Annual Report 2017

ANNUAL REPORT 2017

Table Of Contents

Business
Report
2017

Intesa Sanpaolo Bank at a glance

Year 2017 was mostly characterised by the renaming of Banka Koper d.d. into Banka Intesa Sanpaolo d.d. The change of the Bank's name is part of the strategic plan of the parent company Intesa Sanpaolo to provide its bank in Slovenia with the necessary support in the realisation of ambitious plans to expand operations to the key regions in the country and to offer support to the Slovenian economy, which faces current challenges of technological development.

Within the scope of the renaming of the Bank, several activities were carried out in relation with a new corporate identity of the Bank and rearrangement of branch offices with new captions. Communication activities were designed and carried out using core messages that emphasised new features, particularly in the introduction of new and innovative products and services that resulted from the cooperation of experts within the Group.

On the day the Bank was officially renamed, i.e. 16 January 2017, a central ceremony was organised in Ljubljana, where the Director of a division of subsidiary banks, Ignacio Jaquotot, presented Vojko Čok, Chairman of the Supervisory Board of the Bank at the time and before that a long-standing Chairman of the Board of Banka Koper, a plaque for priceless contribution to the development of the Slovenian bank.

One of the key pillars for the new launch of the Bank's operations is the transfer of majority ownership from the parent company to Privredna banka Zagreb d.d., which is almost fully owned by Intesa Sanpaolo, and, consequently, the establishment of a development centre for the transfer of new products and good practices to both countries.

Intesa Sanpaolo Bank is a universal bank and belongs to the seven largest Slovenian banks. It was established over 60 years ago and boomed in the late 1990s, when it gradually grew from a regional bank to a pan-Slovenian bank. Today, it has 52 branch offices in all major Slovenian towns. At home and abroad, the Bank is known to be innovative, as it provides its clients with state-of-the-art banking products and services.

Intesa Sanpaolo is one of the leading banking groups in the euro area and the leading bank in Italy as regards retail and corporate banking and asset management. On account of its wide network of branch offices in Italy (over 4,800), it offers a diverse range of services to some 12.6 million clients. Its international operations focus on

Central and Eastern Europe and the countries of the Middle East and North Africa. It has subsidiary banks in 12 countries, offering its products and services at some 1,100 branch offices to 7.6 million clients. The international network of specialists in support of corporate customers spreads across 25 countries. It was made in 2007 through the merger of two Italian banking groups, Banca Intesa and Gruppo Sanpaolo IMI, and has been present in Slovenia since 2002.

Privredna banka Zagreb (PBZ) was established in 1966 and over time became the leading financial institution in Croatia and a recognised brand at home and abroad.
In terms of size, it is the second largest bank and banking group in the country, with its market share exceeding 20% in various business segments and 30% in credit card transactions.
With approximately 1.8 million clients, PBZ is a universal credit institution offering a wide range of specialised financial products and services to private individuals, SMEs and legal persons at local and international level. Its business network covers 200 branch offices and over 700 ATM machines covering the entire territory of Croatia.

Ownership structure of Intesa Sanpaolo Bank

	Equity holding in per cent	
Shareholders	**31. 12. 2017**	**31. 12. 2016**
Privredna banka Zagreb d.d.	51,0%	
Intesa Sanpaolo S. p. A.	48,1%	98,9%
Minority shareholders	0,9%	1,1%

International credit ratings

	2017	2016
Long-term	BBB-	BBB
Short-term	F3	F2
Viability	bb	bb
Support	2	2

On 5 May 2017, Fitch Ratings London reduced Intesa Sanpaolo Bank's long-term and short-term rating, while the viability and support rating remained the same as in 2016. Hence, the long-term rating is BBB-, short-term rating is F3, viability rating is bb and support rating is 2.

Therefore, Intesa Sanpaolo Bank maintained in 2017 the top credit rating score among commercial banks in Slovenia, excelling both in terms of business results and capital base as well as of the business effects obtained by the Bank with the majority shareholder Intesa Sanpaolo. Fitch Ratings substantiates the reduced long-term credit rating for Banka Intesa Sanpaolo d.d., primarily with a recent similar step for the parent bank of the Intesa Sanpaolo Group, since the Slovenian bank depends on the support provided by Intesa.

Milestones in the Bank's corporate history

2017

INTESA SANPAOLO BANK

New name Intesa Sanpaolo Bank and the start of a revamp of our business activities.

New ownership structure of the bank within PBZ.

Transition of the most widely used payment card Activa Visa Inspire to contactless mobile payments.

New Advisory Service based on MIFID II.

2016

As the first bank in Slovenia, Banka Koper introduced the contactless mobile payments with smartphones, enabled by the mobile wallet Wave2Pay, which is based on Host Card Emulation technology.

2015

The merger by absorption of the subsidiary Finor Leasing into the Bank's organisational structure.

As the first bank in Slovenia, Banka Koper has created a brand-new cashless payment service using smartphones and QR code technology.

2014

Launch of the mobile and internet banking – Banka IN for Businesses.

2013

Launch of the mobile banking - Banka IN for Individuals.

Beginning of the Inspire debit card issuing.

2012

Establishing of entrepreneurship centers for small businesses.

2011

The first green branch and introduction of electronic signing of bank transactions.

The exclusive issue of the American Express cards.

2008

The Bank launches a new online banking solution - Banka IN.

2007

INTESA SANPAOLO

Banka Koper became a member of Intesa Sanpaolo Group.

2005

Introduction of the first smart payment card.

2002

The bank joins the Sanpaolo IMI Group - its majority shareholder.

2001

Preparations for strategic alliance with the Sanpaolo IMI, S.p.A banking group, establishment of the Open-ended Mutual Pension Fund.

1998

The developement of the i-Net Banka internet banking solution.

1997

New name and a new corporate identity for Banka Koper.

1996

The branch network expands to other Slovenian regions.

1992

Withdrawal from the LB bank system and launch of the first Slovenian payment card - Activa.

1955

Foundation of Istrska komunalna the bank.

Management overview

1. REPORT OF THE MANAGEMENT BOARD

In 2017 the Slovenian Economy experienced a significant progress, highlighting a substantial growth and a positive development of all the main macroeconomic and financial indicators. Eventually, after several years the growth of lending activity also entered into a positive territory, albeit at a slower pace than the overall real economy.

Intesa Sanpaolo Bank Slovenia managed to capture these positive trends, ultimately increasing its overall lending to customers and its deposit basis: on a yearly basis, volumes of total loans to customers grew slightly in excess of 2%, mainly driven by a 7.5% rise of loans to households. At year end, loans to private individuals soared to a total of Eur 645 mln, whereas the volume of loans to the legal entities segment (Eur 1,129 mln) virtually remained at the same level as the previous year. Concurrently, the Bank attracted a larger volume of customer deposits, whose level attained Eur 1,971 mln, (+ 7.1%). Both corporate and individual deposits grew on a year-on-year basis, proving the confidence of the bank's customers on the reliability of the institution.

The improvement of the Bank's operations in the household sector is the outcome of the considerable effort that the bank's management and staff put forward to improve the quality of the banking offer to individual clients. This effort brought the housing loan market share of Intesa Sanpaolo Bank in the vicinity of 7.1% further signalling the Bank's endeavour to establish a business model based on predictable life-cycle patterns of income and savings of private individuals, and on the pursuit of a stable long-term banking relationship and mutual trust with these clients.

Hence, in 2017 the Bank launched several campaigns to attract housing borrowers through a comprehensive mix of variable and fixed-rate loan options, combined with a vast range of long and medium term maturities and insurance packages. Alongside these initiatives, the Bank broadly overhauled its personal and consumer loans catalogue, with a view to accommodate for the growing trend of consumer spending in the domestic market and to signify the commitment to constantly improve its value proposition to its customers.

