that debtor would not be able to settle its credit obligations fully („unlikely to pay“ criteria);
- restructuring exposure criteria.

Purchased or originated credit impaired asset (POCI) assessment

Purchased or originated credit impaired asset is credit impaired at initial recognition.

At every reporting date, Bank recognizes cumulative change in lifetime expected credit losses as impairment gain or loss in profit and loss account. If credit loss for POCI asset decreases after initial recognition, Bank recognizes impairment gain. If credit loss for POCI asset increases after initial recognition, Bank recognizes impairment loss.

During 2019, except for existing POCI assets migrated from Splitska banka d.d., Bank has identified exposures to Fortenova Grupa (collateralized portion of exposure carried at amortized cost), which was again recognized by the resolution of the Agrokor settlement, as new POCI assets. These exposures are disclosed in Note 17 – Loans and receivables from customers.

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

2. ACCOUNTING POLICIES (CONTINUED)

2.12 Impairment of financial assets (continued)

Impairment of financial asset measured at fair value through other comprehensive income

At each reporting date, the Bank reassesses all financial instruments in the scope of impairment to determine if objective evidence of impairment exists. Expected credit loss definition per each stage, significant increase in credit risk identification and expected credit loss calculation methodology is identical to rules implemented for portfolio of financial assets measured at amortised cost.

Impairment of financial assets reclassified from off-balance sheet records

In the ordinary course of business, the Bank assumes contingent liabilities related to guarantees, letters of credit and undrawn loan commitments. When these assets become payable, they are reclassified to assets carried at amortized cost and the calculation of expected credit losses, identification of significant credit risk and impairment is carried out according to the rules for assets carried at amortized cost.

Impairment of financial assets not covered by IFRS 16 and IFRS 15

All financial assets within the scope of IFRS 15 (assets) and IFRS 16 (leases), which are not subject to impairment under IFRS 16 and IFRS 15, are subject to impairment according to IFRS 9 requirements.

2.13 Derivative financial instruments

The Bank uses derivative financial instruments to hedge economically its exposure to foreign exchange and interest rate risks arising from its operational, financing and investing activities.

In accordance with its treasury policy, the Bank does not hold or issue derivative financial instruments for speculative trading purposes. Derivatives are classified within financial instruments that are carried at fair value through profit or loss as financial instruments held for trading or as derivatives that are preferred for hedging purposes.

Derivative financial instruments, including foreign exchange contracts, currency forward agreements and cross-currency swaps, are recognised initially in the statement of financial position and subsequently re-measured at their fair value. The fair values are obtained from quoted market prices or discounted cash flow models as appropriate. All derivatives are recognized as assets if their fair value is positive, i.e. as liabilities if their fair value is negative. Changes in fair value of derivatives that are held for trading are recognized through profit or loss. Changes in the fair value of derivatives that are held as a hedging instrument are recognized through profit or loss together with the change in fair value of the instrument being hedged.

2.14 Sale and repurchase agreements

A financial asset sold under an agreement to repurchase it at a fixed price or at the sale price plus a lender's return or if it is loaned under an agreement to return it to the transferor, it is not derecognised, as the Bank retains substantially all the risks and rewards of ownership.

Securities sold under sale and repurchase agreements ('repos') are included in the statement of financial position as assets as originally classified or the Group reclassifies the asset on its statement of financial position as a repurchase receivable if the transferee obtains the right to sell or pledge the asset. The corresponding liability towards the counterparty is included in amounts due to banks or amounts due to customers as appropriate.

Securities purchased under agreements to purchase and resell ('reverse repos') are recorded as assets due from banks or as loans and receivables as appropriate.

The difference between the sale and repurchase price is treated as interest and accrued over the life of the repo agreement using the effective interest method.

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

2. ACCOUNTING POLICIES (CONTINUED)

2.15 Tangible and intangible assets

Tangible and intangible assets are stated at cost less accumulated depreciation/amortisation and impairment loss, if any. Land and assets under development are not depreciated.

Depreciation and amortisation are provided for all assets, except for land and assets under construction, under the straight line method at rates estimated to write down the cost of each asset to its residual value over the estimated useful life, which is as follows:

	2019	2018
Tangible assets		
Buildings	33-40 years	33-40 years
Computers	4-5 years	4-5 years
Furniture and equipment	2.5-10 years	2.5-10 years
Motor vehicles	4-5 years	4-5 years
Intangible assets		
Investment in leased assets	according to the years of rent	according to the years of rent
Software	3 years	3 years
Contracts with customers	5 years	5 years

2.15 Tangible and intangible assets (continued)

The Bank depreciates buildings for which the value cannot be divided into components at a uniform rate, because it is not possible to estimate the value of each individual component.

The residual value of the asset, the depreciation method and estimated useful lives are reviewed at each reporting date and adjusted if necessary. Where the carrying amount of an asset exceeds its estimated recoverable amount, it is written down to the recoverable amount.

Gains and losses on the sale of property and equipment are determined as the difference between the amount charged and the carrying amount and are included in the statement of profit or loss. In the carrying amount of property and equipment the Bank includes the cost of replacing the part of an item when such cost arises if it is probable that the Bank will have future economic benefits contained in that item and if the purchase value of such item can be reliably estimated. All other repair and maintenance costs are recognized as incurred.

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

2. ACCOUNTING POLICIES (CONTINUED)

2.16 Impairment of tangible and intangible assets

Assets that have an indefinite useful life, such as goodwill, are not subject to amortisation and are tested for impairment at least annually. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Intangible assets that are not yet available for use are assessed at each reporting date. Impairment losses are recognised whenever the carrying amount of an asset exceeds the asset's recoverable amount. Impairment losses are recognised in the statement of comprehensive income. An impairment loss is recognized in all cases where the carrying amount of an asset is greater than its recoverable amount.

The recoverable amount of property and equipment and of intangible assets is the higher of an asset's fair value less costs to sell and value in use. For the purpose of assessing impairment, assets are grouped at the lowest level for which there is 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. Impairment losses on goodwill are not reversed.

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

2.17 Real estate investments

Investments into property are carried at cost less accumulated depreciation and impairment losses. These investments include those investments held for the purpose of earning rent or increasing their market value, but not those held for sale. Investments are depreciated on a straight-line basis at prescribed rates, which write off the acquisition cost over the estimated useful life. The useful life and the residual value are checked and adjusted as necessary at each reporting date. Transfers to and from real estate investments are made when a change of property occurs, which is manifested upon termination or commencement of use by the owner. Investments are derecognized upon disposal or upon final retirement or when no future benefits are expected from disposal. Gains or losses on withdrawal or disposal are recognized in the profit and loss account in the period of withdrawal or disposal.

2.18 Non-current assets held for sale

Assets that are expected to be offset primarily by sale rather than continued use are classified as held for sale. The following conditions must be fulfilled:

the property must be available for sale in its existing condition; its sale must be very probable; as expected and planned sale must occur within one year from the date of classification.

Prior to being classified as held for sale, assets are measured in accordance with the accounting policies of the Bank, after which they are measured at the lower of cost or fair value less costs to sell, whichever is lower. Non-current assets classified as held for sale are not depreciated. At the time of reclassification, when a change of intention or when the conditions required by IFRS 5 are no longer met, the Bank does not restate the comparative information in the Statement of financial position. In the case of reclassification, the valuation is adjusted in accordance with the relevant standards, as if no reclassification had taken place.

2.19 Investment in subsidiaries

Subsidiaries are entities controlled by the Group. Investments in subsidiaries are carried at cost less any impairment losses in the Bank's financial statements.

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

2. ACCOUNTING POLICIES (CONTINUED)

2.20 Assets acquired in lieu of uncollected receivables

Occasionally, the Bank forecloses properties and other assets to recover the outstanding loans and advances to customers. Such properties and other assets are recognised at the lower of the net realisable value and current fair value. The Bank seeks to sell the foreclosed assets and only exceptionally makes them available for its own use.

After initial recognition, the assets taken are measured in accordance with the relevant accounting standards, depending on the intention to hold the asset. The Bank measures the assets under IAS 2 except in rare cases when the asset is put into use.

Gains and losses on the sale of such assets are recognised in the statement of profit or loss and in the statement of comprehensive income.

2.21 Interest-bearing loans

Interest-bearing borrowings are recognised initially at fair value less transaction costs. They are measured subsequently at amortised cost, with any difference between the proceeds (net of transaction costs) and the redemption value being recognised in the statement of comprehensive income over the period of the borrowings using the effective interest method.

2.22 Current accounts and deposits from banks and customers

Current accounts and deposits are measured initially at fair value plus transaction costs and subsequently at amortised cost using the effective interest method.

The definition of the calculation of expected credit losses for each stage, the identification of significant credit risk, and the manner of determining the impairment are consistent with the rules for the portfolio of financial assets carried at amortized cost

2.23 Other financial liabilities

Other financial liabilities include all financial liabilities that are not held for trading or are not predetermined to be stated at fair value through profit or loss. Other financial liabilities include liabilities to other banks, liabilities to customers and other borrowed funds.

2.24 Provisions

The Bank recognises a provision when it has a present legal or constructive obligation as a result of a past event and it is probable that an outflow of resources will be required to settle the obligation. The Management Board determines the adequacy of the provision based by analysing individual items, past loss experience, considering the current economic conditions, the risk characteristics of the various categories of transactions and other pertinent factors at the reporting date. Provisions are discounted to present value where the effect is material.

Restructuring provision are recognized if the Bank has made formal restructuring plan and if initiation of the plan or publishing their main features among those affected with the plan has initiated reasonable expectation that restructuring will be performed. Only direct restructuring costs are included in determining the amount of restructuring provisions, and these are costs that are necessarily related to the restructuring but are not related to the entity's current operations.

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

2. ACCOUNTING POLICIES (CONTINUED)

2.25 Off-balance sheet commitments

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

The definition of the calculation of expected credit losses for each stage, the identification of significant credit risk, and the manner of determining the impairment are consistent with the rules for the portfolio of financial assets that are carried at amortized cost. In the aggregate method, the Bank uses an internal IFRS 9 model to calculate expected credit losses using PD (default probability), LGD (default) and EAD (risk exposure; (risk exposure; 100% credit conversion factor applies to off-balance sheet contingent liabilities) impairment parameters. Please see Note 2.13 for more details.

2.26 Asset managed on behalf of third parties

Assets and income arising thereon, together with related undertakings to return such assets to customers, are excluded from these financial statements when the Bank acts in a fiduciary capacity such as a nominee, trustee or agent. Fees for such services are recognised as income when earned.

2.27 Share capital

Share capital represents the nominal value of paid-in ordinary shares classified as equity and is denominated in Croatian kunas.

Dividends are recognised as a liability in the period in which they are declared.

2.28 Retained earnings

Any profit for the year retained after appropriations is transferred to reserves.

2.29 Borrowing costs

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use or sale, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use or sale.

Investment income earned on the temporary investment of specific borrowings pending their expenditure on qualifying assets is deducted from the borrowing costs eligible for capitalisation.

All other borrowing costs are charged to the profit or loss for the period in which they are incurred. The bank did not have assets that met the criteria for capitalization of borrowing costs.

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

2. ACCOUNTING POLICIES (CONTINUED)

2.30 Reclassification of comparative periods

During 2019, the Bank reclassified certain items in the statement of financial position to align the presentation of the financial statements with IFRSs. Therefore, the previously announced amounts as of December 31, 2018 have been reclassified, as presented below. As there was no change in measurement, these reclassifications had no effect on profit or loss, other comprehensive income and retained earnings.

	Note	Report for 2018	Reclassification	Restated report for 2018
ASSETS				
Cash and balances with Croatian National Bank	14	8,368	-	8,368
Loans and receivables from banks	15	1,026	-	1,026
Financial assets at fair value through profit or loss	16	316	-	316
Loans and receivables from customers	17	25,539	9	25,548
Equity instruments at fair value through other comprehensive income	18a	78	-	78
Debt securities at fair value through other comprehensive income	18b	5,265	-	5,265
Financial asset measured at amortised cost	19	287	-	287
Investments in subsidiaries	20	323	-	323
Property and equipment	21	434	(35)	399
Investment property	22	29	35	64
Intangible assets	23	232	-	232
Deferred tax assets	12	-	-	-
Other assets	24	135	(9)	126
Available for sale assets	25	-	-	-
		<u>42,032</u>	<u>-</u>	<u>42,032</u>
TOTAL ASSETS		42,032	-	42,032

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

2. ACCOUNTING POLICIES (CONTINUED)

2.30 Reclassification of comparative periods (continued)

	Note	Report for 2018	Reclassification	Restated report for 2018
Retail customers				
Demand deposits				
Kuna-denominated		5,127	-	5,127
Foreign currency-denominated		8,523	(12)	8,511
Term deposits				
Kuna-denominated		1,820	-	1,820
Foreign currency-denominated		7,358	-	7,358
		22,828	(12)	22,816
Corporate customers				
Demand deposits				
Kuna-denominated		6,339	-	6,339
Foreign currency-denominated		2,482	12	2,494
Term deposits				
Kuna-denominated		838	-	838
Foreign currency-denominated		573	-	573
		10,232	12	10,244
		33,060	-	33,060

In the financial statements for 2019, the Bank reclassified card transactions receivable from the Note 24 *Other Assets* to the Note 17 *Loans and receivables from customers* in the amount of HRK 9 million.

The Bank made the reclassification from the Note 21 *Property and Equipment* to the Note 22 *Investment property* in the net amount of HRK 35 million.

The Bank made the reclassification within Note 27 *Amounts due to Customers* from the position Retail customers - Demand deposits denominated in foreign currency into the position Corporate customers - Demand deposits denominated in foreign currency in the amount of HRK 12 million.

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

3. ACCOUNTING ESTIMATES AND JUDGEMENTS IN APPLYING ACCOUNTING POLICIES

The Bank makes certain judgments and estimates about uncertain events, including estimates and judgments concerning the future. Such accounting estimates and judgments are regularly reviewed and are based on past experience and other factors, such as the reasonably expected course of future events under given circumstances, but which nevertheless represent sources of uncertainty. The estimation of impairment losses in the Bank's credit risk portfolio represents the most significant source of estimation uncertainty. The risk as well as other key sources of estimation uncertainty with a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are described below.

Impairment losses on financial assets within scope of IFRS 9 impairment

Bank continuously monitors credit worthiness of its customers. In accordance with regulation, impairment of on-balance and off-balance exposures to credit risk is assessed at least quarterly. Impairment losses are recognized mostly against book value of loans and receivables from banks and other customers (disclosed in notes 15 and 17), impairment losses for assets measured at fair value through other comprehensive income (disclosed in note 18), impairment for financial assets measured at amortised cost (disclosed in note 19), and loss allowance for risks and costs resulting from potential liabilities, loan commitments, mostly in form of granted unused credit lines, guarantees, letters of credit and unused credit card limits (disclosed in note 32). Impairment losses are also analysed for the purpose of credit exposure assessment of other assets measured at amortised cost (note 25).

The estimate of provision for credit losses represents the best estimate of the risk of default and expected credit losses (ECL) on financial assets, including all off-balance sheet exposures, on the reporting date, and as a part of this, the fair value estimation of collateral in real estate is the main source of estimation uncertainty. This and other key sources of estimation uncertainty have a significant risk of causing possible significant adjustments to the carrying amounts of assets and liabilities in the next financial year.

Expected credit loss is present value of difference between contractual cash flows that are due to an entity in accordance with the contract and all the cash flows that the entity expects to receive. For lifetime expected credit losses, an entity shall estimate the risk of a default occurring on the financial instrument during its expected life. 12-month expected credit losses are a portion of the lifetime expected credit losses and represent the lifetime cash shortfalls that will result if a default occurs in the 12 months after the reporting date (or a shorter period if the expected life of a financial instrument is less than 12 months), weighted by the probability of that default occurring.

For calculation of expected credit losses Bank uses internal model in accordance with IFRS 9 applying PD (probability of default), LGD (loss given default) and EAD (exposure at default) as impairment parameters. Risk parameters also depend on macroeconomic scenarios. Expected loss (EL) is calculated separately for each scenario and final expected loss (EL) assessment is weighted average of expected loss in cases of multiple scenarios. Model calculation is performed monthly- Basic assumption in the model is credit segmentation based on client type (sovereign, banks, corporate, retail).

When determining impairment that exists on reporting date, but that is not separately identified, Bank uses internal model in accordance with IFRS 9. Loss allowance determined by internal model is increased by the Bank up to minimum amount of 0.8% prescribed by CNB. Loss allowance on all types of financial assets as of 31 December 2019 calculated up to the amount prescribed by CNB is equal to HRK 379 million (2018: HRK 365 million). Adjustment between internal model and amount prescribed by CNB as of 31 December 2019 amounts to HRK 106 million (2018: HRK 27 million).

Taxation

The Bank determines its tax liabilities in accordance with the tax legislation of the Republic of Croatia. Tax returns are subject to the approval of the Tax Administration, which may perform subsequent tax audits of taxpayers' records. The tax calculation and estimates are presented in Note 12.

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

3. ACCOUNTING ESTIMATES AND JUDGEMENTS IN APPLYING ACCOUNTING POLICIES (CONTINUED)

Regulatory requirements

The CNB is responsible for performing prudential oversight over the Bank's operations and may require from the Bank to revise the carrying amounts of its assets and liabilities in accordance with applicable regulations.

Litigation and restructuring costs

The Bank makes provisions for litigation and restructuring costs in accordance with IAS 37. Provisions are recognized when the Bank has a present obligation as a result of past events and for which the Bank is aware that they have been incurred, and if it is probable that an outflow of resources containing economic benefits will be required to settle the liabilities and if the amount of the liabilities can be measured reliably. In addition, provisions are allocated, in accordance with legal requirements, for unidentified losses on off-balance sheet credit risk exposures. Provisions are reduced only for those expenses for which provisions are initially recognized. If an outflow of economic benefits to settle the obligation is no longer probable, provisions are reversed.

When forming provisions for litigation, the Bank also takes into account all the criteria laid down in the Decision of the Croatian National Bank on the obligation to make provisions for litigation conducted against a credit institution.

In the ordinary course of business, several lawsuits and complaints have been filed against the Bank, the outcome of which is uncertain.

According to the Management's estimate, the provisions formed are sufficient to cover the costs of active litigation and restructuring costs.

Estimates for litigation and restructuring costs are disclosed in Note 29 Provisions for liabilities and charges.

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

4. CHANGES IN ACCOUNTING POLICIES

The Bank first adopted IFRS 16 from 1 January 2019.

Bank uses a modified retrospective approach.

The application of modified retrospective approach requires the lessee to account for the cumulative impact of IFRS 16 as an adjustment to equity at the beginning of the current accounting period in which it is first applied.

The Bank applies the following practical expedients available:

- Application of single discount rate to a portfolio of leases with reasonably similar characteristics;
- Adjustment of the right-of-use asset at the date of initial application by the amount of any provision for onerous leases in the statement of financial position;
- Application of simplified method for contracts which become due within 12 months from the date of initial application;
- Exclusion of initial direct costs from the measurement of the right-of-use asset at the date of initial application;
- Application of new knowledge, for example, when determining the lease periods, if the contract provides for the possibility to extend or terminate the lease.

The impact of IFRS 16 on financial statements

At the moment of preparation of these financial statements, the Bank performed all of the tasks related to the implementation of the new IFRS 16. The IFRS 16 implementation project (the Project), started in the 4th quarter of 2017, and was completed in 3 stages:

- a) Stage 1 – Contract analysis, data collection

In the statement of financial position, the Bank reported the following forms of right-to-use assets:

- Office building
- Branch office
- Official car
- ATM slot
- IT equipment
- Parking lot
- Warehouse

Average lease period (useful life of the right-to-use assets) from 1 January 2019:

Office building	5 years
Branch office	5 years
Warehouse	7 years
Official car	2 years
ATM slot	2 years
IT equipment	2 years
Parking lot	1 year

- b) Stage 2 – Contract assessment, Calculations

In line with the application of IFRS 16, an analysis was performed including:

- Effect on the statement of financial position on the date of initial application (1 January 2019)
- Effect of lease contract for leases recognised and measured in line with IFRS 16 on the statement of financial position and statement of profit or loss (including future effects)

The application of tools for calculating the lease determined the value of the right-to-use asset, lease liabilities and deferred tax.

- c) Stage 3 – Implementation of IFRS 16 based on the elaborated concept, development of accounting policy and disclosures

Adjustment description

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

4. CHANGES IN ACCOUNTING POLICIES (CONTINUED)

a) Recognition of lease liabilities

After the adoption of IFRS 16, the Bank recognises the liabilities based on the leases which refer to leases which have been previously classified as “operating leases” in line with the IAS 17 “Leases”. The relevant liabilities are measured at current value of lease receivables on the date of the beginning of the application of IFRS 16. Lease payments are discounted by applying the interest rate of the lease or, if it is impossible to determine that rate immediately, by applying the incremental borrowing rate. The interest rate applied by the Bank is weighted average incremental borrowing rate of the lessee.