In the course of 2017, the Bank also endeavoured to enhance its services to retail customers in the field of financial assets management. A new product combining deposits with investment funds was thus launched to better fit the risk/reward profiles and requirements of our customers; in addition, in conjunction with our fund management partners, the Bank carried out a rationalization of the number and of the features of the investment funds available for retail placement. The ultimate goal of this exercise was to help our relationship managers to better focus on the fundamental characteristics of the investments solutions proposed to our clients together with a simplification of the risk/rewards options available to our clients for the purpose of their better understanding of the products on sale. Eventually, in the Assets Under Management (' AUM') operations, despite the still limited volumes denoted by the domestic system, the Bank managed to outperform the subscription trend recorded in the Slovenian market, notably in the foreign funds segment, where the Bank's market share consistently grew to exceed 30%.

Concerning the corporate sector, the Bank continued to devise a wide range of taylor-made solutions both for specific clusters of enterprises and for individual companies in need to accommodate contingent financial requests. Throughout the year the Bank carried out dedicated campaigns and offers in the SMEs and small businesses areas. At the same time, the Bank continued to relate with the largest corporate entities of the country, leveraging on its status as one of the leading lenders and solution-providers of the country. In this respect, the constant relationship with these entities translated into the finalization of significant long-term lending tickets, which mainly materialized in the last quarter of the year.

In terms of general quality of the banking book, the Bank firmly engaged in the continuation of a de-stocking policy of its Non-Performing Exposures (NPEs) started in the last few years. The Bank's NPEs stock, essentially a legacy of the crisis which affected the Slovenian banking system since the beginning of this decade, was thereby further reduced by 5%, bringing the total NPEs volume down to Eur 167 mln. Accordingly, the NPEs ratio also was reduced to 9%, benefiting from a positive dynamics of cash recoveries and the regular write-off of unrecoverable positions.

The year 2017 also brought about the achievement of significant milestones for some of the strategic projects in which the Bank is engaged. The project of integration with our Intesa Sanpaolo sister bank PBZ of Zagreb, aiming at enhancing the Intesa Sanpaolo presence in the region through the creation of an integrated regional hub, reached a special momentum with the authorisation and the further actual transfer of the Bank's shareholding control to PBZ. A wide range of related business initiatives was accordingly started, in the first place in the field of joint-corporate lending and intra-group funding.

Several other projects were concluded in the course of the year with the aim to improve the Bank's operating infrastructure, in particular in the area of key risk and governance processes, but no only. The Bank continued to be very active in introducing innovations to the Slovenian market, especially in the field of mobile payments. By adding the Visa Inspire debit card to the Wave2Pay mobile wallet, it practically opened the way for all customers to capture state-of-the-art technology to pay for everyday goods and services.

2. REPORT OF THE SUPERVISORY BOARD

REPORT OF THE SUPERVISORY BOARD ON THE EXAMINATION OF THE ANNUAL REPORT FOR THE FINANCIAL YEAR 2017

In accordance with the third paragraph of Article 272 and Article 546. a of the Companies Act (ZGD-1), the Management Board of Banka Intesa Sanpaolo d.d. has prepared and forwarded to the members of the Supervisory Board the following documents for review and approval:

- The Audited Annual Report for the Financial Year 2017,
- The Auditor's Report drawn up by the independent auditor KPMG Slovenija, Limited Liability Company,
- The proposal for the appropriation of profit and
- The report on the relations of the Bank with controlling company and its affiliates including the Auditor's Report drawn up by the independent auditor KPMG Slovenija, Limited Liability Company.

Pursuant to the provisions laid down in Article 282 and Article 546. a of the Companies Act, the Supervisory Board has examined the received documents and hereby presents its findings to the Annual General Meeting of Shareholders of Banka Intesa Sanpaolo d.d. (hereinafter referred to as: AGM) as follows

R E P O R T

1. The way and scope of verification of the management of the Bank during the financial year 2017

In the course of the financial year 2017, the Supervisory Board of the Bank met five times at ordinary meetings and ten times at extraordinary meetings in which it
examined:
- strategic and operating matters in relation to the Bank's development,
- implementation of the business policy and current results posted by the Bank,
- annual and other reports of the Management Board, as well as other important issues relevant to the Bank's business;

and voted:
- on proposed business deals where due to being in excess of the limit on exposure determined for a particular customer, the Supervisory Board of the Bank has to grant its prior approval,
- on giving consent to the disclosures for the Bank for 2016, and
- on other matters of interest.

The materials for the meetings were forwarded to the members of the Supervisory Board in compliance with the Rules of Procedures governing the discharging of the functions of the Supervisory Board and those functions were discharged in line with the aforementioned enactment.

In 2017, the composition of the Supervisory Board did not change.

The Supervisory Board performed its duties in accordance with its principal function, i.e. supervision of the Bank's business run by the Management Board and the Bank's performance in accordance with its powers and focused attention to the following areas, in particular:
- gave prior approval to the budget for the financial year 2017;
- monitored and assessed on a regular basis the compliance with the Bank's business policy for 2017 and the fulfilment of the goals set out within the policy framework;
- monitored the NPL reduction trends;
- monitored the update on IFRS 9 project and the IFRS 9 impact estimation;
- adopted the Recovery Plan of the Parent Company for Banka Intesa Sanpaolo d.d. in part containing the measures which shall be used by the Bank to restore its own financial position in the event of a significant deterioration;
- discussed the annual plan of the Internal Audit Assignments for the year 2017 and the multiyear plan for the period 2017 – 2019;
- examined the annual report on the carrying out of internal control and the measures that arise from the regulations from the field of the fight against money laundering and terrorist financing, and the implementation of restrictive

measures for 2016 and the semi-annual for the first half of 2017;
- examined the annual report of the Compliance and AML Department for 2016 and the action plan for 2017;
- examined the semi-annual report on the Internal Audit Assignments for the second half of 2016 and for the first half of 2017, examined and approved the annual report of the Internal Audit Department for 2016 and examined the quarterly reports;
- verified the activities and reviewed the findings of the Internal Audit Department during the current year;
- re-appointed the director of the Internal Audit Department;
- acknowledged the notice of resignation of the president, deputy president and member of the Management Board and appointed a new president of the Management Board and two new members of the Management Board;
- gave the consent to the policy on selecting and assessing members of the management bodied, and on managing conflicts of interests on the level of members of the Management Board and Supervisory Board;
- took the measures needed to manage the present potential conflict of interest situations;
- acknowledged the ISP Group Report on remuneration of 14 March 2017;
- took note of the minutes of the committees of the Supervisory Board;
- examined the ICAAP Book;
- monitored the Bank's capital adequacy;
- took note of the reports of Banka Slovenije;
- acknowledged the implementation of the Intesa Sanpaolo Group – wide model of the integrated Internal Control System;
- addressed other issues in accordance with powers conferred upon it under law and the Articles of Association.

The committees of the Supervisory Board, and more specifically: the Audit Committee, the Risk Committee and the Nomination Committee provided the Supervisory Board with substantive support in 2017. The Supervisory Board` s committees met regularly and discussed the topics within their respective competences and responsibilities.

The Supervisory Board hereby states that all its members have examined carefully the Annual Report, the Report of the Certified Auditor, Financial Statements, Notes to the Financial Statements, and other notes presented therein. Furthermore, the Supervisory Board assesses that the Annual Report of the Management Board gives a true and fair view of the business events and provide comprehensive information as to operations during the past financial year, and thus complements and expands the information already presented to the Supervisory Board in the course of the financial year. The Bank has safeguarded a high level of operational safety and effectively manages risks it is exposed to in the course of its day-to-day business. Therefore, the Supervisory Board has assessed that considering the circumstances under which the Bank conducted business, the Bank's management and performance were successful during the period under review.