At the date of initial recognition, lease payments included in the measurement of the lease liability include the following types of payment for the right to use the underlying asset during the lease period:

- fixed lease payments net of all lease incentives,
- variable lease payments which depend on market indexes,
- amounts expected to be paid by the lessee based on the guarantee for the remaining value,
- call option, if it is probable that this option will materialise, and
- payments of penalties for terminating the lease, if the lease term reflects the lessee exercising an option to terminate the lease.

The Bank uses the expedients which refer to short-term leases (shorter than 12 months), as in the case of leases with low-value underlying assets (less than USD 5,000) and for which contracts it will not recognise the financial liabilities nor the relevant right-to-use assets. These types of payments are recognised as costs under the straight-line method in the lease period.

b) Recognition of right-to-use assets

Right-to-use assets are initially measured at cost.

The cost of right-to-use assets comprises the following:

- initial assessment of the lease liability,
- all leases paid on the commencement date or earlier, net of any lease incentives,
- initial costs borne directly by the lessee as a consequence of concluding the lease contract,
- cost assessments the lessee shall bear for the dismantling and removal of the relevant asset or for its adaptation/renewal.

c) Assessment application

The implementation of IFRS 16 requires the preparation of certain assessments and calculations, which affect the measurement of financial lease liabilities and the right-to-use assets. This includes, inter alia:

- determining which contracts are subject to IFRS 16,
- determining the duration of these contracts (including contracts without specified duration or contracts which may be prolonged),
- determining interest rates to be applied for discounting future cash flows,
- determining the depreciation rate.

Effect on the statement of financial position

The effect of applying IFRS 16 on the recognition of additional financial liabilities and right-to-use assets is calculated based on the contracts in force with the Bank on 31 December 2018.

In its statement of financial position as of 1 January 2019, the Bank presents the following right-to-use assets and lease liabilities:

Estimated financial effect (note 21)

In HRK millions	1 January 2019
Right-to-use assets	190
Lease liability	190
Cumulative effect recognised as capital adjustment on the date of initial application	-

The weighted average interest rate of the lease / incremental borrowing rate applied on 1 January 2019, in order to recognise the lease liabilities: ~2.18%.

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

5. NET INTEREST INCOME

	2019	2018
Interest income		
Retail loans	864	462
Corporate loans	304	141
Debt securities	88	39
Cash reserves and amounts due from other banks	9	4
	<u>1,265</u>	<u>646</u>
Interest expenses		
Current accounts and deposits from individuals	29	24
Other borrowed funds and amounts owed to banks	24	17
Current accounts and corporate deposits	16	7
Interest expenses IFRS 16	4	-
	<u>73</u>	<u>48</u>

Included in various items within interest income for the year ended 31 December 2019, a total of HRK 74 million (2018: HRK 37 million) refers to the interest income charged on the assets which were previously impaired as Stage 3.

Deferred interest loan origination fees are recognized in interest income as an adjustment to the effective interest income. The total amount of these fees in interest income in 2019 is HRK 44 million (2018: HRK 25 million).

Penalty interest calculated on loans and receivables from customers is shown in other operating income (Note 8).

6. NET FEE AND COMMISSION INCOME

a) NET FEE AND COMMISSION INCOME – analysis by source

	2019	2018
Fee and commission income		
Retail customers	246	116
Corporate customers	138	57
Banks	109	24
	<u>493</u>	<u>197</u>
Fee and commission expense		
Banks	86	41
Corporate customers	29	17
	<u>115</u>	<u>58</u>

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

6. NET FEE AND COMMISSION INCOME (CONTINUED)

b) Net fee and commission income – analysis by fee type

	2019	2018
Fee and commission income		
Domestic payment transaction related fees and commissions	104	52
Package fees charged to individuals	102	41
Card-related fees and commissions	87	35
Merchant fees for card business	54	13
Foreign payment transaction related fees and commissions	35	13
Account maintenance fees	21	12
Asset management, brokerage and consultancy service fees	17	2
Loan-related fees and commissions	16	9
Guarantee-related fees and commissions	16	5
Fees for other services related to client accounts	11	8
Sale of insurance policies	10	3
Interest rate swap fees	8	-
Purchase of cash	3	-
Other fees and commissions received	9	4
	493	197
Fee and commission expense		
Card-related fees and commissions	64	29
Domestic payment transaction related fees and commissions	21	8
Foreign payment transaction related fees and commissions	11	12
Other fees and commissions paid	19	9
	115	58

7. NET GAINS FROM TRADING AND VALUATION OF FINANCIAL INSTRUMENTS

7a Net (losses)/gains from trading and valuation of financial instruments at fair value through profit or loss

	2019	2018
Net gains on derivatives	48	52
Net (loss) on financial asset at fair value through profit or loss	(183)	(3)
	(135)	49

Financial assets measured through profit or loss, to which these net (losses) / gains relate, are included in Note 16.

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

7. NET GAINS FROM TRADING AND VALUATION OF FINANCIAL INSTRUMENTS (CONTINUED)

7b Net gains from trading and valuation of financial instruments at fair value through other comprehensive income

	2019	2018
Realised gains on securities at fair value through other comprehensive income	-	2
	<u>-</u>	<u>2</u>

Financial assets measured through other comprehensive income, to which these net (losses) / gains relate, are included in Note 18.

7c Net gains from trading and converting monetary assets and liabilities

	2019	2018
Net gains from currency sale and purchase	183	64
Net (loss) from conversion of monetary assets and liabilities denominated in foreign currencies and foreign currency clause	(23)	(34)
	<u>160</u>	<u>30</u>

8. OTHER OPERATING INCOME

	2019	2018
Income from inventory write-offs	18	-
Visa and MasterCard awards	8	2
Default interest on loans and receivables from customers	4	6
Gains on sale of foreclosed assets	4	
Gains on disposal of property and equipment	-	2
Amounts recovered through court actions	4	2
Floor plan (PSA) income	3	-
Rental income	3	8
Subsequent recovery of receivables written off in prior years	3	1
Foreign Financial Markets Income (VISA dividend)	1	-
Other income	1	1
	<u>49</u>	<u>22</u>

Revenues from rents are mostly related to revenues from properties rental, out of which HRK 0.3 million (2018: HRK 0.6 million) is related to revenues from properties which are fully leased, while the rest is related to properties which are used by the Bank, and whose insignificant part is leased, as well as revenues from rent which are paid by telecoms for lease of premises at the top of buildings for their antennas and other communication devices.

Income from inventory write-offs mainly refers to the elimination of accrued expenses from previous years for which the Bank has not received credible documentation within the statute of limitations period and these were written off after the statute of limitations had entered into force.

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

9. OTHER OPERATING EXPENSES

	2019	2018
Professional services and cost of material	257	148
Depreciation and amortisation	171	49
Savings deposit insurance premiums	58	30
Administrative expenses	37	24
Marketing costs	30	25
Other taxes and contributions	26	8
Impairment of investment in subsidiaries	8	-
Service and materials costs - Mastercard campaign	8	-
Receivables write-off	4	7
Inventory write-offs	4	-
Costs associated with the sale of receivables	4	3
Write-off of supplies (cards)	3	-
Write-off due to sales	3	-
Tangible and Intangible assets write-off	21	7
Goodwill write-off	-	43
Other costs	1	4
	<u>635</u>	<u>348</u>

Depreciation expenses for 2019 also include depreciation expenses in accordance with IFRS 16 for the Bank in the amount of HRK 34.5 million.

In 2018 and in 2019, the external auditor provided validation-related services: audit of annual financial statements, insight into profit made in the first half of 2019, audit of the reporting package to OTP Bank Nyrt Hungary, other agreed procedures to verify compliance with financial, accounting or regulatory matters, statutory engagement, and assessment of compliance of general information system controls. In accordance with EU Regulation 537/2014, services provided during the year are services that are allowed.

The cost of the audit for the Bank, which in addition to the audit of the financial statements includes the audit of other areas, amounts to HRK 6 million for 2019 (2018: HRK 2.7 million).

The costs of auditing are shown under the position Professional services and cost of materials.

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

10. PERSONNEL EXPENSES

	2019	2018
Gross salaries	317	171
- <i>net salaries</i>	225	121
- <i>taxes, surtaxes and contributions</i>	92	50
Contributions on salaries	49	28
Accrued expenses for bonuses and other employee expenses	46	37
Net provision for severance and retention payments (Note 29)	4	(4)
	<u>416</u>	<u>232</u>

At year-end, the Bank had 2,318 employees (2018: 2,559).

11. NET GAINS / (LOSSES) FROM IMPAIRMENT AND PROVISION CHARGES

	Note	2019	2018
Impairment of loans and receivables from banks	15	1	(1)
Impairment of loans and receivables from customers	17	118	(20)
Impairment of financial assets measured at amortized cost	19	64	(8)
Impairment of investments measured through other comprehensive income	18	5	-
Impairment of other asset	24	(20)	1
Litigation provisions	29	(45)	(4)
Impairment of contingent liabilities and commitments	32	(2)	(14)
		<u>121</u>	<u>(46)</u>

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

12. TAXATION

(a) Income tax expense recognised in profit or loss

	2019	2018
Current income tax	162	49
Net deferred tax (credit)/charge	<u>(27)</u>	<u>(1)</u>
	<u>135</u>	<u>48</u>

(b) Reconciliation of the accounting profit and income tax expense at 18%

	2019	2018
Profit before tax	<u>714</u>	<u>214</u>
Tax at the statutory rate of 18%	129	39
Non-taxable income, net of expenses not recognised for tax purposes	12	9
Expenses not tax deductible until realization	60	-
Utilisation of tax losses from previous years	(30)	-
Current income tax	171	49
Reconciliation of taxes from previous years	(9)	
Deferred tax	<u>(27)</u>	<u>(1)</u>
Income tax	<u>135</u>	<u>48</u>
Effective tax rate	18.91%	22.43%

Adjustment of tax from previous years relates to over-calculated tax in previous periods, which was corrected in 2019.

Current tax expense amounts to HRK 171 million (2018: HRK 49 million), and advances have been paid in the amount of HRK 26 million (2018: HRK 13 million), whereby income tax liability at 31 December 2019 amounted to HRK 145 million (2018: HRK 36 million).

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

12. TAXATION (CONTINUED)

(c) Movement in deferred tax assets and liabilities

	Deferred loan origination fees	Unrealised gains/(losses) on securities at FVTOCI	Tax impact of Splitska banka merger	Other	Total
Balance at 31 December 2018	11	(27)	(72)	54	(34)
Through profit or loss	(4)	-	-	31	27
Through other comprehensive income	-	(24)	-	-	(24)
Through retained earnings (tax on gain from bargain purchase)	-	-	72	-	72
Other movement (IFRS 9 – transfer to current tax liability)	-	-	-	(12)	(12)
Balance at 31 December 2019	7	(51)	-	73	29

The amounts under Other consist of deferred tax assets of HRK 42 million based on unrealized losses on financial assets carried at fair value, HRK 26 million based on provisions for legal expenses; HRK 22 million based on provisions for severance pay and employee retention; HRK 7 million based on expenses for which the Bank has not received invoices by the reporting date; HRK 4 million based on the fair value of the loans from the integration with Splitska banka; HRK 1 million based on the cost of impairment of commercial real estate; deferred tax liabilities of HRK 34 million based on fair value from integration with Splitska banka (customer base, tangible assets and shares in subsidiaries) and HRK 5 million other.

In 2019, the Bank realized the tax impact of the Splitska banka merger after obtaining a positive tax ruling from the competent regulatory authorities.

	Deferred loan origination fees	Unrealised gains/(losses) on securities at FVTOCI	Tax impact of Splitska banka merger	Other	Total
Balance at 1 January 2018	5	(11)	-	54	48
Acquired from Splitska banka d.d.	6	(17)	-	(1)	(12)
Through profit or loss	-	-	-	1	1
Through other comprehensive income	-	1	-	-	1
Through retained earnings (tax on badwill)	-	-	(72)	-	(72)
Balance at 31 December 2018	11	(27)	(72)	54	(34)

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

13. EARNINGS PER SHARE

For the purposes of determining earnings per share, for total earnings the Bank's profit for the current year attributable to the ordinary shareholders of the Bank is used. A reconciliation of the profit for the year attributable to ordinary shareholders is provided below.

	31.12.2019	31.12.2018
Profit attributable to ordinary shareholders	579	166
Weighted average number of shares	<u>19,968,774</u>	<u>19,968,774</u>
Earnings per share basic (in HRK)	<u>29.01</u>	<u>8.33</u>
Earnings per share diluted (in HRK)	<u>29.01</u>	<u>8.33</u>

14. CASH, CURRENT ACCOUNTS WITH BANKS AND BALANCES WITH CROATIAN NATIONAL BANK

	31.12.2019	31.12.2018
Cash in hand	725	821
Current account balance	3,823	3,739
FX settlement account with the CNB	4	20
Current accounts with foreign banks	858	1,274
Current accounts with domestic banks	<u>39</u>	<u>33</u>
Assets included in cash and cash equivalents (Note 33)	5,449	5,887
Obligatory reserve at the Croatian National Bank	<u>2,486</u>	<u>2,481</u>
	<u>7,935</u>	<u>8,368</u>

Foreign currency settlement account with the CNB is an account the Bank has opened for the purpose of settlement of national and cross-border payment transactions in euro in real time via TARGET2. The TARGET2-HR national component commenced production on 1 February 2016 in accordance with the National Migration Plan to SEPA. By including the component, TARGET2-HR becomes the twenty-fifth component of the TARGET2 payment system. Participants in the TARGET2-HR component are the Croatian National Bank and credit institutions that have signed a participation agreement. The Croatian National Bank accrues interest on the PM account in the TARGET2-HR system, which is 0.25% higher than the reference ECB deposit interest rate on excess foreign currency liquidity in excess of its foreign currency reserve obligation.

Due to the nature of the receivables, assets with the CNB do not, as a rule, meet the requirements for classification into higher levels of risk (Stage 2 or Stage 3), and are always segmented into Stage 1.

No special impairment is allocated to assets with the CNB, since there is no expected credit loss, but receivables are included in the basis for calculating minimum impairments for assets classified as Stage 1 and Stage 2.

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

15. LOANS AND RECEIVABLES FROM BANKS

	31.12.2019	31.12.2018
Short-term placements with other banks	853	1,029
Provisions for impairment	<u>(2)</u>	<u>(3)</u>
	<u>851</u>	<u>1,026</u>

Loans and receivables from other banks are measured at amortised cost.

2019

Movement in gross carrying amount:

	Stage 1	Stage 2	Stage 3	POCI	Total
Balance as of 31 December 2018	1,027	-	2	-	1,029
Net new approvals / (termination of recognition)	<u>(176)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(176)</u>
Balance as of 31 December 2019	<u>851</u>	<u>-</u>	<u>2</u>	<u>-</u>	<u>853</u>
				-	

Movement in impairment allowance:

	Stage 1	Stage 2	Stage 3	POCI	Total
Balance as of 31 December 2018	1	-	2	-	3
Net increase / (decrease)	<u>(1)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(1)</u>
Balance as of 31 December 2019	<u>-</u>	<u>-</u>	<u>2</u>	<u>-</u>	<u>2</u>

2018

Movement in gross carrying amount:

	Stage 1	Stage 2	Stage 3	POCI	Total
Balance as of 1 January 2018	117	-	2	-	119
Net new approvals / (termination of recognition)	<u>638</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>638</u>
Acquired by merger of Splitska banka	<u>272</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>272</u>
Balance as of 31 December 2018	<u>1,027</u>	<u>-</u>	<u>2</u>	<u>-</u>	<u>1,029</u>

Movement in impairment allowance:

	Stage 1	Stage 2	Stage 3	POCI	Total
Balance as of 1 January 2018	-	-	2	-	2
Increase	<u>1</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>1</u>
Balance as of 31 December 2018	<u>1</u>	<u>-</u>	<u>2</u>	<u>-</u>	<u>3</u>

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

16. FINANCIAL ASSET AND LIABILITIES AT FAIR VALUE THROUGH PROFIT OR LOSS

	31.12.2019	31.12.2018
Units in open-end investment funds managed by affiliated persons	108	103
Bonds issued by the Republic of Croatia, listed on the market	175	160
Other securities measured at fair value through profit or loss	104	-
Derivative financial assets	22	11
Loans	11	42
	<u>420</u>	<u>316</u>

Other securities measured at fair value through profit or loss relate to securities acquired in the restructuring process of the Agrokor Group (Note 17) and consist of equity instruments in the amount of HRK 25 million and debt instruments in the amount of HRK 79 million.

The total net effect of the settlement is HRK 36 million in revenue and is shown in the following notes:

- Note 11 - income from the reversal of impairment losses in the amount of HRK 288 million recognised in 2018 and loss from created impairment allowances for new investments carried at amortized cost in the amount of HRK 38 million
- Note 7 - fair value adjustment expense for new instruments carried at fair value through profit or loss in the amount of HRK 214 million.

(a) Derivative financial asset and liabilities

	2019			2018		
	Asset	Liabilities	Contracted amount	Asset	Liabilities	Contracted amount
Derivatives held for trading						
FX Swap and Forwards	10	14	3,215	4	10	1,963
Interest rate swap	12	-	476	7	-	253
Derivatives – fair value hedge						
Interest rate swap	-	4	37	-	3	60
Derivatives used to hedge cash flow						
Interest rate swap	-	13	10	-	-	26
	<u>22</u>	<u>31</u>	<u>3,738</u>	<u>11</u>	<u>13</u>	<u>2,302</u>

Derivative financial instruments held for trading allow the Bank and its clients to transfer, modify or reduce the currency and / or interest rate risk. In addition to standard currency derivatives (primarily forwards) used to manage currency risk, the Bank also contracts interest rate swaps to minimize the risk of interest rate fluctuations. The Bank does not use hedge accounting other than the individual derivatives as disclosed in this note. All derivatives have been agreed on the OTC market.

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

17. LOANS AND RECEIVABLES FROM CUSTOMERS

Analysis by type of product

	31.12.2019	31.12.2018
Kuna-denominated		
Retail customers	16,648	15,590
Corporate customers	9,680	9,690
Foreign-currency denominated		
Retail customers	98	78
Corporate customers	<u>2,668</u>	<u>2,735</u>
Total gross loans and receivables	29,094	28,093
Impairment allowance	<u>(2,123)</u>	<u>(2,545)</u>
	<u>26,971</u>	<u>25,548</u>

Included in the loans and receivables from customers are loans incorporating a currency clause, linked to euro (EUR), Swiss franc (CHF) and US dollar (USD), which amount to HRK 12,505 million (2018: HRK 12,556 million). Repayments of principal and interest are determined in the foreign currency and paid in the kuna-equivalent amount translated at the foreign exchange rate applicable on the date of payment. Deferred loan origination fees included in the net loan balance amount to HRK 41 million (2018: HRK 51 million).

2019

Movement in gross carrying amount:

	Stage 1	Stage 2	Stage 3	POCI	Total
Balance as of 31 December 2018	23,520	1,609	1,698	1,266	28,093
Net new approvals / (termination) of recognition*	1,881	(66)	(279)	(170)	1,366
Transfer to Stage 1	579	(498)	(81)	-	-
Transfer to Stage 2	(1,407)	1,498	(91)	-	-
Transfer to Stage 3	(186)	(305)	491	-	-
Sale of receivables	-	-	(54)	(151)	(205)
Written off	-	-	(30)	(130)	(160)
Balance as of 31 December 2019	<u>24,387</u>	<u>2,238</u>	<u>1,654</u>	<u>815</u>	<u>29,094</u>

*does not include write offs and sale of receivables

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

17. LOANS AND RECEIVABLES FROM CUSTOMERS (CONTINUED)

Movement in impairment allowance:

	Stage 1	Stage 2	Stage 3	POCI	Total
Balance as of 31 December 2018	187	108	1,113	1,137	2,545
Net new approvals / (termination) of recognition	(8)	(44)	76	(168)	(144)
Transfer to Stage 1	(5)	5	-	-	-
Transfer to Stage 2		18	(18)	-	-
Transfer to Stage 3	33	-	(33)	-	-
Exchange differences	-	-	7	-	7
Increase due to change of parameters	-	-	26	-	26
Sale of receivables	-	-	(31)	(120)	(151)
Written off	-	-	(30)	(130)	(160)
Balance as of 31 December 2019	207	87	1,110	719	2,123

Agrokor settlement

On 1 March 2019, the Commercial Court in Zagreb accepted the proposal of the special Commissioner and the Temporary Creditors' Council of 28 February 2019, and determined that the commencement date of the implementation of the settlement, the commencement of the implementation of the restructuring measures and actions provided for in the settlement shall be 1 April 2019. As of 1 April 2019, the Bank implemented settlement effects in its books, the derecognition of existing financial instruments was made, as well as the recognition of new financial instruments attributable to the Bank after the settlement. Receivables that were transferred to off-balance sheet records at the end of 2018 were also completely written off.