Furthermore, the Supervisory Board also assessed that the work of the Internal Audit Department was well planned and effective, and supported the activities of the Management Board, Audit Committee and assisted the Supervisory Board when forming opinions and making assessments.

2. The position with regard to the Independent Auditor's Report

The Supervisory Board hereby concludes that the external auditor has expressed in the Auditor's Report an opinion in relation to the financial statements prepared by Banka Intesa Sanpaolo d.d. On this basis, the Supervisory Board hereby adopts the following

p o s i t i o n:

that the Supervisory Board has no objection to the Report of the auditor KPMG Slovenija, limited liability company.

3. Approval of the Annual report for the financial year 2017

On the basis of the insight into operations carried out by the Bank in the course of the financial year and after due examination of the audited Annual Report and the unqualified opinion stated in the external auditor's report, the Supervisory Board hereby

a p p r o v e s a n d a d o p t s

The Annual Report of Banka Intesa Sanpaolo d.d. for the Financial Year 2017.

4. Approval of the proposal on profit appropriation

The members of the Supervisory Board have analysed the proposal regarding the appropriation of the balance-sheet profit. They have found the proposal for the adoption of the distributable profit, to be in line with the dividend policy of the Bank. After due examination of the proposal, the Supervisory Board hereby fully

a g r e e s

with the proposal of the Management Board on the appropriation of the profit.

5. Confirmation of the Report on the relations of the Bank with the controlling company and its affiliates for 2017

5.a. Position with regard to the Auditor's Report

The Supervisory Board hereby establishes that the external auditor in its report has given the following opinion regarding the Report on the relations of the Bank with the controlling company and its affiliates:

»Based on the procedures we have performed and the evidence we have obtained, nothing has come to our attention that causes us to believe that the:

- statements in the report on relations with affiliated companies for the financial year that ended 31 December 2017 are not accurate in all material respects;
- that the Company's execution of legal transactions stated in the Report was disproportionally high in view of circumstances that were known at the time when these transactions were performed;
- that circumstances exist that would in view of other actions mentioned in the Report indicate a significantly different assessment of the disadvantage from the one given by the management,

all by taking into account the above-mentioned criteria.«

The Supervisory Board hereby adopts the following

p o s i t i o n:

The Supervisory Board does not have any objection with regard to the Report of the audit firm KPMG Slovenija.

5.b. Statement of the Management Board of the Bank with regard to the Report on the relations of the Bank with the controlling company and its affiliates

The Management Board of Banka Intesa Sanpaolo d.d. with regard to the Report on the relations of the Bank with the controlling company and its affiliates has stated that Banka Intesa Sanpaolo d.d. in the circumstances known to it at the time when a legal transaction was carried out or abandoned, the Bank received adequate compensation and by the act of abandonment, it was not to its detriment. The Supervisory Board has no objection with regard to the Statement.

Based on the disclosures and information regarding the Bank's operations during the year under review and in-depth examination of the Report on the relations of the Bank with the controlling company and its affiliates and the unqualified opinion of the independent auditor, the Supervisory Board hereby

c o n f i r m s and a p p r o v e s

The Report on the relations of Banka Intesa Sanpaolo d.d. with the controlling company and its affiliates.

Koper, 2 March 2018

Chairman of the Supervisory Board
Uroš Čufer

3. BODIES OF CORPORATE GOVERNANCE

Supervisory Board

The Supervisory Board of Banka Intesa Sanpaolo d.d. is composed of five members: two independent experts and three are representatives of the Intesa Sanpaolo banking group.

No changes were made to the composition of the Supervisory Board in 2017.

Members of the Supervisory Board

As at 31 December 2017:	
Uroš Čufer	*Chairman*
Dr. Borut Bratina	*Deputy Chairman*
Elena Breno	*Member*
Emanuele Collini	*Member*
Silvia Rinaldi	*Member*

Management Board

The Management Board of Banka Intesa Sanpaolo d.d. has six Members.

In 2017, changes were made to the composition of the Management Board. On March 31, 2017, Maurizio Marson, Member of the Management Board responsible for the Retail Division, accepted new assignments within the Intesa Sanpaolo Group in Italy. Thus, the Supervisory Board appointed Ivan Ivičić as a new Member of the Management Board, who thus took over the responsibility for the retail business.

A few months later, specifically on July 13, 2017, on the basis of an agreement on the termination of the employment Agreement for the position of the Deputy Chairman of the Management Board, the function of Igor Kragelj as a Deputy Chairman of the Management Board has been terminated. Igor Kragelj was responsible for the Corporate and SME Division. The Supervisory Board appointed Mr Drago Kavšek as a new Member of the Management Board, who took over the leadership of the above mentioned division.

Due to accepting new assignments at headquarter of the Intesa Sanpaolo Group in Italy, Giancarlo Miranda submitted his resignation as the President of the Management Board. His term of office ended on 31 October 2017. The Supervisory Board appointed Jozef Kausich as the new President of the Management Board. His term of office starts on the day Jozef Kausich receives a licence by the European Central Bank for pursuing the job of a Management Board Member.

Members of the Bank's Management Board

As at 31 December 2017:	
Irena Džaković	*Member*
Rado Grdina	*Member*
Ivan Ivičić	*Member*
Drago Kavšek	*Member*
Aleksander Lozej, M.Sc.	*Member*
Aleksander Milostnik	*Member*

4. ECONOMIC AND BANKING ENVIRONMENT

After three years of growth, economic activity in Slovenia continued to grow in 2017 as well. The successful export sector, which continues to expand primarily on account of foreign demand and export competitiveness of Slovenian companies, contributed the most to the growth. In addition to exports, domestic demand also had a major impact on growth. Last year, private consumption had a favourable effect on GDP growth, also strengthening the consumption of durable and other goods; furthermore, residential investments and investments in engineering structures continue to grow alongside investments in equipment and machinery. After 10 years, GDP surpassed the level before the crisis and the economy transferred from the recovery stage to the stage of economic growth. While private investments increased, the volume of government investments remained at a low level due to decelerated drawing of EU funds.

In line with favourable economic trends, conditions on the labour market also improved. The downward trend in the number of unemployed persons continues. At the end of December 2017, there were 85,060 unemployed persons registered, which is 14.6% less than at the end of 2016. Despite declining unemployment, structural imbalances on the labour market have increased, meaning that companies encounter problems when searching for suitable human resources.

The annual inflation rate in 2017 stood at 1.7% (0.5% at the end of 2016). With recovering private consumption, the prices of goods and services rose. The annual inflation rate is largely the result of increased prices of food and petroleum products.

In 2017, the fiscal position of the state continued to improve. Revenues increased primarily on account of all tax sources and mostly those related to the labour market. Expenditure reduced due to shrinking government investments, while other expenses rose as a result of a gradual release of austerity measures and increased expenditure for goods and services.

After several years of lending activity contraction of banks, lending to the non-banking sector started to grow in 2017. The growth rate of loans strengthened the most in households segment as a result of improved conditions on the labour market and low interest rates. In 2017, all kind of lending to households enjoyed growth. The largest increase was noticed on consumer loans, while mortgages were increasing on a stable growth rate. Banks, however, remain somewhat reserved in corporate lending, while own internal sources for corporate financing have gained ground. Debt security financing fell substantially. Banks continue to favour household financing, since Slovenian households are among the relatively least indebted in the euro area and their position is improving in line with the strengthening of the labour market. The quality of bank's loans further improved in 2017; banks decreased their non-performing loans by restructuring, write offs and sales of NPLs at a discount.

Balance sheet liabilities show continued growth of deposits made by the non-banking sector in 2017, despite the fact that interest rates on deposits remain at historically low levels. Deposits grew in the household and corporate segments, but fell in the general government segment. With low interest rates on deposits, the maturity of deposits continues to shorten substantially, while the share of demand deposits is above average and keeps growing.

Bank profitability has continued for the third year in row, mostly as a result of a positive profit margin. Bank profits exceeded those of the previous year, mostly on account of net reversal of impairments and provisions at the level of the entire banking system. Net interest income continued to decline, but at a slower pace, and its negative effect was partly neutralised by the banks' lower interest expense. After a several-year-long downward trend in operating costs, the latter is gradually coming to an end. Operating costs can be further reduced through consolidation and rationalisation, but investments in digitalisation, mandatory compliance with regulatory requirements and positive growth of labour costs permit it only to a certain extent.

5. AN OVERVIEW OF THE BANK'S OPERATIONS IN 2017

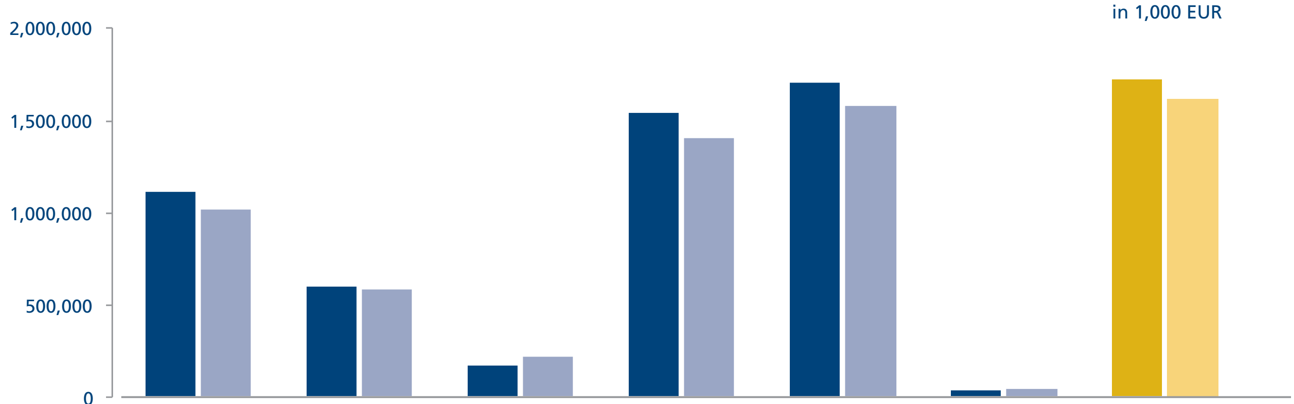
5.1 LENDING OPERATIONS

The recovery of economic activity contributed to the reversal of a downward trend in loan volume that was present since 2011. In 2017, loans to the non-banking sector started growing. The volume of gross loans amounted to EUR 23.1 billion at the end of December 2017, which is a 2.1% increase compared to the end of 2016.

Gross loans by Intesa Sanpaolo Bank to the non-banking sector increased by EUR 44.5 million in 2017 or 2.6% compared to 2016. The Bank's market share in lending to the non-banking sector grew by 3 basis points in 2017, thus achieving 7.7%.

In terms of currency, most loans are in domestic currency (98.9%), while long-term loans prevail in terms of maturity (89.3%). As for the maturity structure, the trend of increasing short-term over long-term loans was recorded also in 2017. Still, short-term loans accounted only for 10.7 per cent of total loans.

An overview of gross lending to the non-banking sector in thousands of euros



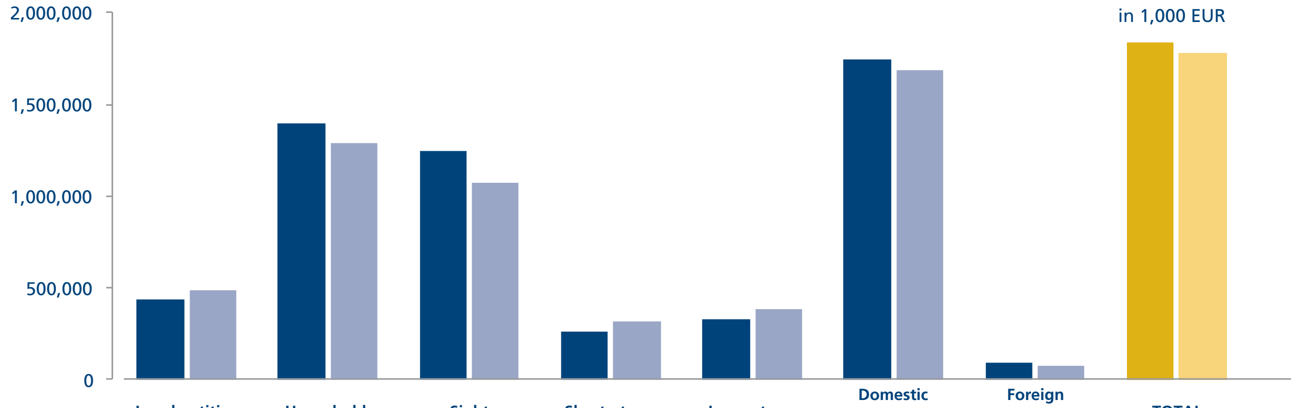
	Legal entities	Households	Short - term	Long - term	Domestic currency	Foreign currency	TOTAL
2017	1,129,338	645,882	190,107	1,585,113	1,756,040	19,180	**1,775,220**
2016	1,129,647	601,097	179,970	1,550,773	1,704,275	26,470	**1,730,744**

Loans to the corporate sector amounted to EUR 1,129.3 million or 63.6%, representing the largest portion of loans to the non-banking sector.

Lending to households (private individuals and sole proprietors) reached EUR 645.9 million or 36.4% of total lending to the non-banking sector. Lending to this customer segment increased by EUR 44.8 million or 7.5% on yearly basis. As in 2017, households mostly borrowed on a long-term basis, while borrowing in foreign currency remained on a low level. Most of long-term loans are mortgage loans. In 2017, the Bank maintained its market share in the segment of private individuals and sole proprietors, which amounts to 6.6% as well as the market share in the segment of corporate clients remained stable at 8.4%.

5.2 DEPOSITS

An overview of deposits and loans from the non-banking sector in thousands of euros



	Legal entities	Households	Sight	Short - term	Long - term	Domestic currency	Foreign currency	TOTAL
2017	512,228	1,459,268	1,418,671	265,959	286,866	1,889,969	81,527	**1,971,496**
2016	435,412	1,404,552	1,245,521	259,523	334,919	1,751,778	88,185	**1,839,963**

In 2017, the Bank increased deposits and loans received from the non-banking sector by 7.1% or EUR 131.5 million, whereby the market share increased by 12 basis points to 7.2%, the market share of household deposits fell by 15 basis points and amounted to 8.0% at the end of 2017, and the market share of deposits by legal entities increased by 59 basis points, thus amounting to 5.7%.

The sight deposits account for a 72.0% share of total deposits and loans received from the non-banking sector. They are followed by long-term deposits (14.5%) and short-term deposits (13.5%). In terms of currency, deposits in domestic currency prevail with a 95.9% share. With respect to the previous year, demand deposits increased by 13.9% in 2017. Short-term deposits increased by 2.5%, while long-term deposits reduced by 14.3%.

The volume of the deposits placed by legal persons increased by 17.6% (by EUR 76.8 million) comparing with 2016. Also in 2017, the deposit structure in terms of currency was dominated by deposits denominated in euro.

Household deposits accounted for 74.0% of all non-bank deposits and at the end of 2017 totalled EUR 1,459.3 million, i.e. EUR 54.7 million more year-on-year. Household deposits were mainly denominated in local currency.

5.3 OTHER SERVICES

5.3.1 Card operations

The Activa System
In 2017, banks that are members of the Activa system continued introducing and issuing contactless cards and furnishing points of sale with contactless POS terminals, while implementing solutions for mobile authentication of customer during on-line purchases. The banks also implemented a new authorisation protocol that provides enhanced reliability and flexibility. Next year, activities within the scope of the Activa system will focus mostly on mobile payments and payment by instalments.