The new instruments consist of loans carried at amortized cost and are disclosed in Note 17 in the nominal value of HRK 55.7 million and of securities disclosed in Note 16 Financial asset and liabilities at fair value through profit or loss.

2018

Movement in gross carrying amount:

	Stage 1	Stage 2	Stage 3	POCI	Total
Balance as of 1 January 2018	9,166	1,036	1,819	-	12,021
Net new approvals / (termination) of recognition	499	20	(201)	(19)	299
Transfer to Stage 1	514	(472)	(42)	-	-
Transfer to Stage 2	(494)	555	(61)	-	-
Transfer to Stage 3	(137)	(53)	190	-	-
Acquired by merger of Splitska banka	13,972	523	249	1,508	16,252
Written off	-	-	(256)	(223)	(479)
Balance as of 31 December 2018	23,520	1,609	1,698	1,266	28,093

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

17. LOANS AND RECEIVABLES FROM CUSTOMERS (CONTINUED)

Movement in impairment allowance:

	Stage 1	Stage 2	Stage 3	POCI	Total
Balance as of 1 January 2018	61	50	1,238	-	1,349
Net new approvals / (termination) of recognition	(44)	25	28	11	20
Transfer to Stage 1	33	(20)	(13)	-	-
Transfer to Stage 2	(4)	26	(22)	-	-
Transfer to Stage 3	(1)	(6)	7	-	-
Acquired by merger of Splitska banka	143	33	133	1,349	1,658
Exchange differences	(1)	-	(2)	-	(3)
Written off	-	-	(256)	(223)	(479)
Balance as of 31 December 2018	187	108	1,113	1,137	2,545

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

17. LOANS AND RECEIVABLES FROM CUSTOMERS (CONTINUED)

Concentration of loans and receivables from customers by industry:

Gross carrying amount before impairment allowance:

	31.12.2019	31.12.2018
Public administration and defence	2,223	2,520
Trade	1,742	2,045
Construction	1,737	1,776
Hotel and restaurant trade	1,148	718
Other production	375	519
Non-metal mineral and chemical products	722	581
Transport and communications	707	420
Food and beverage production	495	439
Metal industry, machinery and transportation	461	478
Publishing	446	455
Wood processing and paper production	376	359
Energy, gas and water supply	393	348
Agriculture, forestry and fisheries	391	302
Real estate property	290	308
Education, health and social security	234	264
Financial intermediation	218	450
Other manufacturing industries	161	235
Other services and social activities	153	129
Mining	76	79
Total corporate loans	<u>12,348</u>	<u>12,425</u>
Retail customers	<u>16,746</u>	<u>15,668</u>
	<u>29,094</u>	<u>28,093</u>
Impairment allowance	<u>(2,123)</u>	<u>(2,545)</u>
	<u>26,971</u>	<u>25,548</u>

Notes to the financial statements (continued)

For the year ended 31 December 2019

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18. FINANCIAL ASSETS AT FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME

	31.12.2019	31.12.2018
Equity securities	111	78
Debt securities	6,094	5,265
	6,205	5,343

(a) Equity securities

	31.12.2019	31.12.2018
Listed	108	74
Unlisted	3	4
	111	78

This note includes equity securities that are not held for trading nor are acquired through acquisitions to which IFRS 3 applies. In accordance with OTP Bank Nyrt policies, they are held at fair value through other comprehensive income – the option of fair value through other comprehensive income.

Non-marketable equity securities whose fair value cannot be measured reliably are recorded at investment cost and they amount to HRK 3 million (2018: HRK 4 million). There is no active market for these securities. Other listed equity securities for which fair value can be measured reliably are held at fair value through other comprehensive income – the option of fair value through other comprehensive income. The equity shares valuation method is explained in Note 41.

The impact of changes in fair value through other comprehensive income is disclosed in Note 31 and 18b.

The Bank received dividends of HRK 683 thousand from VISA International in 2019 (2018: HRK 392 thousand). The equity ownership in VISA International is listed.

Other companies included in the consolidation did not receive any dividend income except for OTP leasing to which SB Leasing, in liquidation in 2019 paid out the full profit for 2018 in the amount of HRK 4,235 thousand.

Overview of the Bank's investments in equity securities with a breakdown of listed and unlisted securities is given below.

Company name	Type of investment	Listed/ unlisted
VISA International	Preferential share	listed
VISA International	Ordinary share	listed
Zagrebačka burza d.d.	Ordinary share	listed
Hrvatski nogometni klub Hajduk Split š.d.d.	Ordinary share	unlisted
Hrvatski registar obveza po kreditima d.o.o.	Investment in ltd.	unlisted
Istarska autocesta d.o.o.	Investment in ltd.	unlisted
Središnje klirinško depozitarno društvo d.d.	Ordinary share	unlisted
SWIFT-Fortis Bank	Preferential share	unlisted
Tržište novca i kratkoročnih vrijednosnica	Ordinary share	unlisted

In 2019, the Bank increased its stake in OTP Leasing to 60% (2018 10%). Accordingly, the share in the said company in the amount of HRK 48 million is shown in Note 20 Investments in Subsidiaries in 2019 (in 2018, the share amounted to HRK 1 million and is disclosed in Note 18, under unlisted equity securities).

Notes to the financial statements (continued)

For the year ended 31 December 2019

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18. FINANCIAL ASSETS AT FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME (CONTINUED)

(b) Debt securities

	31.12.2019	31.12.2018
Bonds of the Croatian Ministry of Finance	2,959	2,747
Foreign government bonds	<u>787</u>	<u>620</u>
Total listed securities	3,746	3,367
Treasury bills of the Croatian Ministry of Finance	<u>2,348</u>	<u>1,898</u>
Total unlisted securities	2,348	1,898
	<u>6,094</u>	<u>5,265</u>

Treasury bills of the Republic of Croatia include short-term HRK and foreign currency long-term bills. In financial assets measured at fair value through other comprehensive income, the Bank classifies debt securities that it intends to hold for collection or sale, and which have met the requirements of the SPPI test. The SPPI test is performed on homogeneous groups of securities.

2019

Movement of gross carrying amount of debt securities:

	Stage 1	Stage 2	Stage 3	POCI	Total
Balance at 31 December 2018	5,265	-	-	-	5,265
Net new approvals / (termination of recognition)	<u>829</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>829</u>
Balance at 31 December 2019	<u>6,094</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>6,094</u>

Movement of impairment allowance included in equity in other reserves (Note 31):

	Stage 1	Stage 2	Stage 3	POCI	Total
Balance at 31 December 2018	11	-	-	-	11
Net increase / (decrease)	<u>(5)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(5)</u>
Balance at 31 December 2019	<u>6</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>6</u>

Notes to the financial statements (continued)

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(All amounts are expressed in millions of HRK)

18. FINANCIAL ASSETS AT FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME (CONTINUED)

2018

Movement of gross carrying amount of debt securities:

	Stage 1	Stage 2	Stage 3	POCI	Total
Balance at 1 January 2018	1,738	-	-	-	1,738
Net new approvals / (termination of recognition)	(114)	-	-	-	(114)
Acquired by merger of Splitska banka	3,641	-	-	-	3,641
Balance at 31 December 2018	5,265	-	-	-	5,265

Movement of impairment allowance included in equity in other reserves (Note 31):

	Stage 1	Stage 2	Stage 3	POCI	Total
Balance at 1 January 2018	4	-	-	-	4
Acquired by merger of Splitska banka	7	-	-	-	7
Balance at 31 December 2018	11	-	-	-	11

19. FINANCIAL ASSETS MEASURED AT AMORTISED COST

	31.12.2019	31.12.2018
Bonds of the Republic of Croatia	16	16
Corporate Bonds	236	234
Corporate bills of exchange	4	120
	256	370
Impairment allowance	(19)	(83)
	237	287

In financial assets measured at amortized cost, the Bank classifies debt securities that it intends to hold for collection, and which have met the requirements of the SPPI test.

The SPPI test is performed on homogeneous groups of securities.

Receivables for unissued Bonds of the Republic of Croatia refer to receivables arising from the purchase of socially-owned apartments for which the Republic of Croatia has never officially issued bonds, and accordingly the Bank made a 100% impairment for the entire amount of receivables.

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

19. FINANCIAL ASSETS MEASURED AT AMORTISED COST (CONTINUED)

2019

Movement in gross carrying amount:

	Stage 1	Stage 2	Stage 3	POCI	Total
Balance at 31 December 2018	248	-	104	18	370
Net new approvals / (termination of recognition)	(8)	-	(88)	(18)	(114)
Balance at 31 December 2019	240	-	16	-	256

Movement in impairment allowance:

	Stage 1	Stage 2	Stage 3	POCI	Total
Balance at 31 December 2018	-	-	75	8	83
Net new approvals / (termination of recognition)	3	-	(59)	(8)	(64)
Balance at 31 December 2019	3	-	16	-	19

2018

Movement in gross carrying amount:

	Stage 1	Stage 2	Stage 3	POCI	Total
Balance at 1 January 2018	-	-	164	-	164
Net new approvals / (termination of recognition)	-	-	(1)	-	(1)
Acquired by merger of Splitska banka	248	-	-	69	317
Write off	-	-	(59)	(51)	(110)
Balance at 31 December 2018	248	-	104	18	370

Movement in impairment allowance:

	Stage 1	Stage 2	Stage 3	POCI	Total
Balance at 1 January 2018	-	-	125	-	125
Net new approvals / (termination of recognition)	(1)	-	9	-	8
Acquired by merger of Splitska banka	1	-	-	59	60
Write off	-	-	(59)	(51)	(110)
Balance at 31 December 2018	-	-	75	8	83

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

20. INVESTMENT IN SUBSIDIARIES

31.12.2019	Headquarter	Ownership percentage	Industry	Investment (acquisition cost after impairment)	Bank's share of net assets
OTP Nekretnine d.o.o.	Zagreb	100%	Organization of project implementation for buildings	260	271
OTP Invest d.o.o.	Zagreb	74.33%	Fund management activities	1	1
Aventin d.o.o. in liquidation	Zadar	100%	Renting and operating of own or leased real estate (leasing)	-	2
OTP Savjetovanje d.o.o.	Zagreb	100%	Business and management consultancy	2	2
OTP Osiguranje d.d.	Zagreb	100%	Life insurance	54	63
OTP Leasing d.d.	Zagreb	60%	Finance and operating lease	48	89
Total investment in subsidiaries:				365	428

Cresco d.o.o. (activity: Real estate business) is 100% owned by OTP Nekretnine d.o.o.

The investment cost is HRK 0 million and the share of OTP Nekretnine in net assets is HRK 2 million.

SB Leasing d.o.o., in liquidation (activity: Finance and operating lease) is 100% owned by OTP Leasing d.d.

Changes in investments in subsidiaries are presented in detail in Note 1.

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

20. INVESTMENT IN SUBSIDIARIES (CONTINUED)

31.12.2018	Headquarter	Ownership percentage	Industry	Investment (acquisition cost after impairment)	Bank's share of net assets
OTP Nekretnine d.o.o.	Zadar	100,00%	Organization of project implementation for buildings	52	58
OTP Invest d.o.o.	Zagreb	74,33%	Fund management activities	8	4
OTP Aventin d.o.o.	Zadar	100,00%	Renting and operating of own or leased real estate (leasing)	-	(55)
OTP Savjetovanje d.o.o.	Zagreb	100,00%	Business and management consultancy	1	1
SB Zgrada d.o.o.	Split	100,00%	Real estate business	208	211
OTP Osiguranje d.d.	Zagreb	100,00%	Life insurance	54	63
Total investment in subsidiaries:				323	282

Cresco d.o.o. (activity: real estate business) is 100% owned by OTP Nekretnine d.o.o. The investment cost is HRK 0 million and the share of OTP Nekretnine in net assets is HRK 0 million.

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

20. INVESTMENT IN SUBSIDIARIES (CONTINUED)

Acquired assets and liabilities of Splitska banka d.d. at the date of merger as of 1 December 2018 (shown in accordance with the Bank's methodology):

	Note	Carrying amount	Fair value adjustment	Total acquired by merger
ASSETS				
Cash and balances with Croatian National Bank	14	4,661	-	4,661
Loans and receivables from banks	15	272	-	272
Financial assets at fair value through profit or loss	16	168	-	168
Loans and receivables from customers	17	14,594	-	14,594
Financial assets at fair value through other comprehensive income	18	3,677	-	3,677
Financial asset measured at amortised cost	19	257	-	257
Investment in subsidiaries	20	256	8	264
Property and equipment	21	82	71	153
Investment property	22	22	7	29
Intangible assets	23	20	162	182
Deferred tax asset	12	26	-	26
Receivables for income tax		1	-	1
Other Assets	25	44	-	44
TOTAL ASSETS		24,080	248	24,328

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

20. INVESTMENT IN SUBSIDIARIES (CONTINUED)

	Note	Carrying amount	Fair value adjustment	Total acquired by merger
LIABILITIES				
Amounts due to other banks	26	160	-	160
Amounts due to customers	27	18,872	-	18,872
Other borrowed funds	28	722	-	722
Financial liabilities at fair value through profit or loss	16	8	-	8
Provisions for liabilities and charges	29	276	-	276
Other liabilities	30	186	-	186
Deferred tax liabilities		-	39	39
Liabilities based on fair valued loans		-	32	32
Total liabilities		20,224	71	20,295
SHAREHOLDERS' EQUITY AND RESERVES				
Total equity and reserves without profit for the year		3,531	-	3,531
Profit for the year		325	-	325
Adjustment on equity		-	177	177
Total share capital and reserves	31	3,856	177	4,033
TOTAL LIABILITIES, SHARE CAPITAL AND RESERVES		24,080	248	24,328

Liabilities based on fair value of loans are the result of acquiring Splitska banka d.d. and calculating goodwill.

Equity adjustment for acquisition cost of Splitska banka d.d.:

Total share capital and reserves of Splitska banka d.d. acquired by merger	4,033
Adjustment for the acquisition cost of Splitska banka d.d.	<u>(3,172)</u>
The effect of merger on the Bank's equity and reserves	<u>861</u>

The effect of the merger on the Bank's capital and reserves is the result of the bargain purchase (goodwill) at the date of acquisition and profit of Splitska banka in the period from the acquisition date to the date of merger. That effect is presented within fair value reserves in amount of HRK 58 million and retained earnings in amount of HRK 803 million (Note 31). Amount that is presented within retained earnings consists of bargain purchase (goodwill) calculated as difference between net fair value of Splitska banka at acquisition date and acquisition cost in amount of HRK 398 million. The remaining part is profit of Splitska banka from the acquisition date till migration date and effect of changes on positions presented at fair value at the acquisition date in amount of HRK 405 million.

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

21. PROPERTY AND EQUIPMENT

Assets recorded in accordance with IAS 16

	Land and buildings	Computers	Furniture and equipment	Motor vehicles and other	Assets under construction	Total
Cost						
Balance at 1 January 2018	327	73	164	5	49	618
Acquired by merger of Splitska banka	141	48	23	1	15	228
Reclassification in Investment property	(50)					(50)
Transfer from assets under construction	25	23	17	1	(66)	-
Additions	-	-	-	-	51	51
Disposals and retirements	-	(1)	(6)	-	(4)	(11)
Balance at 31 December 2018	443	143	198	7	45	836
Balance at 1 January 2019	443	143	198	7	45	836
Transfer from assets under construction	19	28	15	-	(62)	-
Additions	-	-	-	-	67	67
Disposals and retirements	-	(9)	(10)	(1)	(13)	(33)
Balance at 31 December 2019	462	162	203	6	37	870
Accumulated depreciation and impairment						
Balance at 1 January 2018	161	62	127	2	-	352
Acquired by merger of Splitska banka	52	17	6	-	-	75
Reclassification in Investment property	(15)					(15)
Charge for the year	9	9	13	1	-	32
Disposals and retirements	-	(1)	(6)	-	-	(7)
Balance at 31 December 2018	207	87	140	3	-	437
Balance at 1 January 2019	207	87	140	3	-	437
Charge for the year	16	23	17	1	-	57
Disposals and retirements	-	(8)	(9)	(1)	-	(18)
Balance at 31 December 2019	223	102	148	3	-	476
Net carrying amount						
Balance at 31 December 2018	236	56	58	4	45	399
Balance at 31 December 2019	239	60	55	3	37	394

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

21a ASSETS AND LIABILITIES CLASSIFIED ACCORDING TO IFRS 16 - application from 1 January 2019

Assets classified under IFRS 16

	Land and buildings	Furniture and equipment	Motor vehicles and other	Total
Balance at 31 December 2018	-	-	-	-
Initial application	183	5	2	190
Balance at 1 January 2019	183	5	2	190
Additions	17	-	3	20
Disposals and retirements	-	-	-	-
Balance at 31 December 2019	200	5	5	210
Balance at 31 December 2018	-	-	-	-
Depreciation and amortisation cost for the year	-	-	-	-
Balance at 1 January 2019	-	-	-	-
Depreciation and amortisation cost for the year	32	2	1	35
Balance at 31 December 2019	32	2	1	35
Net carrying amount				
Balance at 1 January 2019	183	5	2	190
Balance at 31 December 2019	168	3	4	175

Lease liabilities classified under IFRS 16

At 31 December, lease liabilities amounted to HRK 179 million. The opening balance as of 1 January 2019 amounted to HRK 190 million.

Lease liabilities IFRS 16 - residual maturity (undiscounted amount):

	Up to 1 month	1 to 3 months	3 months to 1 year	1 to 3 years	Over 3 years	Total
Total lease liabilities	3	10	25	76	84	198

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

22. INVESTMENT PROPERTY

	Investment property
Cost	
Balance at 1 January 2018	-
Reclassification from property under IAS 16 (Note 21)	50
Acquired by merger of Splitska banka	29
Balance at 31 December 2018	79
Balance at 1 January 2019	79
Additions	-
Disposals and retirements	-
Balance at 31 December 2019	79
Impairment	
Balance at 1 January 2018	-
Reclassification from property under IAS 16 (Note 21)	15
Charge for the year	-
Disposals and retirements	-
Balance at 31 December 2018	15
Balance at 1 January 2019	15
Charge for the year	1
Disposals and retirements	-
Balance at 31 December 2019	16
Net carrying amount	
Balance at 31 December 2018	64
Balance at 31 December 2019	63

Investment property includes real estate not used by the Bank for operational purposes, but assets intended for sale or lease. The Bank will reclassify the assets it intends to sell in accordance with IFRS 5 when all of the requirements prescribed by said IFRS are met. Assets held for sale are presented in Note 25. The total fair value of investment property is HRK 69 million.

Investment property in 2018 includes also real estate in the amount of HRK 29 million acquired through the merger of Splitska banka.