Intesa Sanpaolo Bank
The Bank was the first in Slovenia to provide the possibility of mobile payments to all its clients holding the transaction account debit card Visa Inspire and a suitable mobile device. Payments are effected using the Wave2Pay mobile-wallet application, which was launched by the Bank in mid-2016 and can be downloaded by users to their mobile device from the app store and activated remotely.

Promotional activities focused on mobile payments and mobile transfer of assets using the Wave2Pay and QL services. The latter, which is integrated into the mobile banking solution, enables users to make instant payments and transfers of assets from the payer's account to the recipient's account in real time.

New products and services

In 2017, Intesa Sanpaolo Bank expanded its range of products and services for its clients based on their expectations, market conditions and legal requirements. The following stand out the most:

- Issue of contactless Activa Visa Inspire and Activa MasterCard cards,
- Provision of mobile payments using the Activa Visa Inspire card within the scope of the Wave2Pay mobile-wallet application,
- Combination of saving schemes in investment funds and a long-term deposit,
- Investment counselling,
- Expanded range of pre-approved consumer credits,
- Introduction of QR code on universal payment order forms.

5.3.2 Marketing and sale of mutual investment funds

In 2017, interest rates on deposits remained low. Most capital markets grew firmly in 2017, which had a positive effect on investors and payments made in mutual funds. According to the Reports published by the Slovenian asset management companies on the Securities Market Agency's website , the estimated net inflows in Slovenian funds amounted to EUR 33.5 million in 2017. Assets in Slovenian funds also increased on account of growing capital markets. According to the data provided by the Bank of Slovenia, mutual funds by foreign asset management companies recorded net outflows of slightly less than EUR 0.6 million between January and October 2017.

Considering the above circumstances, Banka Intesa Sanpaolo d.d. may be proud of its good performance, as it completed 2017 with EUR 15.35 million of net payments in the foreign funds marketed by the Bank. As a result, the Bank's market share in respect of assets in foreign funds on the Slovenian market increased from 23.9% (December 2016) to 34.0% (October 2017). The increase was also the result of a great combination of a deposit with a better interest rate and payment in funds with lower costs. Furthermore, 1195 new saving plans were made in 2017.

In January 2017, Franklin Templeton Investments company deregistered 3 sub-funds in Slovenia and, hence, the Bank was left to offer 7 sub-funds.
In February, Eurizon Capital company made major changes to the funds marketed in Slovenia in order to rationalise operations. Some funds changed their investment policy and some funds merged with other funds.
In October 2017, the Bank took over clients with investments in Franklin Templeton Investments funds in agreement with Banka Sparkasse d.d.
Thus, the offer now comprises the following funds:

- Eurizon Capital S.A. (14 mutual Eurizon Funds and 4 mutual Eurizon Manager Selection Funds),
- Franklin Templeton Investments S.A. (7 mutual Franklin Templeton Investment Funds).

Furthermore, the Bank also markets the funds of three Slovenian asset management companies:

- ALTA Skladi – 19 funds,
- KBM Infond – 21 funds,
- Primorski skladi – 4 funds.

In 2017, the Bank continued the MiFID II and Wealth Management project. The purpose of the project is to establish an advisory model that is in line with MiFID II Directive and the strategy of ISP Group. In September, pilot implementation of the investment counselling service was launched at the Koper branch. The investment counselling service complies with Regulation MiFID II and will be gradually extended to the entire network of our branches in 2018.

In 2017, 20 persons employed in marketing successfully passed the broker exam and obtained a licence for investment counselling, hence the Bank now employs 41 marketing officers with a licence for investment counselling.

Sound results were also the product of marketing campaigns, through which the Bank reduced entry fees for investors and strengthened the marketing of saving plans for mutual funds. In 2017, the Bank concluded 1195 new saving plans and thus surpassed its result from the previous year by 129%.

The ***Moje finance*** magazine assessed the quality of the mutual funds marketed by the Bank for the 7th consecutive year. According to them, the foreign mutual funds marketed in Slovenia by the Bank won two best fund awards, while two other mutual funds received five-star rating.

5.3.3 Leasing

The Finor leasing Office, which is part of the SME network, specialises in the sale of financial leasing throughout Slovenia, both for natural persons and legal entities.

Finor leasing Office employs eight (8) persons working at three units in Koper, Ljubljana and Maribor.

In 2017, 478 leasing contracts were made in the total value of EUR 18.2 million. The most (227 contracts valued at EUR 9.1 million) were made for commercial vehicles, followed by passenger cars (191 contracts valued at EUR 4.8 million), production and other equipment (55 contracts valued at EUR 2.7 million), real estate (2 contracts valued at EUR 1.3 million) and vessels (3 contracts valued at EUR 0.4 million).

Compared to 2016, the Office increased the volume of investments in 2017 by 33.1%.

5.3.4 Open-ended mutual pension funds by Banka Intesa Sanpaolo d.d. (OVPS)

In January 2017, Banka Koper d.d. changed its name into Banka Intesa Sanpaolo d.d. Therefore, the name of the pension fund manager also changed.

The Bank is actively involved in the voluntary pension insurance system within the scope of the Slovenian pension system, as it established and started managing the Banka Koper d.d. open-ended mutual pension fund (OVPS) back in 2001. The fund is intended for collective and individual voluntary supplementary pension insurance.

As at 31 December 2017, the Banka Intesa Sanpaolo d.d. pension fund (OVPS) disclosed total assets amounting to EUR 42.170 million, which is a 3.36% increase with respect to the end of 2016. The increase is primarily the result of favourable trends for investments and reduced pressure by insured persons for the disbursement of saved assets in a single amount.

Despite the fact that tax treatment discourages exceptional withdrawal from the second pillar compared to regular withdrawal, exceptional withdrawals (single disbursement) from the second pillar continue to prevail over regular withdrawals (supplementary pension). Notably, a positive trend in the use of the assets saved in the form of a supplementary pension – a rent – was noticed in 2017.

At the end of 2017, the OVPS pension fund included 6,601 insured persons, 6,102 of whom were included in collective voluntary supplementary pension insurance, while 608 were individually insured persons. There were 109 companies co-funding collective pension schemes in OVPS.

The value of an OVPS unit amounted to EUR 9.7184 as at 31 December 2017 and increased by 0.96% within a year, thus exceeding the guaranteed return, which amounted to 0.7125% in 2017. The 5-year return rate of the OVPS pension fund amounted to 13.38% as at 31 December 2017, while the value of a unit grew by 133.06% from the establishment of OVPS to 31 December 2017.

In 2017, Banka Intesa Sanpaolo d.d. still offered its insured persons one mutual pension fund with a guaranteed net paid-in premium and guaranteed minimum return rate. The decision adopted in 2016 on the establishment of a fund of pension funds and transformation of the existing mutual pension fund into a guaranteed sub-fund was realised in 2017. The Bank obtained decisions from the Ministry of Labour, Family, Social Affairs and Equal Opportunities on the approval of the pension schemes of the fund of pension funds for individual and collective insurance, and a decision by the Securities Market Agency on the approval of Governance Rules for the Moj Steber fund of pension funds. Within the scope of the Moj Steber fund, the Bank manages three sub-funds as of 1 January 2018:

Moj Steber Dynamic, intended for insured persons aged 40 or less,
Moj Steber Balanced, intended for insured persons aged between 40 and 55, and
Moj Steber Guaranteed, intended for insured persons aged 55 or more.

Such a form of investment policy of the fund of pension funds with various investment policies intended for different age categories is called the life-cycle investment policy and is an extended investment strategy method in developed economies, where the horizon of saving is long and intended for acquiring additional funds for the disbursement of a supplementary pension after an insured person retires.