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

23. INTANGIBLE ASSETS

	Leasehold improvements	Software	Contracts with clients	Asset acquired but not brought into use	Total
Cost					
Balance at 1 January 2018	58	103	-	7	168
Acquired by merger of Splitska banka	39	241	283	4	567
Transfer from assets under development	4	7	-	(11)	-
Additions	-	-	-	37	37
Disposals and retirements	(4)	-	-	(2)	(6)
Balance at 31 December 2018	97	351	283	35	766
Balance at 1 January 2019	97	351	283	35	766
Transfer from assets under development	3	41	-	(44)	-
Additions	-	-	-	34	34
Disposals and retirements	(13)	-	-	(6)	(19)
Balance at 31 December 2019	87	392	283	19	781
Accumulated depreciation and impairment					
Balance at 1 January 2018	50	86	-	-	136
Acquired by merger of Splitska banka	33	231	121	-	385
Charge for the year	2	10	5	-	17
Disposals and retirements	(4)	-	-	-	(4)
Balance at 31 December 2018	81	327	126	-	534
Balance at 1 January 2019	81	327	126	-	534
Charge for the year	4	25	49	-	78
Disposals and retirements	(13)	-	-	-	(13)
Balance at 31 December 2019	72	352	175	-	599
Net carrying amount					
Balance at 31 December 2018	17	24	157	34	232
Balance at 31 December 2019	15	40	108	19	182

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

24. OTHER ASSETS

	31.12.2019	31.12.2018
Other financial assets		
Accrued fees and commissions	50	46
Accounts receivable	43	39
Receivables in respect of credit card operations	<u>68</u>	<u>40</u>
Other asset that is subject to impairment in accordance with IFRS 9	161	125
Impairment allowance	(49)	(31)
Net other assets after impairment	<u>112</u>	<u>94</u>
Other non-financial assets		
Asset taken in lieu for uncollected receivables	6	12
Prepaid expenses	6	9
Other	<u>11</u>	<u>11</u>
Other non-financial assets (not subject to impairment in accordance with IFRS 9)	<u>23</u>	<u>32</u>
	<u>135</u>	<u>126</u>

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

24. OTHER ASSETS (CONTINUED)

Movement in gross carrying amount:

	Stage 1	Stage 2	Stage 3	POCI	Total
Balance at 1 January 2018	43	-	13	-	56
Net new approvals / (termination of recognition)	21	(1)	(2)	-	18
Acquired by merger of Splitska banka	32	1	3	15	51
Balance at 31 December 2018	96	-	14	15	125
Net new approvals / (termination of recognition)	8	-	30	-	38
Transfer to Stage 1	1	-	(1)	-	-
Transfer to Stage 2	-	-	-	-	-
Transfer to Stage 3	(2)	-	17	(15)	-
Write off	-	-	(2)	-	(2)
Balance at 31 December 2019	103	-	58	-	161

Movement in impairment allowance:

	Stage 1	Stage 2	Stage 3	POCI	Total
Balance at 1 January 2018	-	-	12	-	12
Net increase / (decrease)	-	-	(1)	-	(1)
Acquired by merger of Splitska banka	2	-	3	15	20
Balance at 31 December 2018	2	-	14	15	31
Net increase / (decrease)	(1)	-	21	-	20
Transfer to Stage 1	1	-	(1)	-	-
Transfer to Stage 2	-	-	-	-	-
Transfer to Stage 3	-	-	15	(15)	-
Write off	-	-	(2)	-	(2)
Balance at 31 December 2019	2	-	47	-	49

25. NON-CURRENT ASSETS HELD FOR SALE

The Bank reclassifies assets acquired in the course of collection to assets held for sale in accordance with IFRS 5 Non-current Assets Held for Sale.

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

26. AMOUNTS DUE TO OTHER BANKS

	31.12.2019	31.12.2018
Demand deposits		
Kuna-denominated	102	102
Foreign-currency denominated	19	21
Term deposits	<u>1,688</u>	<u>530</u>
	<u>1,809</u>	<u>653</u>

27. AMOUNTS DUE TO CUSTOMERS

	31.12.2019	31.12.2018
Retail customers		
Demand deposits		
Kuna-denominated	6,133	5,127
Foreign-currency denominated	9,439	8,511
Term deposits		
Kuna-denominated	1,747	1,820
Foreign-currency denominated	<u>6,265</u>	<u>7,358</u>
	<u>23,584</u>	<u>22,816</u>
Corporate customers		
Demand deposits		
Kuna-denominated	6,928	6,339
Foreign-currency denominated	1,932	2,494
Term deposits		
Kuna-denominated	555	838
Foreign-currency denominated	<u>552</u>	<u>573</u>
	<u>9,967</u>	<u>10,244</u>
	<u>33,551</u>	<u>33,060</u>

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

28. OTHER BORROWED FUNDS

	31.12.2019	31.12.2018
Domestic lenders:		
HBOR (Croatian Bank for Reconstruction and Development)	1,107	1,324
Ministry of Finance	3	3
Others	<u>2</u>	<u>1</u>
	<u>1,112</u>	<u>1,328</u>

(a) Liabilities to the Croatian Bank for Reconstruction and Development (HBOR)

Funds borrowed from HBOR are designated for approving loans to end-beneficiaries – corporate and retail customers – under the programmes supported by HBOR.

(b) Liabilities to the Ministry of Finance

This is a liability to the Croatian Ministry of Finance transferred from Dubrovačka banka and relates to interest on the so-called “frozen” foreign currency savings.

(c) Other borrowed funds

This obligation relates to the commitment to the Fund for financing employment growth in economically inadequately developed and highly migrant areas of the SFRY (former Yugoslavia) to finance employment growth in economically underdeveloped areas. The funds were intended for the establishment of private entities for the returnee from temporary work from the Federal Republic of Germany. These funds were transferred to banks, which were granted to individuals with the irrevocable guarantee of the Fund.

29. PROVISIONS FOR LIABILITIES AND CHARGES

	31.12.2019	31.12.2018
Litigation provision	253	212
Provision for severance and retention payments	110	208
Provisions for overpayments and conversion of CHF loans	<u>10</u>	<u>10</u>
	373	430
Provisions for off-balance sheet items (Note 32)	<u>111</u>	<u>109</u>
	<u>484</u>	<u>539</u>

Litigation provision related to legal actions against the Bank, i.e. where the Bank is the defendant, amount to HRK 253 million (2018: HRK 212 million).

Provisions for litigation are calculated in accordance with IAS 37 (Note 2.24 and Note 3).

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

29. PROVISIONS FOR LIABILITIES AND CHARGES (CONTINUED)

Provisions for legal cases for loans in Swiss francs:

Provisions for legal cases regarding the CHF loans are presented within the litigation provisions, and amount to HRK 56 million (2018: HRK 8 million). The increase in provisions compared to 2018 is the result of increased number of lawsuits against the Bank received during 2019.

The Bank estimates each CHF loan lawsuit on an individual basis and sets the provision accordingly, rather than setting a lump sum provision for all lawsuits.

The provisions recognised in the financial statements are measured using all currently available information and represent the best estimate of the liabilities considering significant uncertainties related to their timing and amount.

The Bank is of the opinion that, taking into consideration all above mentioned, the outcome of the already received legal claims is not expected to give rise to any significant loss exceeding the provision provided for at 31 December 2019.

Events related to loans in Swiss francs

In September 2019 the Supreme Court of the Republic of Croatia brought a ruling, that, in a large extent, confirms the earlier ruling of the High Commercial Court of the Republic of Croatia dated June 2018, in the case of protection of collective interest and rights of the consumers who had taken loans with principals indexed to Swiss franc (Ruling No. Rev- 2221/2018- 11 of the Supreme Court of the Republic of Croatia, hereinafter referred to as "the Ruling").

At this point, it is not yet possible to ascertain the consequences of the Ruling reached in the procedure initiated for the protection of collective interests and rights of the consumers with CHF-indexed loans.

Thus, possible financial ramifications of this Ruling on the Bank will ultimately depend on: the number of individual law suits submitted by the customers, amounts claimed by the customers in such law suits, rulings of the competent courts, legal interpretations of the Supreme Court of the Republic of Croatia given in respect of the appeals on points of law or in model procedures, which will be binding for the lower instance courts, and the legal possibility to question the position of the session of the Civil Division of the Supreme Court of the Republic of Croatia regarding the start of the statute of limitations for restitution claims from null and void contracts in individual cases, up to filing a complaint with the Constitutional Court of the Republic of Croatia.

As such, possible liabilities of the Bank arising from the ruling of competent courts in relation to individual law suits submitted by the customers are considered contingent liabilities.

Based on all available evidence and taking into account the degree of uncertainty in relation to the outcome of future events related to the Ruling, the judgement of the management is that it is not possible to adequately estimate the outcome and financial effect of the respective contingent liabilities.

As permitted by IAS 37.92, in order not to prejudice the outcomes of the proceedings and the interests of the Bank, no further disclosures are made about the contingent liabilities in connection with the Ruling.

Severance and retention payment provisions in the amount of HRK 110 million (2018: HRK 208 million) contain provisions for:

- employee restructuring liabilities - HRK 99 million (2018: HRK 201 million)
- liability for severance pay and jubilee awards HRK 11 million (2018: HRK 7 million)

Provisions in the amount of HRK 99 million have been formed in accordance with IAS 37 under the restructuring plan or by the sector which includes a detailed list of employees and sectors included in the plan, the expenses that will be incurred for each employee and the implementation date, and will be used during 2020 and 2021 until the final completion of the restructuring process.

Provisions for severance payments and jubilee awards are formed in accordance with IAS 19. Provisions expenses under IAS 19 are presented in Note 10 Employee expenses.

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

29. PROVISIONS FOR LIABILITIES AND CHARGES (CONTINUED)

Litigation provision

	2019	2018
Balance at 1 January	212	131
Acquired by merger of Splitska banka	-	77
Paid out	(4)	-
Net charge to statement of profit or loss (Note 11)	45	4
Balance at 31 December	253	212

Provision for severance and retention payments

	2019	2018
Balance at 1 January	208	100
Acquired by merger of Splitska banka	-	117
Paid out	(102)	(5)
Net charge to statement of profit or loss (Note 10)	4	(4)
Balance at 31 December	110	208

Provisions for other liabilities

	2019	2018
Balance as of 1 January	10	3
Acquired by merger of Splitska banka	-	8
Conversions completed by the year-end	-	(1)
Balance as of 31 December	10	10

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

30. OTHER LIABILITIES

	31.12.2019	31.12.2018
Liabilities in respect of credit card operations	125	112
Amounts due to suppliers	54	81
Funds in transfer	98	49
Accrued expenses for bonuses and other employee benefits	56	64
Salaries and contributions payable	29	32
Liability for payments of deposits previously credited to income	9	15
Liabilities in respect of opening of accounts (escrow accounts)	7	12
Due to State Agency for Deposit insurance and Bank Rehabilitation for saving deposits insurance	15	13
Liabilities for fees	1	9
Accrued expenses	34	2
Advances received	2	2
Value added tax payable	3	5
Other liabilities	22	38
	<u>455</u>	<u>434</u>

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

31. SHAREHOLDERS' EQUITY AND RESERVES

SHARE CAPITAL

As of 31 December 2019 the share capital of the Bank consisted of 19,968,774 ordinary shares (2018: 19,968,774 ordinary shares), with a nominal value of HRK 200 each, which represents HRK 3,993,755 thousand of equity capital of the Bank (2018: HRK 3,993,755 thousand). All ordinary shares provide equal rights and carry one vote per share.

There were no dividend payments during 2018.

During 2019, the Bank paid a dividend of HRK 491 million. The Bank's subsidiaries in the Republic of Croatia did not have any dividend payments during 2019.

The Bank does not plan to pay a dividend from profit for 2019.

SHARE PREMIUM

The premium on issued shares consists of premiums arising from the issuance of new ordinary shares from previous years in the amount of HRK 167 million and from the premiums arising from the purchase of own ordinary shares from previous years in the amount of HRK 4 million.

RESERVES

Legal and statutory reserves

	31.12.2019	31.12.2018
Statutory reserves	200	44
Legal reserves	199	43
	<u>399</u>	<u>87</u>

The legal reserve has been formed in accordance with Croatian law, which requires 5% of the profit for the year to be transferred to this reserve until it reaches 5% of the issued share capital. The legal reserve, in the amount of up to 5% of the issued share capital, can be utilised to cover current and prior year losses. In addition, in accordance with the Bank's Statute, an additional reserve equivalent to the legal reserve has been created in an amount of up to 5% of the share capital for the purpose of covering impairment losses and for the same purposes as the legal reserve. Changes in other reserves are reflected in the Statement of changes in shareholders' equity.

Fair value reserves

	31.12.2019	31.12.2018
Reserve for measuring fair value of financial asset at fair value through other comprehensive income – equity instruments	59	31
Reserve for measuring fair value of financial asset at fair value through other comprehensive income – debt instruments	145	66
Expected credit losses on financial asset at fair value through other comprehensive income (Note 18)	6	11
Total fair value reserves:	<u>210</u>	<u>108</u>

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

31. SHAREHOLDERS' EQUITY AND RESERVES (CONTINUED)

Fair value reserves (continued)

Movement in the fair value reserves is as following:

Equity instruments

	2019	2018
Balance as of 1 January	31	20
Acquired by merger of Splitska banka – before tax	-	9
Acquired by merger of Splitska banka – tax	-	(2)
Increase / decrease in reserves	34	5
Tax	(6)	(1)
Balance as of 31 December of the current year	59	31

Debt instruments

	2019	2018
Balance as of 1 January	66	29
Acquired by merger of Splitska banka – before tax	-	53
Acquired by merger of Splitska banka – tax	-	(9)
Increase / decrease in reserves (Note 31)	97	(9)
Tax	(18)	2
Balance as of 31 December of the current year	145	66

Fair value reserve comprises unrealized gains and losses from the change in the fair value of financial assets through other comprehensive income.

General banking risks reserves

	31.12.2019	31.12.2018
General banking risks reserves	106	106
Other reserves	3	3
Total other reserves	109	109

According to earlier CNB regulations, the Bank had to create reserves for general banking risks if the increase in balance sheet and off-balance sheet exposures exceeded 15% of the corresponding balance sheet and off-balance sheet exposures of the previous year.

The general banking risk reserve was not transferable to retained earnings or other reserves, or otherwise distributable until the expiry of a consecutive three-year period from the period in which the Bank reported an annual growth over 15%. As the three-year period expired in 2011, the reserve was available to be utilised by the Bank as the Bank's retained earnings.

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

31. SHAREHOLDERS' EQUITY AND RESERVES (CONTINUED)

Other reserves

Other reserves of the Bank refer to the funds collected on the bonds of the Republic of Croatia (Big Bonds from 2004).

RETAINED EARNINGS

Retained earnings refer to the cumulative gains of the Bank retained in previous years adjusted for the dividend paid in 2019. Movement of retained earnings is presented in Unconsolidated statement of changes in shareholders' equity.

32. CONTINGENT LIABILITIES AND COMMITMENTS

	31.12.2019	31.12.2018
Guarantees	1,483	1,517
Letters of credit	39	48
Approved unused facilities and global lines	<u>6,370</u>	<u>6,066</u>
	7,892	7,631
Impairment provisions for contingent liabilities and commitments	<u>(111)</u>	<u>(109)</u>
	<u>7,781</u>	<u>7,522</u>

2019

Movement of gross carrying amount:

	Stage 1	Stage 2	Stage 3	POCI	Total
Balance as of 31 December 2018	7,510	-	121	-	7,631
Net new approvals / (termination of recognition)	303	-	(42)	-	261
Transfer to Stage 1	(8)	-	8	-	-
Transfer to Stage 2	-	-	-	-	-
Transfer to Stage 3	<u>23</u>	-	<u>(23)</u>	-	-
Balance as of 31 December 2019	<u>7,828</u>	-	<u>64</u>	-	<u>7,892</u>

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

32. CONTINGENT LIABILITIES AND COMMITMENTS (CONTINUED)

Movement in impairment allowance:

	Stage 1	Stage 2	Stage 3	POCI	Total
Balance as of 31 December 2018	51	-	58	-	109
Net new approvals / (termination of recognition)	17	-	(18)	-	(1)
Transfer to Stage 1	(1)	-	1	-	-
Transfer to Stage 2	-	-	-	-	-
Transfer to Stage 3	7	-	(7)	-	-
Increase due to change of risk parameters			3		3
Balance as of 31 December 2019	74	-	37	-	111

2018

Movement of gross carrying amount:

	Stage 1	Stage 2	Stage 3	POCI	Total
Balance as of 1 January 2018	1,309	50	42	-	1,401
Net new approvals / (termination of recognition)	400	(72)	(9)	-	319
Transfer to Stage 1	60	(45)	(15)	-	-
Transfer to Stage 2	-	-	-	-	-
Transfer to Stage 3	(4)	(1)	5	-	-
Acquired by merger of Splitska banka	5,745	68	98	-	5,911
Balance as of 31 December 2018	7,510	-	121	-	7,631

Movement in impairment allowance:

	Stage 1	Stage 2	Stage 3	POCI	Total
Balance as of 1 January 2018	10	5	5	-	20
Net new approvals / (termination of recognition)	4	(1)	11	-	14
Transfer to Stage 1	6	(4)	(2)	-	-
Transfer to Stage 2	-	-	-	-	-
Transfer to Stage 3	-	-	-	-	-
Acquired by merger of Splitska banka	31	-	44	-	75
Balance as of 31 December 2018	51	-	58	-	109

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

33. CASH AND CASH EQUIVALENTS

For the purposes of cash flow statements, cash and cash equivalent comprise the following balances with original maturities of up to 90 days:

	31.12.2019	31.12.2018
Cash and balances with Croatian National Bank (<i>Note 14</i>)	5,449	5,887
Loans and receivables from banks (<i>Note 15</i>)	<u>832</u>	<u>1,009</u>
	<u>6,281</u>	<u>6,896</u>

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

34. CAPITAL RISK MANAGEMENT

The Croatian National Bank ("the CNB"), as the Bank's principal regulator, determines and supervises the capital requirements of the Bank as a whole. The amount of capital allocated to individual operations is based primarily on regulatory requirements. The allocation of capital to specific activities is performed independent of individuals in charge of those activities. Although the maximisation of return on the risk-weighted capital is the key basis used in determining the allocation of capital to the Bank's individual activities, it is not the only basis in the decision-making process. Synergies with other activities, availability of the Management Board and other resources, as well as the alignment of the activities with the Bank's long-term strategic goals are also considered. The directors review the Bank's capital management and allocation policies regularly.

The capital adequacy ratio is determined as the ratio of the regulatory capital to the risk-weighted assets, risk exposures, the overall uncovered exposures, foreign exchange risk and operational risk.

The Bank's regulatory capital amounts to HRK 5,838 million (2018: HRK 5,288 millions) and is composed entirely of the Common Equity Tier 1 (CET1) capital. The capital adequacy ratio is 21.18% (2018: 20.19%).

During 2019, the Bank met and complied with all of the regulatory requirements defining the maintenance of a sufficient level of capital to cover all risks and required capital buffers. The Bank confirmed its strong and stable capital position.

In accordance with Article 92 of Regulation (EU) No. 575/2013, the prescribed minimum capital ratios are the following:

- ✓ ordinary share capital rate in the amount of 4.5% of total risk exposure,
- ✓ share capital rate in the amount of 6% of total risk exposure,
- ✓ total capital rate in the amount of 8% of total risk exposure.

In addition to the minimum capital rates, the Bank is on an individual basis, in accordance with Articles 117, 118 and 130 of the Credit Institutions Act and Articles 129, 130 and 133 of the Directive 2013/36/EU, also obliged to comply with the following protective layers of ordinary share capital:

- ✓ a buffer for capital safeguarding in the amount of 2.5% of total risk exposure,
- ✓ a buffer for structural systemic risk in the amount of 3% of total risk exposure,
- ✓ an institution-specific countercyclical capital buffer.

Credit institutions are required to maintain an institution-specific countercyclical capital buffer equivalent to their total exposure amount calculated in accordance with Article 92 (3) of Regulation (EU) No. 575/2013, multiplied by the weighted average of the countercyclical buffer rates calculated in accordance with Article 140 of the Directive 2013/36/EU. Based on an analytical assessment of the evolution of systemic risks of a cyclical nature, the CNB has determined that the rate of the countercyclical capital buffer is 0%.

Based on the CNB Decision, the Bank has been identified as Other Systemically Important Credit Institution (OSI Credit Institution) on a consolidated and individual basis. Consequently, the Bank is also obliged to maintain a buffer rate for the OSI Credit Institution amounting to 2% of the total amount of risk exposure in the form of ordinary share capital on an individual and consolidated basis. Given that the buffer layer for structural systemic risk, at the level of 3% of the total amount of risk exposure in the form of ordinary share capital, is higher than the buffer rate for the OSI Credit Institution, pursuant to Article 139 (1) and (3) of the Credit Institutions Act, the Bank maintains a buffer layer for structural systemic risk at a level of 3%, i.e. larger of the aforementioned two prescribed amounts.

The Bank's regulatory capital and capital rate have been calculated in accordance with the requirements of the European Banking Authority (hereinafter: EBA) and the national discretion of the CNB and are presented in the table below.

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

34. CAPITAL RISK MANAGEMENT (CONTINUED)

Regulatory capital

	31.12.2019	31.12.2018
Share capital	3,994	3,994
Share premium	171	171
Retained earnings	1,073	975
Other reserves	718	304
Transitional adjustments to ordinary share capital	54	55
Deductions under EBA requirements	(172)	(211)
Common Equity Tier 1 capital	5,838	5,288
Core capital	5,838	5,288
Regulatory capital	5,838	5,288
Risk-weighted assets and other risk components	27,562	26,195
Common Equity Tier 1 capital ratio	21.18%	20.19%
Core capital ratio	21.18%	20.19%
Total capital ratio	21.18%	20.19%

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

35. CREDIT RISK

The Bank is exposed to credit risk, which is the risk that the counterparty will not be able to settle in full the amounts owed as they fall due. The Bank structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to a single borrower, or a group of borrowers and industry segments. The Bank monitors the risks and reviews them on an annual or more frequent basis. The exposure to credit risk for all assets is limited by the carrying amount of each asset reported in the statement of financial position. The exposure to credit risk of derivatives which relate to foreign currencies is equal to the sum of the positive current market value of the underlying contract and the potential exposure to the counterparty risk. Additionally, the Bank is exposed to credit risk on off-balance-sheet items, which include undrawn commitments to extend credit, issued guarantees and letters of credit.

The Bank manages its exposure to credit risk by analysing regularly the ability of the borrowers and potential borrowers to repay interest and principal and by revising the credit limits, where necessary, or obtaining collateral, corporate or personal guarantees.

	Note	31.12.2019	31.12.2018
ASSETS			
Cash and balances with the Croatian National Bank	14	7,210	7,547
Loans and receivables from banks	15	851	1,026
Financial assets at fair value through profit or loss	16	22	11
Loans and receivables from customers	17	26,971	25,548
Financial assets that are valued through other comprehensive income	18b	6,094	5,265
Financial assets measured at amortized cost	19	237	287
Other financial assets	24	112	94
		<u>41,497</u>	<u>39,778</u>

Credit risk exposure is presented net of impairment provisions, without taking into account pledges and other collateral instruments.

The (gross) credit risk exposure for contingent liabilities and commitments (Note 32) is as follows:

	31.12.2019	31.12.2018
Guarantees and letters of credit	1,522	1,565
Approved unused facilities and other liabilities	<u>6,370</u>	<u>6,066</u>
	<u>7,892</u>	<u>7,631</u>

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

35. CREDIT RISK (CONTINUED)

Collateral and other forms of credit risk insurance

In the umbrella document – Rules on Securing of Receivables (November 2019), the Bank defines conditions under which certain collaterals, which serve to reduce credit risk, are acceptable, and methods of their initial and subsequent regular valuation.

The basic types of acceptable collaterals that are accepted with value are:

- for corporate lending: cash, state guarantees, bank guarantees, real estate, movable property, transfers of state claims, insurance policies.
- for lending to private persons: cash, real estate, insurance policies.

The Bank also accepts corporate guarantees and interests in corporations that are accepted with value only under certain conditions and letters of comfort from parent companies for loans granted to subsidiaries, shares in companies and operational security instruments such as debentures and bills of exchange, which are not accepted with value.

As of 31 December 2019, the total value of collateral held by the Bank as collateral for loans and advances and contingent liabilities and commitments amounts to HRK 31,379 million (2018: HRK 31,568 million).

Total allocated value of collaterals as of 31 December 2019 amounts to HRK 14,895 million (2018: HRK 13,690 million).

The tables below present maximum exposure to credit risk by category of financial assets, total market value of collateral allocated, the remaining collateral available (to the extent to which the total market value of the collateral is greater than the exposure to which it refers) and the maximum exposure after deducting the allocated collateral value.

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

35. CREDIT RISK (CONTINUED)

2019	Maximum credit risk exposure (gross exposure)	Total allocated market value of collateral	Deposits	Real estate	Guarantees	Other	Maximum exposure after deducting the market value of collateral	Available collateral value (above gross exposure)
Cash and balances with the Croatian National Bank	7,210	-	-	-	-	-	7,210	-
Loans and receivables from banks	853	-	-	-	-	-	853	-
Financial assets at fair value through profit or loss	22	-	-	-	-	-	22	-
Loans and receivables from customers	29,094	13,987	200	11,417	2,180	190	15,107	15,822
Financial assets that are valued through other comprehensive income	6,094	-	-	-	-	-	6,094	-
Financial assets measured at amortized cost	256	-	-	-	-	-	256	-
Other financial assets	161	-	-	-	-	-	161	-
Total credit risk exposure of balance sheet items	43,690	13,987	200	11,417	2,180	190	29,703	15,822
Guarantees and letters of credit	1,522	316	15	294	-	7	1,206	460
Approved unused facilities and global lines	6,370	592	19	418	151	4	5,778	202
Total credit risk exposure of off-balance sheet items	7,892	908	34	712	151	11	6,984	662
Total credit risk exposure	51,582	14,895	234	12,129	2,331	201	36,687	16,484

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

35. CREDIT RISK (CONTINUED)

2018	Maximum credit risk exposure (gross exposure)	Total allocated market value of collateral	Deposits	Real estate	Guarantees	Other	Maximum exposure after deducting the market value of collateral	Available collateral value (above gross exposure)
Cash and balances with the Croatian National Bank	7,547	-	-	-	-	-	7,547	-
Loans and receivables from banks	1,029	-	-	-	-	-	1,029	-
Financial assets at fair value through profit or loss	11	-	-	-	-	-	11	-
Loans and receivables from customers	28,093	13,178	318	10,645	2,030	185	14,915	17,506
Financial assets that are valued through other comprehensive income	5,265	-	-	-	-	-	5,265	-
Financial assets measured at amortized cost	370	-	-	-	-	-	370	-
Other financial assets	125	-	-	-	-	-	125	-
Total credit risk exposure of balance sheet items	42,440	13,178	318	10,645	2,030	185	29,262	17,506
Guarantees and letters of credit	1,565	347	14	331	-	2	1,218	364
Approved unused facilities and global lines	6,066	165	19	131	13	2	5,901	8
Total credit risk exposure of off-balance sheet items	7,631	512	33	462	13	4	7,119	372
Total credit risk exposure	50,071	13,690	351	11,107	2,043	189	36,381	17,878

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

35. CREDIT RISK (CONTINUED)

Allocated value of collaterals for balance sheet and off-balance sheet asset items is presented as the market value net of previous liabilities without applying haircut, in such a way that it is spread up to the maximum amount of exposure of an individual placement. If the value of the collateral at the level of placement is greater than the total exposure of the placement, the excess, that is, the value of the collateral above the gross exposure is summarized (all types of collateral) in a separate column. If a single placement is covered by multiple types of collateral with a value, and one type of collateral is sufficient to cover the entire gross exposure of the placement, the allocated value of that single collateral is shown, and the value of other collateral in that placement is shown in the item above the gross exposure amount. The allocation priority by type of collateral is determined as follows:

- Deposits
- Real estate
- Guarantees
- Vessels

Deposits

A deposit (term deposit or blocked amount in the Bank's transaction account) as a collateral is a special type of pledged assets from which the Bank is entitled to settle their claims in the event of the debtor defaulting, whereby the Bank shall collect their debt directly, without the enforcement procedure. If the deposit does not meet all the necessary conditions, the financial pledge can be seized through court proceedings or in other (out-of-court) procedures, which are not deemed as direct collection. When the liability ceases to exist, the control over the deposit shall be restored to the debtor or the collateral issuer.

Real estate

Real estate taken as collateral by the Bank may be residential or non-residential. Residential real estate: real estate (share in property) for residential purposes entered or to be entered in the real estate register as residential houses or apartments, together with associated land, provided that the relevant building permit is issued or, in case of simple structures, only an official certificate of construction, which is or will be occupied or rented by the owner. All other real estate belongs to the category of non-residential real estate. Real estate can only be pledged by mortgaging. The mortgage can be entered in the land registers for the real estate as a whole or in case of real estate in regulated co-ownership parts for the entire portion belonging to a co-owner.

When granting housing loans, particular emphasis is placed on limiting production based on the LTV (Loan to value) indicator, which represents the ratio between the exposure and the market value of the mortgaged real estate. Eligible LTVs can be up to 100%, where a maximum of 45% of total placements can be with an LTV ratio of over 80%, only for the best locations in Croatia that are determined based on the economic strength statistics, tourism potential and real estate sales in individual cities and municipalities. In addition, production is limited to 8% of loans with an LTV of more than 90% and 5% of loans with an LTV of more than 95%.

Loans with a foreign currency clause can only be approved for loans with LTV rates of up to 90%, except for clients with a currency of receipt equivalent to the loan currency.

Furthermore, since they are non-purpose, mortgage loans have additional restrictions on the amount, term and LTV indicator of maximum up to 62.5%.

Guarantees

The Bank accepts the following guarantees to secure its claims, each of which may be absolute (unconditional) or contingent (conditional):

- ✓ Bank guarantee/confirmed letter of credit
- ✓ Company guarantee
- ✓ Personal guarantee (guarantors)/joint guarantee (co-debt).
- ✓ Special forms of guarantee
 - HAMAG guarantee
 - Guarantee by the Government of the Republic of Croatia and the Croatian National Bank
 - Guarantee by OECD member states, their central banks
 - Guarantee of local self-government units of the Republic of Croatia
 - Guarantee by HBOR (including insurance policy) and international development banks.

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

35. CREDIT RISK (CONTINUED)

The guarantee must, as a rule, be unconditional and irrevocable (written guarantee statement/guarantee agreement, with "on first demand" and "no objection" clauses, without additional conditions). An exception is the HAMAG guarantee, where conditional guarantees, up to the amount of the guarantee, also have collateral value.

Other

The Bank also accepts the following types of collateral for its claims:

- ✓ machines
- ✓ equipment
- ✓ personal and commercial vehicles
- ✓ stocks
- ✓ airplanes
- ✓ naval vessels, floating and stationary coastal structures, yachts and boats, inland navigation vessels
- ✓ other movable property (patents, trademarks, and similar)
- ✓ securities
- ✓ cessions

With these types of collateral, particular attention is paid to checking whether the pledger owns the lien or not. With the exception of floating objects and civil aircraft whose ownership is recorded in official registers, the lienor must in any case provide credible proof of the origin of the lien (original invoice, customs documents, supporting documents, comparison of the markings on these documents with the marking on the property, etc.).

Concentration of assets and liabilities relating to a group of related parties - Republic of Croatia

	Note	31.12.2019	31.12.2018
Current account with the Croatian National Bank	14	3,828	3,759
Obligatory reserve with the Croatian National Bank	14	2,486	2,481
Treasury bills of the Ministry of Finance	18	2,348	1,898
Bonds of the Ministry of Finance	18	2,959	2,747
Bonds of the Ministry of Finance	19	16	16
Loans and receivables from customers	17	<u>1,494</u>	<u>1,764</u>
Total asset:		13,131	12,665
Other borrowed funds	28	<u>1,114</u>	<u>1,333</u>
Total liabilities:		<u>1,114</u>	<u>1,333</u>

Notes to the financial statements (continued)

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(All amounts are expressed in millions of HRK)

35. CREDIT RISK (CONTINUED)

Concentration of assets and liabilities* with respect to territorial division

	Croatia	Hungary	Other	Total
As of 31 December 2019				
Assets	38,734	988	1,775	41,497
Contingent liabilities	7,719	17	45	7,781
	46,453	1,005	1,820	49,278
	Croatia	Hungary	Other	Total
As of 31 December 2018				
Assets	36,768	1,078	1,932	39,778
Contingent liabilities	7,522	-	-	7,522
	44,290	1,078	1,932	47,300

*includes net exposure (gross exposure net of impairment allowance)

Notes to the financial statements (continued)

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(All amounts are expressed in millions of HRK)

36. MARKET RISK

MARKET RISK IN TRADING BOOK

Market risk is the effect of external influences on the value of positions in the Bank's portfolio due to changes in prices or fluctuations in the financial markets. Market risk, by that definition, consists of:

- Currency risk
- Interest rate risk and
- Price risk

The basic objective of market risk management in the Trading Book is to make profit by taking advantage of fluctuations in exchange rates and interest rates, which means limiting losses that may result from their adverse fluctuations so as not to endanger the profitability and operation of the Bank.

The market risks in the Trading Book to which the Bank is exposed are managed by an organizational unit named Treasury Department which has the status of an active Treasury and thus can leave open positions in the Trading Book, which are the result of the banking activity itself, and further engage in speculative trading in order to realize a positive financial result.

The Market Risk Department is responsible for daily monitoring and reporting of market risk exposures in the Trading Book, control of all positions for which there is market risk exposure and compliance with the limits adopted by the Management Board, at the proposal of the Assets and Liabilities Committee of OTP Bank Nyrt. The limits are revised and approved on an annual basis, the amount of which is determined by the Bank's business policy and market conditions, as well as by the policy of the OTP Bank Nyrt as a whole.

The Asset and Liability Management Department is responsible for managing the Bank's remaining foreign exchange position, which is the difference between the Bank's total foreign exchange position (as measured by the regulatory report - currency risk) and the open foreign exchange positions of the Treasury Department. Due to the fact that, in accordance with the internal rules, the Asset and Liability Management Department has no limit for foreign currency risk exposure, the subject position is closed daily.

Value at Risk (VaR)

VaR is an estimate of the maximum amount that a portfolio, with a defined level of confidence and for a defined period, can lose from its value.

VaR is calculated for a holding period of one day and with a confidence level of 99%, using a historical simulation method based on a 252-day observation period.

Defining the VaR limit provides a risk measurement tool designed to limit potential losses of the Bank and in case of turbulent market conditions in a way that encourages closing of positions amid increased market uncertainty.

Fluctuations of VaR indicator

	Minimum	Average	Maximum	End of year
2019				
Interest rate risk	0.04	0.23	1.17	0.33
Currency risk	0.00	0.10	0.58	0.01
Total VaR	0.04	0.27	0.96	0.33
2018				
Interest rate risk	0.15	0.17	0.19	0.18
Currency risk	0.01	0.06	0.18	0.02
Total VaR	0.14	0.17	0.25	0.17

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

36. MARKET RISK (CONTINUED)

FOREIGN EXCHANGE (FX) RISK IN TRADING BOOK

FX risk is the risk that arises from changes in the exchange rate and causes fluctuations in a particular financial instrument and is continuously monitored through an open FX position (daily and intra-daily) in each currency managed by the organizational unit of the Treasury Department. Exposure to the FX risk or open FX position is the difference between assets and liabilities expressed in foreign currency or linked to the foreign currency. Open FX position can be long or short, depending on whether the FX risk exposure is greater on asset (long position) or liabilities (short position).

The Bank's internal rules set the maximum allowed open position in individual currencies and open FX position limit on global level. Position limit is maximum allowed exposure of individual position that can be held or traded. Net open position is sum of individual open positions (difference between long and short position), while gross position is absolute sum of individual open positions.

Fluctuations of open foreign exchange position by major currencies (in HRK million)

	Minimum	Average	Maximum	End of year
2019				
EUR	0.1	47.1	153.2	0.1
USD	0.0	0.2	1.3	0.3
CHF	0.0	0.1	0.7	0.0
Global foreign exchange position	1.4	48.2	155.4	2.9
2018				
EUR	0.4	44.7	137.7	7.3
USD	0.0	0.2	1.7	0.1
CHF	0.0	0.2	1.8	0.0
Global foreign exchange position	0.7	46.2	139.3	8.1

The Asset and Liability Management Department is responsible for managing the Bank's remaining foreign exchange position, which is the difference between the Bank's total foreign exchange position (as measured by the regulatory VR report) and the Treasury Department's open foreign exchange position. Due to the fact that in accordance with internal rules, Asset and Liability Management Department has no limit for foreign currency risk exposure, the subject position is closed daily.

The currency structure of total assets and liabilities is shown in the tables below.

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

36. MARKET RISK (CONTINUED)

TOTAL FOREIGN EXCHANGE (FX) RISK (CONTINUED)

	EUR*	USD*	HRK	Other currencies*	Total
As of 31 December 2019					
Assets					
Cash and balances with the Croatian National Bank	273	29	6,936	697	7,935
Loans and receivables from other banks	448	85	3	315	851
Financial assets at fair value through profit or loss	264	32	124	-	420
Loans and receivables from customers	14,708	258	11,992	13	26,971
Equity securities at fair value through other comprehensive income	-	105	6	-	111
Debt securities at fair value through other comprehensive income	1,644	491	3,959	-	6,094
Investment at amortized cost	-	68	169	-	237
Investment in subsidiaries	-	-	365	-	365
Property and equipment	-	-	394	-	394
Assets classified under IFRS 16	-	-	175	-	175
Investment property	-	-	63	-	63
Intangible asset	-	-	182	-	182
Deferred tax assets	-	-	29	-	29
Other assets	2	-	133	-	135
Non-current assets held for sale	-	-	1	-	1
Total assets	17,339	1,068	24,531	1,025	43,963
Liabilities					
Amounts due to other banks	1,698	6	102	3	1,809
Amounts due to customers	15,539	2,038	15,357	617	33,551
Other borrowed funds	577	1	534	-	1,112
Financial liabilities at fair value through profit or loss	17	-	14	-	31
Provisions	15	-	469	-	484
Deferred tax liabilities	-	-	-	-	-
Current liability for income tax	-	-	145	-	145
Lease liabilities classified under IFRS 16	-	-	179	-	179
Other Liabilities	231	-	224	-	455
Total Liabilities	18,077	2,045	17,024	620	37,766
Net foreign exchange position	(738)	(977)	7,507	405	6,197

* currency clause in the stated currency is included

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

36. MARKET RISK (CONTINUED)

TOTAL FOREIGN EXCHANGE (FX) RISK (CONTINUED)

	EUR*	USD*	HRK	Other currencies*	Ukupno
As of 31 December 2018					
Asset					
Cash and balances with the Croatian National Bank	447	52	6,924	945	8,368
Loans and receivables from other banks	715	309	2	-	1,026
Financial assets at fair value through profit or loss	154	-	162	-	316
Loans and receivables from customers	14,881	97	10,489	81	25,548
Equity securities at fair value through other comprehensive income	-	72	6	-	78
Debt securities at fair value through other comprehensive income	1,622	461	3,173	9	5,265
Investment at amortized cost	-	66	220	1	287
Investment in subsidiaries	-	-	323	-	323
Property and equipment	-	-	399	-	399
Investment property	-	-	64	-	64
Intangible asset	-	-	232	-	232
Goodwill	-	-	-	-	-
Other Asset	14	-	111	1	126
Total Asset	17,833	1,057	22,105	1,037	42,032
Liabilities					
Amounts due to other banks	550	1	102	-	653
Amounts due to customers	16,128	2,125	14,114	693	33,060
Other borrowed funds	696	-	632	-	1,328
Financial liabilities at fair value through profit or loss	3	-	10	-	13
Provisions	15	-	524	-	539
Deferred tax liabilities	-	-	34	-	34
Current liability for income tax	-	-	36	-	36
Other Liabilities	22	-	404	8	434
Total Liabilities	17,414	2,126	15,856	701	36,097
Net foreign exchange position	419	(1,069)	6,249	336	5,935

* currency clause in the stated currency is included

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

36. MARKET RISK (CONTINUED)

INTEREST RATE RISK IN TRADING BOOK

Interest rate risk is the risk of changes in the fair value of a financial instrument due to changes in market interest rates. The Bank is allowed to trade / hold only those interest rate risk instruments for which there is valid approval of the Management Board, at the proposal of the Asset and Liability Management Committee of OTP Bank Nyrta, and if there are valid and sufficient limits.

Interest rate risk limits limit the Treasury's exposure to bonds, interest rate swaps (IRSs), Forward rate agreements (FRAs), repo deals and other derivative transactions containing interest rate risk.

Risk is measured by calculating the change in the net present value of the portfolio in the event of a shift in the reference interest rate curve by 1 basis point and is limited by the BPV (Basis Point Value) limits.

The tables below show the sensitivity to change in interest rate where the increase in the net present value of all future cash flows is shown as a positive number and a decrease as a negative number.

Overview of sensitivity to changes in interest rates of 1 basis point per currency (in HRK thousand)

31.12.2019	1W-1Y	1Y-10Y	10y-15Y	TOTAL
EUR	21.19	37.60	(0.08)	58.71
HRK	(69.50)	38.73	0.00	(30.77)
USD	45.25	0.53	0.00	45.78
other	0.00	0.00	0.00	0.00
Total	(3.06)	76.86	(0.08)	73.72

31.12.2018	1W-1Y	1Y-10Y	10y-15Y	TOTAL
EUR	4.89	22.71	0.00	27.61
USD	13.39	(0.05)	0.00	13.34
HRK	(16.68)	55.11	0.00	38.44
other	0.01	0.00	0.00	0.01
Total	1.62	77.77	0.00	79.40

INTEREST RISK IN BANKING BOOK

Interest sensitivity of assets and liabilities

Interest rate risk represents the exposure of Bank to unexpected or unfavorable fluctuations of market interest rates in the future. Interest rate risk has an impact both on the profit and loss account and on future cash flows and the market value of the Bank's assets, liabilities and off-balance sheet instruments.

The purpose of interest rate risk management is to protect the Bank from unacceptably high interest rate risk exposure, but acceptable exposure to interest rate risk is defined by the amount of individual limits that the Bank establishes through the ratio of the amount of potential loss and regulatory capital, as well as based on the ability and desire of OTP Bank to take interest rate risk.