Such a form of investment policy provides younger insured persons with a riskier, share-oriented investment, while the level of risk reduces with the ageing of an insured person and their approach to retirement up to the last and lowest risk level, where insured persons are again part of a guaranteed pension sub-fund and its members until their they choose the supplementary pension payer or, rather, until they retire.

5.3.5 Depositary banking

Banka Intesa Sanpaolo d.d. was the first bank in Slovenia that provided depositary services for investment funds in 2004. Since then, the Bank has obtained a great deal of knowledge and experiences. The provision of depositary services is a very responsible task, since the accuracy of items in the funds' books of account need to be checked on a daily basis, along with the accuracy of net asset value and unit value calculation, conversion of payments in the funds, claims for disbursement, and investment compliance with the provisions of investment policy. The depositary is also the custodian of the assets held in each investment funds, since the latter is kept in accounts that were opened by the depositary on behalf of and for the account of an individual fund – owner. Furthermore, the depositary keeps an eye over proper operations of the investment fund and over its assets.

2017 was a year of challenges, since the Slovenian legislation was brought in line with the provisions of the EU Directive governing the method of implementation of depositary services. The harmonisation and implementation of new requirements was completed and the Bank is now ready to provide its clients with top quality depositary banking services.

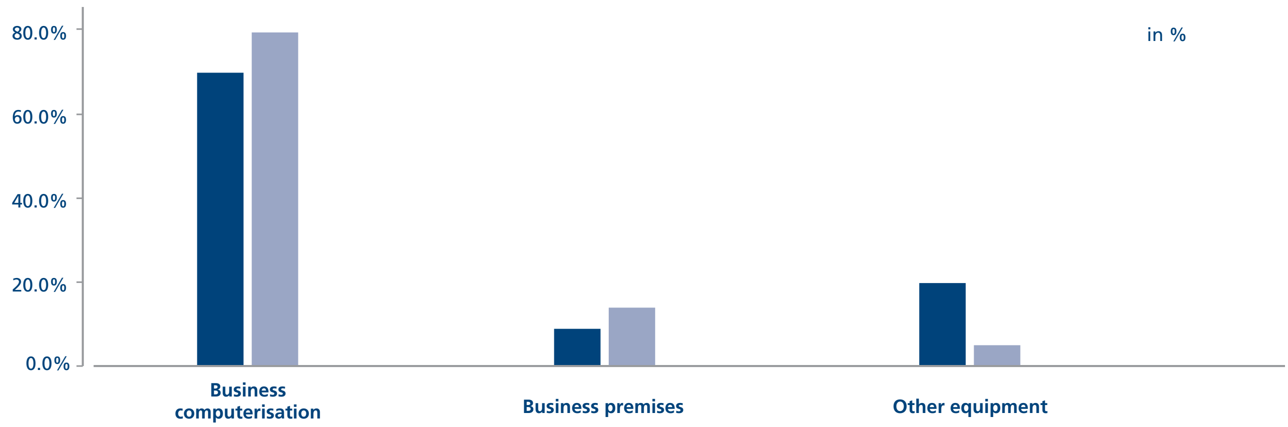
At the end of 2017, Banka Intesa Sanpaolo d.d. rendered depositary services for mutual funds (UCITS), pension funds and internal funds at insurance companies. At the end of the year, it made an agreement with a new client under which the volume of assets under custody will further increase, drawing close to EUR 0.8 billion.

6. THE BANK'S ORGANIC GROWTH AND DEVELOPMENT

6.1 CAPITAL INVESTMENTS

In 2017, Banka Intesa Sanpaolo d.d. continued pursuing its long-term development programme and invested EUR 1.0 million in the computerisation of business operations, commercial premises and other equipment. However, the Bank allocated EUR 0.2 million less for investments than in the previous year.

Structure of capital investments in 2017



	Business computerisation	Business premises	Other equipment
2017	68,9%	16,4%	14,7%
2016	71,1%	8,5%	20,5%

The majority of investments (EUR 0.7 million or 68.9%) was allocated to business computerisation. Increasingly stricter requirements regarding banking safety require yearly investments in ensuring the safety of services.

In 2017, the Bank allocated EUR 0.2 million or 16.4% of total investments for the rearrangement of business premises into a modern banking service and for the design of its branches pursuant to the corporate identity of the banking group.

6.2 INFORMATION TECHNOLOGY AND TECHNOLOGICAL DEVELOPMENT

As regards **business solutions** in 2017, the Bank:

- continued implementing the **Mobile payments (QL)** solution. This is a Banka IN **"mobile wallet,"** an innovative solution on the Slovenian market. The solution complements the existing payment mechanisms, replaces cash management and low-value payments, and provides simple and transparent handling of domestic payment transactions, both for the service provider as well as user, in real time. The solution is intended for clients and non-clients of the Bank;
- started activities in a project within the scope of the Intesa Sanpaolo Group, i.e. **"Global Transaction Banking,"** completed the implementation of "Cash management" functionality, and started activities for making real-time payments in Slovenia and within the Intesa Sanpaolo Group;
- implemented the **"Wealth Shaper"** app support for carrying out **investment counselling** processes pursuant to **Mifid** regulations and obtained a licence to provide in investment services, i.e. investment counselling and investment research and financial analyses or other forms of general recommendations relating to transactions in financial instruments.
  The investment counselling process includes the identification of an investor profile, an analysis of the current profile, presentation of a recommended portfolio, preparation of an offer, execution of orders and after-sale activities.

As regards **risk management** in 2017, the Bank:

- started developing **ratings** for small enterprises and natural persons

- continues activities in **the optimisation of processes** of deviations from baseline commissions and interest rates.

In **regulatory affairs** and compliance in 2017, the Bank:

- implemented the functionalities related with **IFRS 9**;

- set up, pursuant to the guidelines provided by the parent bank, the project of a **"data management system,"** aimed at establishing internal data management rules, procedures and organisation, upgrading the existing solutions and data warehouse of the Bank, and setting up a central database within the scope of the parent bank. The implementation of stage 1 of the project is planned for 2017.

As regards **business optimisation** in 2017, the Bank:

- completed refurbishing **teller equipment,** where it first introduced electronic document signing equipment in 2013 and then electronic document capture equipment at the point of origin. Hence, the Bank provided fully paperless operations of tellers and commercial officers, optimised business processes, sped up the most frequent operations and substantially reduced the costs related with document storage;

- **upgraded the Navision ERP system,** this optimising processes in that area;

- continued intensively **optimising the key business processes and paperless operations,** thereby pursuing its medium-term digital strategy.

As regards **information security** in 2017, the Bank:

- **implemented a solution for detecting abuses in online and mobile banking** pursuant to ECB guidelines for online payments. In 2017, the Bank plans to set up a process of regular monitoring of abuses in the area. The solution may be upgraded to other fields of banking;

- increased the level of system security by implementing "Hardening" in all operating systems;

- renewed the entire **WAN network** and raised the level of security.

As regards **operational risks** in 2017, the Bank:

- **implemented a new "data centre" architecture in Slovenia** pursuant to the requirements of the parent bank and provided the availability of all critical systems of the Bank in case of failure of the entire primary location in Koper.

7. ACTIVITIES IN THE FIELD OF SUSTAINABLE DEVELOPMENT

The principles and values deriving from the Bank's Code of Ethics require each employee to strive to realise them in day-to-day activities. Any consistency and persistence pays off, with the results shown in improved relations with all key stakeholders of the Bank, which represent important foundations for successful operations in the long term.

The greatest recognition to the Bank's activities was given to the efforts made in Human Resources, with Intesa Sanpaolo Bank ranked among top 10 employers in the country according to the research conducted by Mojedelo.com employment portal. The mentioned research included several thousand respondents, who assessed their employer's reputation under three criteria, i.e. with respect to the knowledge of a company among candidates on the labour market, consideration of a company as a potential employer, and with respect to the level of selected employer.