Bank manages the interest rate risk arising from the trading book items from the interest rate risk arising from the following transactions included in the banking book:

- commercial business (loans and deposits from clients);
- own account transactions (which include instruments of financial assets measured at fair value through other comprehensive income and a portfolio of financial assets measured at amortized cost);
- interbank transactions;
- derivatives concluded for the purpose of banking book (e.g. interest rate swaps);
- other transactions that affect the interest rate risk in the banking book.

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

36. MARKET RISK (CONTINUED)

INTEREST RISK IN BANKING BOOK (CONTINUED)

Interest sensitivity of assets and liabilities (continued)

The management of structural interest rate risk arising from items in the banking book is the responsibility of the Asset and Liability Management Department, which is part of the Bank's Financial Sector.

The methods used to measure interest rate risk exposure are as follows:

- Analysis of non-compliance risk
- Yield curve risk analysis
- Baseline risk analysis

Interest-rate risk management as required by the Croatian National Bank

Pursuant to the Decision on managing banking-book interest rate risk, the Bank has the obligation to measure and evaluate the negative impact of interest rate risk in the banking book on the net interest income or gains and economic value in the banking book. For the purpose of Croatian National Bank reporting, and related to the aspect of impact on the economic value in the banking book, the Bank is obliged to apply the higher level of:

- 1) standard interest-rate shock represented by a parallel positive or negative shift in interest rates by 200 basis points, applying the lower level of rate of 0%, except for the cases in which there is negative interest rate or
- 2) internally calculated changes of economic value calculated as 1st and 99th percentile attributable daily changes of interest rates during the period of 5 years scaled to a year that lasts 240 days.

According to CNB regulations, ratio of change of economic value of the banking book and regulatory capital must not exceed 20%, while the internal threshold is set at 10% of regulatory capital.

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

36. MARKET RISK (CONTINUED)

Interest-rate risk management as required by the Croatian National Bank (continued)

An overview of the Bank's sensitivity to interest rate fluctuations measured in accordance with regulatory reporting requirements at 31 December 2019 is indicated in the table below:

Change in the economic value of the banking book_parallel shift in interest rates by +/- 200 bp

	Up to 1 year	1 to 3 years	3 to 5 years	5 to 7 years	7 to 10 years	over 10 years	Total
Gap in HRK	3,304	2,154	1,410	(401)	114	(37)	6,544
Gap in EUR	(2,230)	1,023	1,060	(148)	(302)	2	(595)
Gap in other currencies	(988)	134	141	2	1	2	(708)
Total	86	3,311	2,611	(547)	(187)	(33)	5,241
Net weighted position by currency_HRK				195			
Net weighted position by currency_EUR				60			
Net weighted position by currency _other currencies				(3)			
Change in economic value				252			
Regulatory capital				5,841			
(Change in economic value / Regulatory capital)*100				4.3%			

An overview of the Bank's sensitivity to interest rate fluctuations measured in accordance with the statutory reporting requirements as of 31 December 2018 is indicated in the table below:

Change in the economic value of the banking book_parallel shift in interest rates by +/- 200 bp

	Up to 1 year	1 to 3 years	3 to 5 years	5 to 7 years	7 to 10 years	over 10 years	Total
Gap in HRK	3,217	1,159	1,316	(655)	114	9	5,160
Gap in EUR	(586)	286	1,055	(25)	(402)	35	363
Gap in other currencies	-(1,202)	318	3	3	3	3	(872)
Total	1,429	1,763	2,374	(677)	(285)	47	4,651
Net weighted position by currency_HRK				147			
Net weighted position by currency_EUR				41			
Net weighted position by currency _other currencies				(4)			
Change in economic value				184			
Regulatory capital				5,287			
(Change in economic value / Regulatory capital)*100				3.5%			

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

36. MARKET RISK (CONTINUED)

Interest-rate risk management as required by the Croatian National Bank (continued)

The table below shows the average effective interest rates for interest-bearing financial assets and financial liabilities:

	Interest rate 2019	Interest rate 2018
	%	%
Cash and balances with the Croatian National Bank	0.0	0.0
Loans and receivables from other banks	0.1	0.4
Loans and receivables from customers	4.1	4.4
Debt securities at fair value through other comprehensive income	1.4	1.6
Investments at amortized cost	4.0	4.4
Amounts due to other banks	0.0	0.0
Amounts due to customers	0.1	0.2
Other borrowed funds	1.4	1.5

PRICE RISK IN TRADING BOOK

Price risk is the risk of change in the value of an instrument as a result of changes in market prices, and the Bank invests primarily in high quality government instruments, therefore the Bank considers the price risk to be low.

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

37. LIQUIDITY RISK

Liquidity risk management

Cash flow management policy aimed at maintaining a balance between cash receipts and expenses is part of the Bank's wider asset and liability management policy. To ensure a satisfactory level of liquidity reserves, the Bank consistently implements the cash flow monitoring and planning process and anticipates future liquidity needs taking into account changes in the Bank's economic, legislative and other circumstances. This planning involves identifying known, expected and potential cash outflows and developing strategies to meet the Bank's liquidity requirements in certain currencies. It is important to emphasize that the Bank, when managing its liquidity risk, seeks to ensure the currency matching of the liquid assets' portfolio with the currency distribution of its net liquidity outflows.

Bank's liquidity risk management is the responsibility of the Asset and Liability Management Division in the Financial Sector. The Asset and Liability Committee (ALCO) determines the Bank's liquidity risk tolerance, regularly reviews and approves the liquidity risk management strategy and ensures the effective management of liquidity risk by the Asset and Liability Department. The Asset and Liability Department also proposes a liquidity risk management strategy and establishes a framework for managing these risks to ensure that the Bank has sufficient liquidity and regularly reports to ALCO. In addition, the Asset and Liability Department manages liquidity and reserve requirements with the CNB on a daily basis, maintains liquidity reserves in order to meet prescribed requirements and internal limits, and, in addition, implements the ALCO-approved liquidity risk strategy and ensures that appropriate controls, procedures and information flows are in place. In addition to short-term liquidity, the Asset and Liability Department is also responsible for managing medium and long-term liquidity, and adopts operational decisions based on information provided to them by various Bank departments related to operations that affect liquidity.

The operational management of the foreign exchange liquidity of the OTP Bank in Croatia is centralized and is managed according to the concept of the Liquidity pool of the Parent Company. Under this framework, OTP Bank Nyrt Hungary retains a liquidity buffer in case of a liquidity shock (deposit or business-related shock) and for financing the regular operations of the Bank. Unlike foreign currency liquidity, the operational management of the HRK liquidity of the Bank is the responsibility of each individual member company.

In order to ensure liquidity stress resilience, the Bank maintains an adequate reserve of high-quality assets that can be sold or pledged to obtain funds under stress conditions.

Highly liquid financial assets include:

- liquid assets on accounts with the Croatian National Bank (balance of assets on the giro account and foreign currency settlement account with the CNB minus the obligatory reserve requirement);
- liquid assets placed with banks;
- liquid assets placed in securities that are measured at fair value through other comprehensive income

In addition to the aforementioned, the short-term and long-term financing lines offered by the Parent Company in foreign currency, which, together with customer deposits, represent the Bank's sole sources of financing should be taken into account in the liquidity buffer.

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

37. LIQUIDITY RISK (CONTINUED)

Review of the fluctuations of liquid assets as of 31 December 2019 and 31 December 2018 is indicated in the table below:

	31.12.2019	31.12.2018
Giro account	3,823	3,739
Mandatory maintenance of the HRK mandatory reserve with the CNB	(1,066)	(1,064)
Foreign currency settlement account with the Croatian National Bank	4	20
Mandatory maintenance of the foreign currency mandatory reserve with the CNB	(11)	(7)
Liquid assets on accounts with the Croatian National Bank	2,750	2,688
Current accounts with foreign banks	858	1,274
Current accounts with domestic banks	39	33
Short-term placements with other banks	853	1,029
Liquid assets placed with banks	1,750	2,336
Bonds of the Republic of Croatia	2,959	2,747
Foreign country bonds	788	620
Treasury bills of the Republic of Croatia	2,347	1,898
Total liquid assets placed in securities that are measured at fair value through other comprehensive income	6,094	5,265
Total liquid assets	10,594	10,289

All indicated liquid assets are either due or marketable or liable for a period of up to one month.

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

37. LIQUIDITY RISK (CONTINUED)

Maturity structure of securities representing the Bank's liquidity reserve as of 31 December 2019 and 31 December 2018 is indicated in the tables below:

31.12.2019

	Total	Up to 1 year	1 to 3 years	3 to 5 years	Over 5 years
Bonds of the Republic of Croatia	2,959	24	1,828	465	642
Foreign government bonds	787	246	85	456	-
Treasury bills of the Republic of Croatia	<u>2,348</u>	<u>2,348</u>	<u>-</u>	<u>-</u>	<u>-</u>
Liquid assets placed in securities	<u>6,094</u>	<u>2,618</u>	<u>1,913</u>	<u>921</u>	<u>642</u>

31.12.2018

	Total	Up to 1 year	1 to 3 years	3 to 5 years	Over 5 years
Bonds of the Republic of Croatia	2,747	141	1,021	817	768
Foreign government bonds	620	-	329	291	-
Treasury bills of the Republic of Croatia	<u>1,898</u>	<u>1,898</u>	<u>-</u>	<u>-</u>	<u>-</u>
Liquid assets placed in securities	<u>5,265</u>	<u>2,039</u>	<u>1,350</u>	<u>1,108</u>	<u>768</u>

Bank assets are considered encumbered if they are pledged or subject to any form of contract to secure, hedge or enhance the lending of any balance sheet or off-balance sheet transactions from which they cannot be freely withdrawn (for example, to pledge for funding sources). Pledged assets subject to withdrawal restrictions, such as assets requiring prior approval prior to withdrawal or replacement with other assets, are considered encumbered. As of 31 December 2019, the Bank had no impaired asset burden other than the mandatory reserve of HRK 2,487 million. Existing sources of financing were sufficient to cover the Bank's liquidity needs.

Liquidity risk measures

In order to comply with the legal and internal regulations and decisions, establish the principle of safety and stability and achieve the planned profitability of operations, the Bank applies a system of measuring and limiting liquidity risk and reporting of the subject risk. In accordance with the market practices, exposure to liquidity risk is determined through:

- regulatory limits
- internal limits

The Bank has the obligation to maintain the following regulatory liquidity indicators:

- mandatory reserve
- percentage coverage of foreign currency liabilities with short-term foreign currency claims
- liquidity coverage ratio
- requirement related to stable sources of funding

Mandatory reserve

CNB prescribes to banks the obligation to allocate and maintain mandatory reserves, in the form of deposits with the CNB, as well as other liquid claims.

As of 31 December 2019, the mandatory reserve rate was 12% of the prescribed basis. The basis of the calculation is the average monthly balance of current accounts and deposits, loans and repo transactions received, debt securities issued, and hybrid and subordinated instruments.

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

37. LIQUIDITY RISK (CONTINUED)

Pursuant to regulatory provisions, the allocation of the HRK mandatory reserve component amounted to 70%, while the allocation of the foreign currency mandatory reserve component amounted to 0%. In addition to the prescribed 70% of the mandatory reserve requirement in HRK on the account of the CNB, banks are obliged to maintain the remaining 30% through the average daily balance on settlement accounts and on accounts for coverage of negative balances on settlement accounts in the National Clearing System. This includes 75% of the foreign currency mandatory reserve required to be held by the Bank in HRK and added to the HRK mandatory reserve.

The decision of the CNB of 15 December 2015 ended the obligation to allocate the foreign currency mandatory reserve, i.e. enabled the banks to maintain the total foreign currency mandatory reserve with an average daily balance:

- of the liquid foreign currency claims from OECD member states and credit institutions in OECD countries with the lowest ratings by Standard Poor's and FitchRatings of: AA-, respectively by Moody's: Aa3,
- of the funds in the own euro settlement accounts with the Croatian National Bank; and
- of the foreign cash and checks denominated in foreign currency.

With the same decision, the CNB introduces an obligation for all banks, except savings banks, to maintain at least 2% (of the total foreign currency portion of the mandatory reserve requirement) in their own foreign currency euro settlement account with the CNB, or own PM account within the TARGET2-HR system.

The Croatian National Bank does not pay a fee on HRK mandatory reserves. Interest rate to applied to the special account for a portion of the foreign currency reserve requirement that the Bank is obliged to maintain (PM account within the TARGET2-HR system) is the reference interest rate of the European Central Bank.

Percentage coverage of foreign currency liabilities with short-term foreign currency claims

Pursuant to the Decision on minimum required foreign currency claims, the Bank is required to maintain the prescribed ratio between certain short-term foreign currency receivables and foreign currency liabilities on a daily basis.

Since March 2011, the minimum prescribed ratio between short-term foreign currency receivables and foreign currency liabilities is 17%.

The maintenance of the stated ratio as of 31 December 2019 and 31 December 2018 for the Bank is indicated in the table below:

	31.12.2019	31.12.2018
Short-term foreign currency claims	3,586	3,911
Foreign currency liabilities	19,881	19,479
Minimum required foreign currency claims (%)	18.04%	20.08%
Regulatory limit	17.00%	17.00%
Internal minimum	17.25%	17.25%
Internal optimum	17.75%	17.75%

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

37. LIQUIDITY RISK (CONTINUED)

Liquidity coverage ratio

In accordance with the Regulation 575/2013 of the European Parliament and the Delegated Commission Regulation (EU) No. 2015/61, the Bank is required to maintain the prescribed ratio of liquid assets and net liquid outflows (LCR) to a minimum of 100% since January 2018 (during 2017, the minimum prescribed coefficient level was 80%).

The liquidity coverage ratio (LCR) request as of 31 December 2019 and 31 December 2018 for the Bank is indicated in the table below:

	31.12.2019		31.12.2018	
	Amount	Weighted amount	Amount	Weighted amount
Liquidity buffer (HQLA)	9,730	9,704	9,029	8,985
Cash and reserves with the Central Bank	3,385	3,385	3,386	3,386
Total 1st and 2nd degree assets	6,345	6,319	5,643	5,599
Total net liquidity outflows	37,174	4,915	36,118	4,968
Inflows	2,606	1,995	2,804	2,384
Cash receivables from non-financial clients	1,142	605	730	395
Cash receivables from financial clients	1,355	1,355	1,506	1,506
Other inflows	109	35	568	483
Outflows	39,780	6,910	38,922	7,352
Retail deposits	25,937	2,112	25,090	2,127
Non-operational deposits	7,236	3,912	7,815	4,558
Other liabilities	6,607	886	6,017	667
Liquidity coverage ratio (%)_LCR		197%		181%
Regulatory limit		100%		100%
Internal minimum		110%		110%
Internal optimum		120%		120%

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

37. LIQUIDITY RISK (CONTINUED)

When managing a liquidity buffer in terms of a Liquidity Coverage Ratio requirement (LCR), and in order to ensure the security, liquidity and adequate diversification of its own investments, the Bank is guided by the requirements set out in Delegated Commission Regulation (EU) No. 2015/61 as well as by the provisions of the Bank's Liquidity Risk Management Procedure regarding the investment portfolio management. Accordingly, the management of the liquid assets portfolio recognized in the liquidity buffer includes:

- minimizing credit risk or loss risk due to default of the security issuer (or guarantor) by (i) pre-determining and constantly monitoring the issuers whose securities have already been purchased or can be purchased and (ii) diversifying the portfolio and limiting the investment by issuer so that the potential losses of individual securities are minimized,
- minimizing the risk of the market value of the securities in the portfolio decreasing due to changes in general interest rates, taking into account (i) that the portfolio is structured so that the securities mature in order to meet the cash requirements for current operations, avoiding the need to sell securities on the open market before maturity with a high transaction cost and (ii) investing operating assets primarily in short-term securities (limiting the maximum maturity or duration of the portfolio),
- not opening currency risks related to the portfolio of liquid foreign currency assets,
- achieving a competitive rate of return, given the constraints on credit, interest rate and currency risk mitigation and liquidity goals,
- portfolio diversification to reduce the risk of loss resulting from the concentration of assets in a particular type, currency, country or economic sector,
- assessing the marketability of the portfolio primarily through the possibility of collateralizing with the Croatian National Bank or the European Central Bank and then by examining the market situation of professional services at the Bank.

Requirement for stable sources of funding

Regulation 575/2013 of the European Parliament and the Delegated Commission Regulation (EU) No. 2015/61, prescribe the bank's obligation to report on stable sources of financing (NSFR) whose minimum level is 100%.

Changes in net stable funding ratio requirements (NSFR) as of 31 December 2019 and 31 December 2018 for the Bank is indicated in the table below:

	31.12.2019	31.12.2018
Items providing stable funding sources	33,778	32,270
Items requiring stable funding sources	23,098	23,360
Net stable funding ratio requirements (%)_NSFR	146%	138%
Regulatory limit	100%	100%
Internal minimum	110%	110%
Internal optimum	120%	120%

In addition to the regulatory liquidity ratios indicated above, the Bank also uses a number of other internal indicators to help monitor short-term and long-term liquidity risk exposures based on the balance sheet structure (such as the net loan-to-deposit ratio, the share of liquid assets in total assets, the concentration of deposits received from an individual client and twenty largest depositors, and projected funding needs).

The aforementioned internal liquidity indicators are monitored through ALCO and daily reports in accordance with the defined reporting dynamics.

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

37. LIQUIDITY RISK (CONTINUED)

Stress testing

In order to meet the expected and unexpected cash needs, the liquidity management strategy includes planning for contingencies (local and global crises). Namely, the planned activities are continuously adjusted to the market situation, taking into account the structure of assets and liabilities and the maximum level of liquidity reserves.

The Bank prescribes and carries out stress tests of its liquidity, taking into account the factors specific for the Bank (crisis of the institution) as well as market factors (market crisis). Tests are conducted for shorter and longer periods of stressful circumstances with varying intensity of stressful circumstances: from normal (predictable or normal) circumstances to unusual (extreme) circumstances.

On a monthly basis, the Bank performs liquidity stress testing to determine and quantify its exposure to potential liquidity stress, analyzing potential effects on its liquidity position.

Stress tests consist of applying assumptions of development inside and outside the budget to inflows and outflows of client funds (with particular attention being paid to the concentration of deposits) and determining the net outflows of client funds under stress, which are compared to the liquid assets that can be obtained using the liquidity reserve and alternative sources of financing.

Notes to the financial statements (continued)

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(All amounts are expressed in millions of HRK)

37. LIQUIDITY RISK (CONTINUED)

	Up to 1 month	1 to 3 months	3 months to 1 year	1 to 3 years	Over 3 years	Total
As of 31 December 2019						
Liabilities						
Amounts due to other banks	643	1,116	55	-	-	1,814
Amounts due to customers	26,155	1,744	4,633	644	409	33,585
Other borrowed funds	7	52	183	350	579	1,171
Financial liabilities at fair value through profit or loss	8	2	4	-	17	31
Other liabilities	455	-	-	-	-	455
Total Liabilities	27,268	2,914	4,875	994	1,005	37,056
As of 31 December 2018						
Liabilities						
Amounts due to other banks	123	445	42	54	-	664
Amounts due to customers	24,208	1,897	5,594	869	549	33,117
Other borrowed funds	8	60	227	438	666	1,399
Financial liabilities at fair value through profit or loss	7	1	2	1	2	13
Other liabilities	434	-	-	-	-	434
Total Liabilities	24,780	2,403	5,865	1,362	1,217	35,627

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

38. OPERATIONAL RISK

Operational risk is the risk of loss resulting from inadequately defined or improperly executed business process, human error, inappropriate system operation or as a result of external factors, including legal risk.

The Bank's activities in the area of managing operational risk are in line with the applicable regulations and good operational risk management practice, and are regularly revised to reflect any changes therein. Framework for managing operational risk at the Bank is provided by the Operational Risk Management Rules, the Operational Risk Collection Procedure as well as the Procedure for Managing Key Risk Indicators.

The Bank defined the business continuity management strategy: Business Continuity Plan, as well as the Crisis Communication Handbook, that define the system supporting the continuity of operations in cases where they become temporarily discontinued as a result of an exceptional event.

Operational risks are managed in a decentralised manner so that the responsibility for managing operational risks rests with the managers and staff in charge of those organisational units in which operational risks are inherent to the activities performed by those units. They best understand, control and monitor the processes taking place in their organisational units and their duty is to ensure that the processes they manage follow appropriate procedures and are safe from the aspect of incurrance of operational risks. Operational risk management activities that are a joint responsibility of all the Bank's organisational units include the following: identification, measurement, assessment and analysis, as well as monitoring operational risks.