Before that, Intesa Sanpaolo Bank was ranked among the top 11 most attractive employers in the opinion of participants in the October independent opinion survey entitled "Employer attraction," which is conducted by Competo company rendering HR services.

Both recognitions are extremely important for the Bank, since its visibility and reputation matters not only to clients and business partners, but also to ambitious job seekers who are ready to face the challenges of modern times and will not consent to being average.

7.1 RESPONSIBILITY TOWARDS EMPLOYEES

7.1.1 Training programmes

Systematic training provides the basis for employee development at Intesa Sanpaolo Bank. There were 11,547 hours of training realised altogether, which is an average of 15.4 hours per employee. Most, 82%, of all training was in-house training provided by in-house and external lecturers. In-house lecturers carried out 31% of all training.

Due to the introduction of the advisory model in investment services, the Bank placed most attention to training employees in investment counselling.

The provision of undisturbed and safe operations again required ongoing awareness raising among all employees on the importance of preventing money laundering and terrorist financing, and on the compliance of the Bank's overall operations, particularly as regards personal data protection.

7.1.2 Development of key personnel

In key personnel development, training activities continued within the scope of two programmes, namely the Talent Management Programme, which is intended for young promising employees, and Manager Development Programme, which is focused on the development of managerial staff.

At the end of 2016, the development programme for the 2nd generation of talents completed successfully. In 2017, activities started to include the 3rd generation. The project is aimed at providing HR support for the Bank's new business guidelines, which is why the development programme will be intended for the development of talented personnel in commercial affairs.

Within the scope of the Manager Development Programme, all managers – from Board Members to branch managers – attended a workshop to the topic of efficient management and communication of changes. Within the scope of the Talent Management Programme, a selection procedure was conducted and a development programme was drafted for a 3-year period.

7.1.3 Concern for and dialogue with employees

At the beginning of 2017, the Bank received the results of organisational climate measurements within the scope of the Group. Based on the results obtained, the work group prepared a new or, rather, revised action plan for the introduction of improvements in five areas: establishment of systematic provision of information and communication between organisations, upgrade of the reward scheme in relation to annual interviews, development of managers, development of talents for commercial affairs, and simplification of the monthly reward scheme for business network affairs. Permanent concern for improving employee relations and satisfaction also improves relations between employees and clients.

7.2 RESPONSIBILITY TOWARDS CUSTOMERS

The highest form of the Bank's responsibility towards clients is shown in due consideration of their needs and wishes. The Bank learns of the latter in various ways, either through direct contact with clients, by collecting complaints, proposals and commendations at specifically marked spots in branches and on the Bank's website, or through the Customer Satisfaction Retail Benchmarking Survey, which was again carried out in 2017. The Bank successfully resolved more than half of the complaints received.

Among activities to improve the quality of operations and attitude towards clients, carried out under the traditional "Posluh 100%" brand name, the Bank again introduced an initiative for its employees to provide ideas on how to improve internal work processes, work with clients and the Bank's products and services. Within a month, as long as the competition lasted, 218 proposals for improvements were submitted, which proves the employees' focus on customer relations.

The top recognition received by the Bank in 2017, rewarding its efforts in the introduction of improvements, is the Best Bank certificate presented by Moje finance magazine in as many as three categories: residential loan with a fixed interest rate of up to EUR 40,000 for a 10-year period, lowest fee for debit card cancellation or replacement, and the lowest fee for managing a classic account.

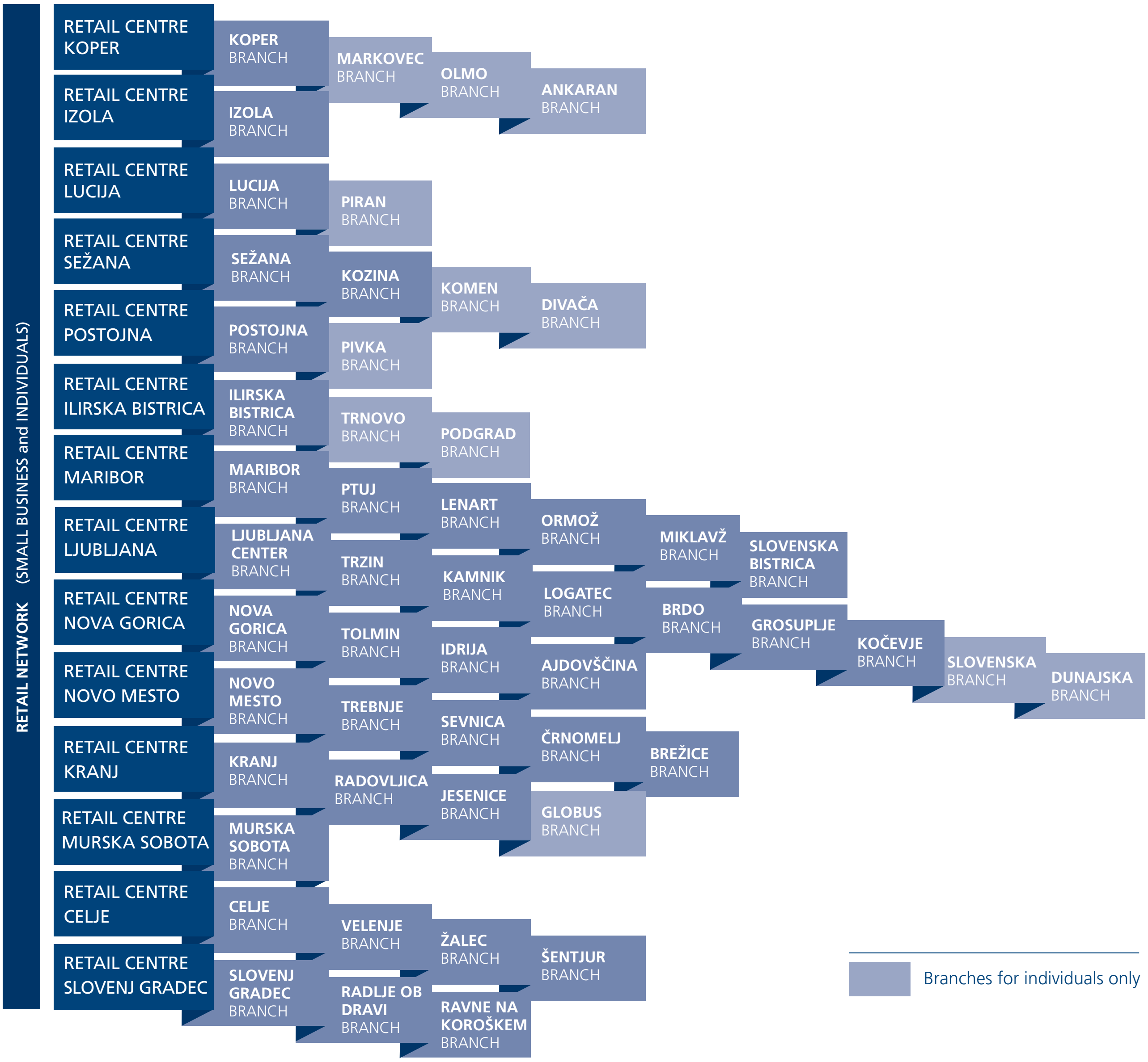
The Bank continued to encourage existing clients to spread the word of the Bank's quality operations and reputation among their friends and acquaintances within the scope of the "Invite a Friend" (Povabi prijatelja) motivation programme.