Department for Operational Risks and Business Continuity Management operates as an independent unit within the Risk Management Sector, Department for Operational Risk Management. Department for Operational Risks and Business Continuity Management is responsible for: suggesting the set-up of the operational risk management environment and the rules governing this area, for collecting data about losses caused by operational risks, conducting analysis, documenting and preparing reports on operational risk events and providing assistance and support to all organizational units of the Bank in understanding the structured approach to managing operational risks.

In line with the decentralised operational risk management methodology, process owners are responsible for consistent identification and assessment of operational risks, followed by the establishment and implementation of measures for managing risks identified in the respective areas and processes for which they are responsible.

In order to obtain a full view of the Bank's exposure to the risk, an Operational Risk Management Committee has been established.

2019 was a post integration year in which the Bank focused primarily on sales activities in the network, resulting in a diminished focus on management controls. As a result, in 2019, a number of operational risk events were recorded, primarily misuse of the network, with a number of employees violating a number of procedures and internal rules. Specific two operational risk events were related to internal fraud in two branch offices.

Following these developments, the Bank's management has taken a number of related measures, namely: new controls have been defined as well as executors and deadlines for implementation; on-site training was conducted; new key risk indicators (KRIs) implemented; new procedures for carrying out risk self-assessment and control mechanisms (RCSA) have been introduced. The aim of all these measures is to improve management controls and strengthen discipline in their implementation. The Bank has also taken adequate sanction measures regarding employees involved in fraudulent activities. The negative financial impact of fraud is covered by the results of the current year.

The Bank applies a simplified approach in determining the capital requirements for operational risk.

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

39. RELATED PARTY TRANSACTIONS

The Bank is the parent of the OTP Bank Group in Croatia. The Bank considers to be immediately related to its key shareholders and their subsidiaries; its subsidiaries and associates; the investment funds managed by one of its subsidiaries, OTP invest d.o.o.; Supervisory Board members, Management Board members; close family members of the Management Board members; and entities controlled, jointly controlled or significantly influenced by key management personnel and their close family members, in accordance with the definition contained in International Accounting Standard 24 "Related Party Disclosures" (IAS 24).

As of 31 December 2019, the Bank holds shares in the following open-end investment funds managed by OTP Invest d.o.o.: OTP uravnoteženi fond, OTP indeksni fond, OTP euro novčani fond, OTP Absolute fond, OTP Short-term bond fond and OTP Novčani fond in the amount of HRK 108 million (2018: HRK 103 million).

At the end of 2019 and during 2019, balances and the underlying transactions with related parties, excluding investments in subsidiaries (Note 20), were as follows:

	31.12.2019		31.12.2018	
	Receivables	Liabilities	Receivables	Liabilities
OTP Bank Nyrt Hungary	497	1,639	773	463
OTP Bank Romania S.A.	2	-	7	-
SKB Banka	-	12	-	-
OTP Nekretnine d.o.o.	85	104	-	1
OTP Invest d.o.o.	-	2	-	2
OTP Aventin d.o.o. in liquidation*	-	-	24	-
OTP Leasing d.d.	54	170	40	105
Cresco d.o.o.	5	1	10	-
OTP Savjetovanje d.o.o.	-	2	-	1
SB Zgrada d.o.o.**	-	-	-	4
SB Leasing d.o.o. in liquidation	39	44	92	19
OTP Osiguranje d.d.	1	35	-	41
Zelena nekretnina	-	13	-	-
	683	2,022	946	636

* The company has been in liquidation since 25 October 2019.

** The company was merged with OTP Nekretnine d.o.o. on 23 December 2019.

Notes to the financial statements (continued)

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(All amounts are expressed in millions of HRK)

39. RELATED PARTY TRANSACTIONS (CONTINUED)

	2019		2018	
	Income	Expenses	Income	Expenses
OTP Bank Nyrt Hungary	116	115	145	16
OTP Nekretnine d.o.o.	-	6	-	5
OTP Invest d.o.o.	-	7	-	-
Aventin d.o.o. in liquidation*	11	6	4	-
OTP Leasing d.d.****	3	2	3	1
Splitska banka d.d.***	-	-	5	-
SB Zgrada d.o.o.**	-	3	-	1
SB Leasing d.o.o. in liquidation****	3	-	3	1
OTP Osiguranje d.d.	8	4	7	4
Other related parties in Hungary	-	1	-	2
	141	144	167	30

* The company has been in liquidation since 25 October 2019.

** The company was merged with OTP Real Estate on 23 December 2019 and its revenues and expenses are presented from January 1 to 22 December 2019.

*** Splitska banka d.d. was merged with the Bank on 1 December 2018 and shows revenue and expenses from 1 January to 30 November 2018

**** The Bank acquired a majority interest on 1 April 2019, and its revenues and expenses are presented from that date until the end of 2019.

Remuneration paid to key management personnel for 2019 amounted to HRK 11 million (2018: HRK 9 million) and are comprised of short-term benefits. Included in key management personnel are Management Board members. Remuneration paid to Supervisory Board members for 2019 amounted to HRK 1 million (2018: HRK 1 million).

40. FUNDS MANAGED ON BEHALF OF THIRD PARTIES

The Bank manages funds on behalf of third parties, which consist mainly of loans provided by one legal person to another through the Bank as agent. These assets are accounted for separately from those of the Bank, and the Bank has no liability in connection with these transactions. The Bank charges a fee for these services.

At 31 December 2019, funds managed by the Bank on behalf of third parties amounted to HRK 178 million (2018: HRK 195 million). As of 31 December 2019, the total portfolio of securities of domestic and foreign clients the Bank has under custody, including domestic pension and investment funds, amounted to HRK 66,545 million (2018: HRK 52,545 million), of which HRK 4,707 million refers to Bank's subsidiaries OTP Invest, OTP Insurance and OTP bank Plc (2018: HRK 740 million - OTP Invest and OTP Insurance securities portfolio at 31.12.2018).

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

41. FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES

The fair value of financial instruments is the amount for which an asset could be exchanged or a liability settled, between knowledgeable willing parties in an arm's-length transaction. Where available, fair value is based on quoted market prices. However, market prices for a significant portion of financial instruments of the Bank are not readily available. In circumstances where quoted market prices are not readily available, fair value is estimated using alternative techniques or financial assets are measured at cost, amortised cost or indexed cost.

Valuation techniques and assumptions for the purposes of measuring fair value

The fair values of financial assets and financial liabilities are determined as follows:

- fair values of financial assets and financial liabilities with standard terms and conditions and traded on active liquid markets are determined by reference to quoted market prices (includes listed redeemable notes, bills of exchange, debentures and perpetual notes);
- fair values of other financial assets and financial liabilities (excluding derivative instruments) are determined in accordance with generally accepted pricing models based on discounted cash flow analysis using prices from observable current market transactions and dealer quotes for similar instruments;
- fair values of derivative instruments are calculated using quoted prices; where such prices are not available, a discounted cash flow analysis is performed using the applicable yield curve for the duration of the instruments for non-optional derivatives;
- while option pricing models are used for optional derivatives; foreign currency forward contracts are measured using quoted forward exchange rates and yield curves derived from quoted interest rates under contracts with similar maturities; interest rate swaps are measured at the present value of future cash flows estimated and discounted based on the applicable yield curves derived from quoted interest rates.

Financial instruments that are measured subsequent to initial recognition at fair value are grouped into three levels based on the degree to which the fair value is observable:

- Level 1 fair value measurements are those derived from quoted prices (unadjusted) in active markets for identical assets or liabilities.
- Level 2 fair value measurements are those derived from inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from the prices).
- Level 3 fair value measurements are those derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data (unobservable inputs).

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

41. FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES (CONTINUED)

2019

	Level 1	Level 2	Level 3	Total
Financial asset at fair value through profit or loss (Note 16)				
Units in open-end investment funds	-	108	-	108
Bonds of Republic of Croatia (listed)	175	-	-	175
Currency swaps and forward contracts	-	10	-	10
Interest rate swaps	-	12	-	12
Other securities at fair value through profit or loss	-	-	104	104
Loans	-	-	11	11
	175	130	115	420
Financial asset at fair value through other comprehensive income (Note 18a i 18b)				
Listed investments				
<i>Debt securities of Republic of Croatia</i>	2,959	-	-	2,959
<i>Debt securities of Foreign countries</i>	787	-	-	787
<i>Equity securities</i>	39	-	69	108
Unlisted investments				
<i>Treasury bills of Republic of Croatia</i>	1,042	1,306	-	2,348
<i>Equity securities</i>	-	-	3	3
	4,827	1,306	72	6,205
	5,002	1,436	187	6,625
Financial liabilities at fair value through profit or loss				
Currency swaps and forward contracts	-	14	-	14
Interest rate swaps	-	17	-	17
	-	31	-	31
	5,002	1,405	187	6,594

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

41. FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES (CONTINUED)

2018

	Level 1	Level 2	Level 3	Total
Financial asset at fair value through profit or loss				
Units in open-end investment funds	-	103	-	103
Bonds of Republic of Croatia (listed)	160	-	-	160
Currency swaps and forward contracts	-	4	-	4
Interest rate swaps	-	7	-	7
Loans	-	31	11	42
	160	145	11	316
Financial asset at fair value through other comprehensive income				
Listed investments				
<i>Debt securities of Republic of Croatia</i>	2,747	-	-	2,747
<i>Debt securities of Foreign countries</i>	620	-	-	620
<i>Equity securities</i>	27	-	47	74
Unlisted investments				
<i>Treasury bills of Republic of Croatia</i>	-	1,898	-	1,898
<i>Equity securities</i>	-	-	4	4
	3,394	1,898	51	5,343
	3,554	2,043	62	5,659
Financial liabilities at fair value through profit or loss				
Currency swaps and forward contracts	-	10	-	10
Interest rate swaps	-	3	-	3
	-	13	-	13
	3,554	2,030	62	5,646

Fair value of financial assets and financial liabilities of the Bank measured at fair value

Some of the Bank's financial assets are measured at fair value at the end of each reporting period. The table below provides the information about the fair value measurement of financial assets and liabilities (valuation techniques and the inputs to the techniques used).

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

41. FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES (CONTINUED)

Fair value of financial assets and financial liabilities of the Bank measured at fair value (continued)

Financial asset / financial liabilities	Fair value as of		Fair value level	Valuation method and key inputs	Significant unobservable inputs	Unobservable inputs in relation to fair value
	2019	2018				
1) Share in open-end investment funds (Note 16)	Which are held for trading: Assets: 108	Which are held for trading: Assets: 103	Level 2	The quoted purchase price by the fund established on the basis of net assets of the funds.	Not applicable	Not applicable
2) Currency swaps and forward contracts (Note 16)	Assets: 10 Liabilities: 14	Assets: 4 Liabilities: 10	Level 2	Discounted cash flow. Future cash flow is estimated by the forward rates available at the end of the reporting period and contracted forward rates, discounted using a rate reflecting the counterparty credit risk.	Not applicable	Not applicable
3) Interest rate swaps (Note 16)	<u>Held for trading</u> Assets: 12 Liabilities: -	<u>Held for trading</u> Assets: 7 Liabilities: -	Level 2	Discounted cash flow. Future cash flow is estimated by forward rates (from the yield curve available at the end of the reporting period) and contracted interest rates, discounted using a rate that reflects the counterparty credit risk.	Not applicable	Not applicable
	<u>Fair value hedge:</u> Assets: - Liabilities: 4	<u>Fair value hedge:</u> Assets: - Liabilities: 3				
	<u>Cash flow hedge:</u> Assets: Liabilities: 13	<u>Cash flow hedge:</u> Assets: - Liabilities: -				
4) Debt securities listed (Note 16 and Note 18)	Debt securities held for trading and are quoted in Croatia - issued by the Republic of Croatia: 175	Debt securities held for trading and are quoted in Croatia - issued by the Republic of Croatia: 160	Level 1	Prices quoted on an active market.	Not applicable	Not applicable
	Debt securities that are valued through other comprehensive income - issued by the Republic of Croatia: 2,959 - issued by foreign countries: 787	Debt securities that are valued through other comprehensive income - issued by the Republic of Croatia: 2,747 - issued by foreign countries: 620	Level 1	Prices quoted on an active market.	Not applicable	Not applicable
5) Equity securities (Note 18)	Listed in Croatia - shares: 2	Listed in Croatia - shares: 2	Level 1	Prices quoted on an active market.	Not applicable	Not applicable
	Listed abroad - shares: 37	Listed abroad - shares: 25				
	Listed abroad: - shares: 69	Listed abroad: - shares: 47	Level 3	Quoted ordinary share prices adjusted for conversion factor and estimated risk	Not applicable	Not applicable
	Not quoted: - shares: 3	Not quoted: - shares: 4	Level 3	At cost subject to impairment testing	Not applicable	Not applicable

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

41. FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES (CONTINUED)

Fair value of financial assets and financial liabilities of the Bank measured at fair value (continued)

Financial asset / financial liabilities	Fair value as of		Fair value level	Valuation method and key inputs	Significant unobservable inputs	Unobservable inputs in relation to fair value
	2019	2018				
6) Debt securities that are not quoted (Note 18)	Treasury bills issued by the Republic of Croatia: 1,042	Treasury bills issued by the Republic of Croatia: -	Level 1	Discounted cash flow. Discounted by applying a rate that reflects the market interest rate, including the counterparty credit risk.	Not applicable	Not applicable
	Treasury bills issued by the Republic of Croatia: 1,306	Treasury bills issued by the Republic of Croatia: 1,898	Level 2			
7) Loans (Note 16)	Loans: -	Loans: 31	Level 2	Discounted cash flow. Discounted by applying a rate that reflects the market interest rate, including the counterparty credit risk.	Not applicable	Not applicable
	Loans: 11	Loans: 11	Level 3	Discounted cash flow. Discounted by applying the effective interest rate.	Not applicable	Not applicable

Movement of Level 3 Financial Instruments at Fair Value

The fair value level of financial instruments is determined at the beginning of each reporting period. The following table shows the reconciliation of the opening and closing amounts of Level 3 financial assets and liabilities that are carried at fair value:

Acquired by the merger of Splitska banka	44
Total gains and losses recognized in other comprehensive income	<u>18</u>
Balance as of 31 December 2018	<u>62</u>
Balance as of 1 January 2019	62
Total gains and losses recognized in other comprehensive income	<u>21</u>
Balance as of 31 December 2019	<u>83</u>

Financial instruments not measured at fair value

In arriving at the fair value of these financial instruments certain assumptions, estimates and methods were used. Because of the relatively short period to maturity, the fair values of Loans and receivables from banks and Amounts due to other banks are considered not to differ significantly from their carrying amounts.

For investments measured at amortized cost, corporate bonds with longer maturities are valued at quoted prices on the market or the price is derived by discounting cash flows, while for corporate bills of exchange, due to shorter maturities, it is assumed that the fair value does not differ significantly from their carrying amount.

The fair values of Loans and receivables from customers and Amounts due to customers were estimated using the expected future cash flows using as the discount rate the current average market rate for identical loans and deposits. Partly recoverable and fully irrecoverable loans and receivables were not considered in measuring the fair value because their recoverable amount is assumed to reflect their fair price.

Because of the specific features of the credit lines provided by HBOR and their restricted transferability as well as the standardised terms and conditions HBOR applies to all commercial banks, the carrying amount of the credit lines is assumed to reflect their fair values.

Notes to the financial statements (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

41. FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES (CONTINUED)

Financial instruments not measured at fair value (continued)

Balance as of 31.12.2019

	Note	Carrying amount	Fair value			Total
			Level 1	Level 2	Level 3	
Financial asset						
Loans and receivables from banks	15	851			855	855
Loans and receivables from customers	17	26,971			27,270	27,270
Investments at amortization cost	19	<u>237</u>		<u>249</u>	<u>4</u>	<u>253</u>
Financial liabilities						
Liabilities to other banks	26	1,809			1,809	1,809
Liabilities to customers	27	<u>33,551</u>			<u>33,560</u>	<u>33,560</u>

Balance as of 31.12.2018

	Note	Carrying amount	Fair value			Total
			Level 1	Level 2	Level 3	
Financial asset						
Loans and receivables from banks	15	1,026	-	-	1,026	1,026
Loans and receivables from customers	17	25,548	-	-	25,904	25,904
Investments at amortization cost	19	<u>287</u>		<u>241</u>	<u>53</u>	<u>294</u>
Financial liabilities						
Liabilities to other banks	26	653	-	-	653	653
Liabilities to customers	27	<u>33,060</u>	-	-	<u>33,059</u>	<u>33,059</u>

42. SUBSEQUENT EVENTS

Changes to the Bank's Supervisory Board

Zsolt Ardó is the new member of the Supervisory Board since 18 February 2020.

Amendment to the Decision on the classification of exposures into risk groups and the method of determining credit losses (Official Gazette 114/2017, 110/2018)

The Decision amending the Decision on the classification of exposures into risk groups and the method of determining credit losses, Article 6, provided for a transitional period until 31 December 2019 on the maintenance of minimum impairments, for exposures classified in Stage 1 and Stage 2, in the amount of 0.8%. Considering that the European Central Bank conducts a comprehensive assessment of the 5 largest banks in the Republic of Croatia, which includes OTP Banka d.d., the Bank, on a prudent basis, introduced a transitional period by 30 June 2020 at the latest, in which the 0.8% minimum will continue to be applied for impairment on exposures classified in Stage 1 and Stage 2.

Merger of OTP Savjetovanje d.o.o. to OTP Invest d.o.o.

On 12 March 2020, the General Assembly of OTP Savjetovanje d.o.o. brought a Decision on merger of the company to OTP Invest d.o.o.

Occurrence and spread of corona virus

The emergence and spread of corona virus in the Republic of Croatia and the measures taken to stop the spread of the virus and suppress it will certainly have negative effects on the entire Croatian economy. In order to mitigate these effects, the Government of the Republic of Croatia presented a number of measures to support the economy.

However, given the recent events, the uncertainty over how long the measures will be in place and the fact that the tailoring of the measures to support the economy is still ongoing, it is not possible to reliably estimate the effects at the date of issuing these financial statements.

Appendix - Supplementary financial statements and reports for the Croatian National Bank
For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

Pursuant to the Accounting Act of the Republic of Croatia, the Croatian National Bank adopted a Decision on the structure and content of the Annual Financial Statements of credit institutions, Official Gazette 42/18 ("Decision").

In the following tables, the financial statements are presented in accordance with the aforementioned Decision.

The amounts for 2018 are reclassified. (note 2.31)

Appendix - Supplementary financial statements and reports for the Croatian National Bank
(continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

Statement of profit or loss – unaudited

In millions HRK	In accordance with Croatian National Bank decision 2019	Accounting standards for banks in Croatia 2019	Difference 2019	In accordance with Croatian National Bank decision 2018	Accounting standards for banks in Croatia 2018	Difference 2018
Interest income	1,277	1,265	12	652	646	6
(Interest expense)	(78)	(73)	(5)	(48)	(48)	-
(Expenses on share capital repayable on demand)	-	-	-	-	-	-
Dividend income	1	1	-	-	-	-
Fee and commission income	493	493	-	197	197	-
(Fee and commission expense)	(115)	(115)	-	(58)	(58)	-
Gains or (-) losses on derecognition of financial assets and liabilities not measured at fair value through profit or loss, net	-	-	-	2	2	-
Gains or (-) losses on financial assets and liabilities held for trading, net	224	221	3	116	116	-
Gains or (-) losses on non-trading financial assets mandatory at fair value through profit or loss, net	(177)	(173)	(4)	(3)	(3)	-
Gains or (-) losses on financial assets and liabilities designated at fair value through profit or loss, net	-	-	-	-	-	-
Gains or (-) losses from hedge accounting, net	(2)	-	(2)	-	-	-
Exchange differences [gain or (-) loss], net	(23)	(23)	-	(34)	(34)	-
Gains or (-) losses on derecognition of non-financial assets, net	-	-	-	-	-	-
Other operating income	41	48	(7)	16	22	(6)
(Other operating expenses)	(111)	-	(111)	(53)	-	(53)
Total operating income, net	1,530	1,644	(114)	787	840	(53)
(Administrative expenses)	(759)	(870)	111	(435)	(488)	53
(Depreciation)	(171)	(171)	-	(49)	(49)	-
Modification gains or (-) losses, net	-	-	-	-	-	-
(Provisions or (-) reversal of provisions)	(47)	121	(168)	(17)	(46)	29
(Impairment or (-) reversal of impairment on financial assets not measured at fair value through profit or loss)	171	-	171	(29)	-	(29)
(Impairment or (-) reversal of impairment of investments in subsidiaries, joint ventures and associates)	(8)	(8)	-	-	-	-
(Impairment or (-) reversal of impairment on non-financial assets)	(2)	(2)	-	(43)	-	(43)
Negative goodwill recognised in profit or loss	-	-	-	-	(43)	43
Share of the profit or (-) loss of investments in subsidiaries, joint ventures and associates accounted for using the equity method	-	-	-	-	-	-
Profit or (-) loss from non-current assets and disposal groups classified as held for sale not qualifying as discontinued operations	-	-	-	-	-	-
Profit or (-) loss before tax from continuing operations	714	714	-	214	214	-
(Tax expense or (-) income related to profit or loss from continuing operations)	(135)	(135)	-	(48)	(48)	-
Profit or (-) loss after tax from continuing operations	579	579	-	166	166	-
Profit or (-) loss after tax from discontinued operations	-	-	-	-	-	-
Profit or (-) loss before tax from discontinued operations	-	-	-	-	-	-
(Tax expense or (-) income related to discontinued operations)	-	-	-	-	-	-
Profit or (-) loss for the year	579	579	-	166	166	-
Attributable to minority interest (non-controlling interests)	-	-	-	-	-	-
Attributable to owners of the parent	579	579	-	166	166	-

Appendix - Supplementary financial statements and reports for the Croatian National Bank
(continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

Statement of other comprehensive income – unaudited

In millions HRK	In accordance with Croatian National Bank decision 2019	Accounting standards for banks in Croatia 2019	Difference 2019	In accordance with Croatian National Bank decision 2018	Accounting standards for banks in Croatia 2018	Difference 2018
Profit or (–) loss for the year	579	579		166	166	-
Other comprehensive income (3. + 15.)	102	102		55	55	-
Items not to be reclassified to profit or loss (from 4. to 10. + 13. + 14.)	28	28		11	11	-
Tangible assets	-	-		-	-	-
Intangible assets	-	-		-	-	-
Actuarial gains or (-) losses on defined benefit pension plans	-	-		-	-	-
Non-current assets and disposal groups held for sale	-	-		-	-	-
Share of other recognised income and expense of entities accounted for using the equity method	-	-		-	-	-
Fair value changes of equity instruments measured at fair value through other comprehensive income	34	34		14	14	-
Gains or (-) losses from hedge accounting of equity instruments at fair value through other comprehensive income, net	-	-		-	-	-
Fair value changes of equity instruments measured at fair value through other comprehensive income (hedged item)	-	-		-	-	-
Fair value changes of equity instruments measured at fair value through other comprehensive income (hedging instrument)	-	-		-	-	-
Fair value changes of financial liabilities at fair value through profit or loss attributable to changes in their credit risk	-	-		-	-	-
Income tax relating to items that will not be reclassified	(6)	(6)		(3)	(3)	-
Items that may be reclassified to profit or loss (from 16. to 23.)	74	74		44	44	-
Hedges of net investments in foreign operations						
(effective portion)	-	-		-	-	-
Foreign currency translation	-	-		-	-	-
Cash flow hedges (effective portion)	-	-		-	-	-
Hedging instruments (not designated elements)	-	-		-	-	-
Debt instruments at fair value through other comprehensive income	92	92		51	51	-
Non-current assets and disposal groups held for sale	-	-		-	-	-
Share of other recognised income and expense of investments in subsidiaries, joint ventures and associates	-	-		-	-	-
Income tax relating to items that may be reclassified to profit or (-) loss	(18)	(18)		(7)	(7)	-
Total comprehensive income for the year (1. + 2.; 25. + 26.)	681	681		221	221	-
Attributable to minority interest (non-controlling interest)	-	-		-	-	-
Attributable to owners of the parent	681	681		221	221	-

Appendix - Supplementary financial statements and reports for the Croatian National Bank
(continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

Presentation of the reconciliation of items presented in the Statement of profit or loss and Statement of other comprehensive income presented as part of the Annual Report and items presented in accordance with the CNB Decision:

Penalty interest income is presented as part of Interest income position in accordance with the Decision while in the Annual Report they are presented as part of Other operating income.

In accordance with the Decision, interest income from financial assets held for trading and non-traded financial assets that are obligatory measured at fair value through profit or loss, are presented in Interest income position, while in the Annual Report they are shown in Gains or losses on non-trading financial assets mandatory at fair value through profit or loss.

In accordance with the Decision, interest expenses from financial liabilities held for trading and derivatives used as a hedging instrument are presented in Interest expense, while in the Annual Report these expenses are presented in the item Gains or losses on financial assets and liabilities held for trading.

In accordance with the Decision part of the other expenses is presented as part of the Other operating expenses while in the Annual Report all other expenses and operating expenses are shown in the position of Other operating expenses.

In accordance with the Decision operating expenses (excluding other operating expenses) and employee expenses are presented in the Administrative expenditure position, while in the Annual Report, employee expenditure and other operating expenses are stated in separate positions.

In accordance with the Decision provisions for off-balance sheet liabilities and provisions for litigations are presented as part of the Provisions item while in the Annual Report the provisions for impairment of financial instruments are presented in that position as well.

Impairment of financial instruments in accordance with the Decision is presented in a separate position called Impairment or Reversal of impairment loss on financial assets not measured at fair value through profit or loss.

The following are additional differences in the Statement of profit or loss as reported for year 2018:

In accordance with the Decision, the write-off of goodwill is presented in the Impairment on non-financial assets position while in the Annual Report the write-off of goodwill is displayed as a separate position.

Appendix - Supplementary financial statements and reports for the Croatian National Bank
(continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

Statement of financial position – unaudited

Assets	In accordance with Croatian National Bank decision 2019	Accounting standards for banks in Croatia 2019	Difference 2019	In accordance with Croatian National Bank decision 2018	Accounting standards for banks in Croatia 2018	Difference 2018
Cash, cash balances at central banks and other demand deposits	5,450	8,786	(3,336)	5,887	9,394	(3,507)
Cash on hand	725	725	-	821	821	-
Cash balances at central banks	3,828	6,313	(2,485)	3,759	6,240	(2,481)
Other demand deposits	897	1,748	(851)	1,307	2,333	(1,026)
Financial assets held for trading	196	197	(1)	171	171	-
Derivatives	21	22	(1)	11	11	-
Equity instruments	-	-	-	-	-	-
Debt securities	175	175	-	160	160	-
Loans and advances	-	-	-	-	-	-
Non-trading financial assets mandatory at fair value through profit or loss	223	223	-	145	145	-
Equity instruments	133	133	-	103	103	-
Debt securities	79	79	-	-	-	-
Loans and advances	11	11	-	42	42	-
Financial assets designated at fair value through profit or loss	-	-	-	-	-	-
Debt securities	-	-	-	-	-	-
Loans and advances	-	-	-	-	-	-
Financial assets at fair value through other comprehensive income	6,205	6,205	-	5,343	5,343	-
Equity instruments	111	111	-	78	78	-
Debt securities	6,094	6,094	-	5,265	5,265	-
Loans and advances	-	-	-	-	-	-
Financial assets at amortised cost	30,733	27,208	3,525	29,552	25,835	3,717
Debt securities	237	237	-	288	287	1
Loans and advances	30,496	26,971	3,525	29,264	25,548	3,716
Derivatives – Hedge accounting	-	-	-	-	-	-
Fair value changes of the hedged items in portfolio hedge of interest rate risk	-	-	-	-	-	-
Investments in subsidiaries, joint ventures and associates	365	365	-	323	323	-
Tangible assets	632	632	-	463	463	-
Intangible assets	182	182	-	232	232	-
Tax assets	29	29	-	-	-	-
Other assets	19	135	(116)	21	126	(105)
Non-current assets and disposal groups classified as held for sale	7	1	6	12	-	12
Total assets	44,041	43,963	78	42,149	42,032	117

Appendix - Supplementary financial statements and reports for the Croatian National Bank
(continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

Statement of financial position – unaudited (continued)

Liabilities and equity	In accordance with Croatian National Bank decision 2019	Accounting standards for banks in Croatia 2019	Difference 2019	In accordance with Croatian National Bank decision 2018	Accounting standards for banks in Croatia 2018	Difference 2018
Financial liabilities held for trading	26	31	(5)	10	13	(3)
Derivatives	26	31	(5)	10	13	(3)
Short positions	-	-	-	-	-	-
Deposits	-	-	-	-	-	-
Debt securities issued	-	-	-	-	-	-
Other financial liabilities	-	-	-	-	-	-
Financial liabilities designated at fair value through profit or loss	-	-	-	-	-	-
Deposits	-	-	-	-	-	-
Debt securities issued	-	-	-	-	-	-
Other financial liabilities	-	-	-	-	-	-
Financial liabilities measured at amortised cost	36,560	36,472	88	34,960	35,041	(81)
Deposits	36,380	36,472	(92)	34,951	35,041	(90)
Debt securities issued	-	-	-	-	-	-
Other financial liabilities	180	-	180	9	-	9
Derivatives – Hedge accounting	5	-	5	3	-	3
Fair value changes of the hedged items in portfolio hedge of interest rate risk	-	-	-	-	-	-
Provisions	505	484	21	569	539	30
Tax liabilities	152	145	7	79	70	9
Share capital repayable on demand	-	-	-	-	-	-
Other liabilities	596	634	(38)	593	434	159
Liabilities included in disposal groups classified as held for sale	-	-	-	-	-	-
Total liabilities	37,844	37,766	78	36,214	36,097	117
Equity	-	-	-	-	-	-
Share capital	3,994	3,994	-	3,994	3,994	0
Share premium	171	171	-	171	171	0
Equity instruments issued other than capital	-	-	-	-	-	-
Other equity	-	-	-	-	-	-
Accumulated other comprehensive income	210	210	-	108	108	-
Retained earnings	735	1,314	(579)	1,300	1,466	(166)
Revaluation reserves	-	-	-	-	-	-
Other reserves	508	508	-	196	196	-
(-) Treasury shares	-	-	-	-	-	-
Profit or loss attributable to owners of the parent company	579	-	579	166	-	166
(-) Interim dividends	-	-	-	-	-	-
Minority interests (Non-controlling interests)	-	-	-	-	-	-
Total equity	6,197	6,197	-	5,935	5,935	-
Total liabilities and equity	44,041	43,963	78	42,149	42,032	117

Appendix - Supplementary financial statements and reports for the Croatian National Bank
(continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

Presentation of the reconciliation of items presented in the Statement of financial position presented as part of the Annual Report and items presented in accordance with the CNB Decision:

Assets

In the Annual Report, the CNB's mandatory reserve is presented in the Cash and balances with Croatian National Bank, while loans and receivables from banks are presented separately in Loans and receivables from banks. In accordance with the Decision these positions are presented as part of Financial assets at amortized cost in Loans and advances.

In accordance with the Decision, receivables on currency SWAP contracts are presented in Other assets, while in the Annual Report they are presented in the position of Financial assets held for trading.

In accordance with the Decision, pre-paid loan approval revenue and prepaid card revenue are presented in Other liabilities measured at amortized cost, while in the Annual Report fees for loan approval are presented as part of the Loans and advances and card fees as part of the Other assets at amortized cost.

In accordance with the Decision, receivables for credit cards together with penalty interest rates for credit cards are presented as part of the Loans and advances at amortized cost, while in the Annual Report they are partly presented in the position of Other assets at amortized cost, and partly in Loans and advances at amortized cost.

In accordance with the Decision, Assets acquired in lieu of uncollected receivables are presented in a separate position, while in the Annual Report they part of the Other assets.

Liabilities

Pursuant to the Decision, derivatives relating to hedge accounting are presented in a separate position, while in the Annual Report they are presented under Financial liabilities held for trading.

In accordance with the Decision, bearer deposits are stated in the position of Other Liabilities measured at amortized cost, while in the Annual Report they are stated as part of the Liabilities due to customers.

Lease liabilities (IFRS 16) and fee liabilities are recognized in accordance with the Decision in the position of Other financial liabilities measured at amortized cost, while in the Annual Report they are presented under Other liabilities.

In accordance with the Decision, loans received from financial institutions, other short-term and long-term loans and issued subordinated debt instruments are presented in separate positions, while in the Annual Report they are presented within the aggregate position of Other liabilities.

In accordance with the Decision, liabilities for the payment of previously written-off deposits and provisions for bonuses and other employee remuneration are presented as part of the Provisions, while in the Annual Report they are presented within the positions of Other liabilities.

In accordance with the Decision, the value added tax liability and other taxes and contributions to the Republic of Croatia are presented in the position of Tax liabilities, while in the Annual Report they are presented as part of Other liabilities.

Equity

In accordance with the Decision, the profit for year is presented in a separate position, while in the Annual Report it is presented as part of the Retained earnings.

Appendix - Supplementary financial statements and reports for the Croatian National Bank (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

Statement of changes in equity – unaudited

2019

	Capital	Share premium	Equity instruments issued other than Capital	Other equity	Accumulated other comprehensive income	Retained earnings	Revaluation reserves	Other reserves	(-) Treasury shares	Profit or (-) loss attributable to owners of the parent	(-) Interim dividends	Non-controlling interest		Total
												Accumulated Other Comprehensive Income	Other items	
Opening balance [before restatement]	3,994	171	-	-	108	1,300	-	196	-	166	-	-	-	5,935
Effects of corrections of errors	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Effects of changes in accounting policies	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Opening balance [current period] (1. + 2. + 3.)	3,994	171	-	-	108	1,300	-	196	-	166	-	-	-	5,935
Issuance of ordinary shares	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Issuance of preference shares	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Issuance of other equity instruments	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Exercise or expiration of other equity instruments issued	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Conversion of debt to equity	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Capital reduction	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Dividends	-	-	-	-	-	(491)	-	-	-	-	-	-	-	(491)
Purchase of treasury shares	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Sale or cancellation of treasury shares	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Reclassification of financial instruments from equity to liability	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Reclassification of financial instruments from liability to equity	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Transfers among components of equity	-	-	-	-	-	(146)	-	312	-	(166)	-	-	-	-
Equity increase or (-) decrease resulting from business combinations	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Share based payments	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Other increase or (-) decrease in equity	-	-	-	-	-	72	-	-	-	-	-	-	-	72
Total comprehensive income for the year	-	-	-	-	102	-	-	-	-	579	-	-	-	681
Closing balance [current period] (from 4. to 20.)	3,994	171	-	-	210	735	-	508	-	579	-	-	-	6,197

Appendix - Supplementary financial statements and reports for the Croatian National Bank (continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

Statement of changes in equity – unaudited (continued)

2018

	Capital	Share premium	Equity instruments issued other than Capital	Other equity	Accumulated other comprehensive income	Retained earnings	Revaluation reserves	Other reserves	(-) Treasury shares	Profit or (-) loss attributable to owners of the parent	(-) Interim dividends	Non-controlling interest		Total
												Accumulated Other Comprehensive Income	Other items	
Opening balance [before restatement]	3,994	171	-	-	54	575	-	191	-	52	-	-	-	5,037
Effects of corrections of errors	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Effects of changes in accounting policies	-	-	-	-	(1)	(53)	-	-	-	-	-	-	-	(54)
Opening balance [current period] (1. + 2. + 3.)	3,994	171	-	-	53	522	-	191	-	52	-	-	-	4,983
Issuance of ordinary shares	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Issuance of preference shares	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Issuance of other equity instruments	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Exercise or expiration of other equity instruments issued	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Conversion of debt to equity	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Capital reduction	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Dividends	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Purchase of treasury shares	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Sale or cancellation of treasury shares	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Reclassification of financial instruments from equity to liability	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Reclassification of financial instruments from liability to equity	-	-	-	-	-	(5)	-	5	-	-	-	-	-	-
Transfers among components of equity	-	-	-	-	-	52	-	-	-	(52)	-	-	-	-
Equity increase or (-) decrease resulting from business combinations	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Share based payments	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Other increase or (-) decrease in equity	-	-	-	-	-	731	-	-	-	-	-	-	-	731
Total comprehensive income for the year	-	-	-	-	55	-	-	-	-	166	-	-	-	221
Closing balance [current period] (from 4. to 20.)	3,994	171	-	-	108	1,300	-	196	-	166	-	-	-	5,935

Appendix - Supplementary financial statements and reports for the Croatian National Bank

(continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

Statement of cash flows – unaudited

	2019	2018
Operating activities – indirect method		
Profit/(loss) before tax	714	214
Adjustments:	-	-
Impairment and provisions	(109)	41
Depreciation	171	49
Net unrealised (gains)/losses on financial assets at fair value through statement of profit or loss	183	3
Loss/(profit) from the sale of tangible assets	21	6
Other non-cash items	(1,190)	(524)
Changes in assets and liabilities from operating activities		
Deposits with the Croatian National Bank	(5)	(40)
Deposits with financial institutions and loans to financial institutions	-	(17)
Loans and advances to other clients	(1,479)	(375)
Securities and other financial instruments at fair value through other comprehensive income	(711)	172
Securities and other financial instruments held for trading	(25)	(46)
Securities and other financial instruments at fair value through statement of profit of loss, not traded	(5)	(92)
Securities and other financial instruments at fair value through statement of profit or loss	51	-
Securities and other financial instruments at amortized cost	16	2
Other assets from operating activities	(38)	(28)
Deposits from financial institutions	1,206	529
Transaction accounts of other clients	2,338	2,577
Savings deposits of other clients	(526)	(374)
Time deposits of other clients	(1,485)	(1,193)
Derivative financial liabilities and other traded liabilities	18	3
Other liabilities from operating activities	(66)	89
Interest received from operating activities [indirect method]	1,290	678
Dividends received from operating activities [indirect method]	-	-
Interest paid from operating activities [indirect method]	(102)	(67)
(Income taxes paid)	(40)	(37)
Net cash flow from operating activities	227	1,570
Investing activities		
Cash receipts from the sale / payments for the purchase of tangible and intangible assets	(97)	(88)
Cash receipts from the sale / payments for the purchase of investments in branches, associates and joint ventures	(51)	-
Cash receipts from the sale / payments for the purchase of securities and other financial instruments held to maturity	-	-
Dividends received from investing activities	-	-
Other receipts/payments from investing activities	-	-
Net cash flow from investing activities	(148)	(88)
Financing activities		
Net increase/(decrease) in loans received from financing activities	(252)	(330)
Net increase/(decrease) of debt securities issued	-	-
Net increase/(decrease) of Tier 2 capital instruments	-	-
Increase of share capital	-	-
(Dividends paid)	(491)	-
Other receipts/(payments) from financing activities	-	-
Net cash flow from financing activities	(743)	(330)
Net increase/(decrease) of cash and cash equivalents	(664)	1,152
Cash and cash equivalents at the beginning of period	6,896	2,359
Effect of exchange rate fluctuations on cash and cash equivalents	49	(33)
Cash and cash equivalents acquired by merger of Splitska banka	-	3,418
Cash and cash equivalents at the end of period	6,281	6,896

Appendix - Supplementary financial statements and reports for the Croatian National Bank

(continued)

For the year ended 31 December 2019

(All amounts are expressed in millions of HRK)

Presentation of the reconciliation of items presented in the Statement of cash flows as part of the Annual Report and items presented in accordance with the CNB Decision:

Impairment and provisions position from the Decision, is presented in four separate items in the Annual report: Impairment Losses, Impairment of investments in subsidiaries, Provisions for legal actions and off-balance sheet items and Other provisions.

In accordance with the Decision, the position Other non-cash items includes the write-off of goodwill, interest income, interest expense, inventory write-off revenues, other operating expenses and exchange rate differences, while in the Annual report they are presented as separate items: Goodwill write-off, Interest income, Interest expense, Revenue from cancellation of accrued expenses, Other non-cash items and Exchange rate differences, respectively.

The item Financial assets and liabilities carried at fair value through profit or loss as presented in the Annual report is presented in accordance with the Decision as three separate items: Securities and other financial instruments held for trading, Securities and other financial instruments at fair value through statement of profit or loss - not traded, Derivative financial liabilities and other traded liabilities.

The item Amounts due to customers as presented in the Annual is presented in accordance with the Decision as three separate items: Transaction accounts of other clients, Savings deposits of other clients and Time deposits of other clients.

In accordance with the Decision, other banking institutions are presented as part of the Deposits from financial institutions, while in the Annual report they are presented as part of Loans and receivables from customers position.

The Other liabilities position in accordance with the Decision is presented in the Annual report as part of Other liabilities and Provisions.

The Cash receipts from the sale / payments for the purchase of tangible and intangible assets position in accordance with the Decision is presented in the Annual report as Purchases of tangible and intangible assets and Proceeds from sale of repossessed real estate.

The item Net increase / decrease / of loans received from financing activities in accordance with the Decision, is divided into two items in the Annual Report: Lease payments (IFRS 16) and Decrease of other borrowed funds.