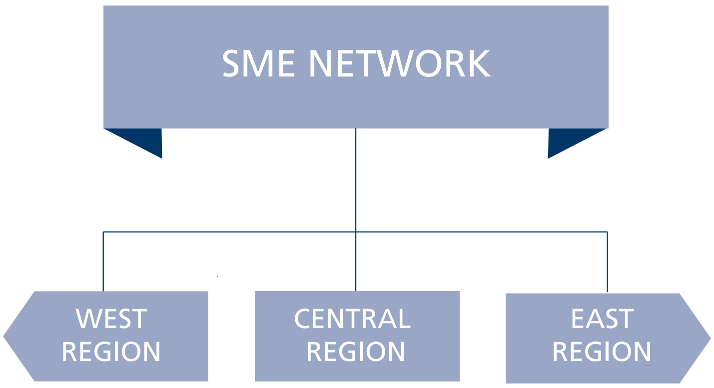
7.3 CORPORATE SOCIAL RESPONSIBILITY

Various clubs, institutions and sports organisations organise and carry out numerous sports activities in our environment in order to preserve traditional values and stimulate the youth to exercise in nature and lead a healthy life style. Intesa Sanpaolo Bank donated small, but numerous incentives in order to help realise many plans and efforts of the mentioned organisations.

In sponsorship, the Bank dedicated most funds for general sponsorship of the second largest running event in the country, the 4th Istrian Marathon, which in 2017 included in its track Ankaran as the 4th coastal municipality. Participation at the Marathon was record-breaking and also included over 400 runners from the Intesa Sanpaolo Group.

8. TERRITORIAL CHART OF COMMERCIAL UNITS





9. INTERNAL ORGANISATION CHART

10. THE CORPORATE GOVERNANCE STATEMENT OF BANKA INTESA SANPAOLO D.D.

THE CORPORATE GOVERNANCE STATEMENT OF BANKA INTESA SANPAOLO D.D.

In accordance with the fifth paragraph of Article 70 the Companies Act – ZGD-1 (Official Gazette of the Republic of Slovenia, No. 55/2015), Banka Intesa Sanpaolo d.d., gives the following

Corporate governance statement
The corporate governance statement is an integral part of the annual report for 2017 and it is available on the website of the company http://www.intesasanpaolobank.si/.

1. The corporate governance code which Banka Intesa Sanpaolo d.d. decided to use

Banka Intesa Sanpaolo d.d. hereby declares that for governance it observes the effective legislation, regulations, other legislative and secondary legislative acts and internal rules and instructions.

The company has the two-tier system of governance under which the company is run by the management board; its operations are supervised by the supervisory board. The bodies of the company are the general meeting of shareholders, the supervisory board and the management board.

2. Deviations from corporate governance codes

Banka Intesa Sanpaolo d. d. for governance does not deviate from the regulations stated in the first point of this corporate governance statement. Banka Intesa Sanpaolo d.d. does not use any special corporate governance codes, since in that segment it is bound by the codes of the parent bank. Of very high importance for its operations also with regard to governance of the company are the following internal acts:

- Code of Ethics of Banka Intesa Sanpaolo d.d.
- Code of Conduct in Banka Intesa Sanpaolo d.d.

3. The description of the principal characteristics of internal control and corporate governance systems in the company in connection with the financial reporting procedure.

With the aim of ensuring appropriate financial reporting procedures Banka Intesa Sanpaolo d.d. pursues the Rules of procedure on accounting and accounting policies of the group. Accounting control in the broader sense is provided through the system of internal controls. It shall encompass adequate and effective internal controls, its implementation and monitoring. Internal controls system covers all significant risks to which the bank is exposed and includes checking of administrative and accounting procedures, verification of bank´ s compliance with applicable legislation, standards, codes and internal rules and verification of information security. The descriptions of business processes including control activities for mayor areas of bank´ s business, namely landing, accepting deposits, current accounts and trading business are laid down. The processes related to financial reporting or composition of financial statements (daily and monthly closing of the general ledger) are also set out.

The principal identified risks in this area are managed with an appropriate system of authorisations, delimitation of duties, compliance with the accounting rules, documenting of all business events, the custody system, posting on the day of a business event, inbuilt control mechanisms in source applications and archiving pursuant to the laws and internal regulations. With an efficient controlling mechanism in the area of accounting reporting, the bank ensures:
- a reliable decision-making and operational support system,
- accurate, complete and timely accounting data and the resulting accounting and other reports of the Bank, and
- compliance with legal and other requirements.

In compliance with the Banking Act the independent Internal Audit Department is established. The Internal Audit Department performs the tasks of internal auditing and reports on its proceedings to the corporate bodies of the bank.

Risk management at is implemented in accordance with the banking legislation, guidelines of the parent bank and internal policies and procedures in which are laid down the principles and guidance of risk management.

The master business strategy, accepted principles of the bank´ s propensity to assume risk which include the monitoring of risk profile and of specific risks, internal policies of risk management, approved by the bank´ s Management Board and Supervisory Board lay down the objectives and the guidelines concerning the taking of risk and the methods and criteria of risk management.

4. The data on principal shareholders

The data on major direct and indirect ownership of the securities issued by Banka Intesa Sanpaolo d.d. within the meaning of achieving qualifying holding as specified in the Takeover Act.

The ownership structure of Banka Intesa Sanpaolo d.d.

Equity holding in per cent

Shareholders	31. 12. 2017	31. 12. 2016
Privredna banka Zagreb d.d.	51.0%	-
Intesa Sanpaolo S. P. A.	48.1%	98.9%
Minority shareholders	0.9%	1.1%

5. The data on the holders of securities that give special controlling rights

As at 31.12.2017, no security issued by Banka Intesa Sanpaolo d.d. gives any special controlling rights.

6. The data on restrictions on voting rights

In relation to the shares issued by Banka Intesa Sanpaolo d.d., as at 31.12.2017, there are no restrictions on voting rights.

7. Information on the appointment or replacement of members of the management or supervisory bodies and amendments to articles of association

In accordance with the provisions laid down in the articles of association of Banka Intesa Sanpaolo d.d., in the text in force as of 31.12.2017, the members of the supervisory board are elected by simple majority and discharged by the general meeting of shareholders with a two-thirds vote of the represented share capital. The management board is appointed and dismissed by the supervisory board with simple majority of votes. The general meeting of shareholders decides on amendments to the articles of association with a two-thirds vote of the represented share capital.

8. Information on authorisations to the members of management

The members of management do not have any special authorisations.

9. Information on the general meeting of shareholders of Banka Intesa Sanpaolo d.d.

In accordance with the provisions of the Companies Act (ZGD-1), the general meeting of shareholders is the ultimate body of the company. The shareholders exercise their management rights in matters of the company at the general meeting of shareholders of the company, where they pass fundamental and statutory resolutions. Convening the general meeting of shareholders is regulated by the articles of association of the company in accordance with effective legislation. The general meeting of shareholders is convened by the management board on its own initiative, at the request of the supervisory board or at the request of the shareholders of the company that represent at least 5% of the share capital of the company. The management board convenes the general meeting of shareholders of the company no less than one month before the meeting. The right to attend the general meeting of shareholders of the company is granted to all the shareholders registered in the shareholder's register as shareholders of the company at the end of the fourth day prior to the general meeting of shareholders, as well as to their proxies and authorised persons, and who apply to the company to attend the meeting no later than at the end of the fourth day prior to the general meeting of shareholders.

At the general meeting of shareholders of Banka Intesa Sanpaolo d.d. held on 21.06.2017, the shareholders were notified of the annual report of the company for the financial year 2016, the opinion of the independent auditor to the annual report, the report of the supervisory board to the annual report and remuneration of the members of the management board and of the supervisory board in 2016. The shareholders passed the resolution on the distribution the accumulated profit and gave discharge to the management board and to the supervisory board.

10. The data on the composition and functioning of the management or supervisory bodies and their committees

The supervisory board

The supervisory board of Banka Intesa Sanpaolo d.d. is composed of five members of which two are external experts and three are the representatives of the Intesa Sanpaolo banking group.

The members of the supervisory board as of 31.12. 2017 are:

Uroš Čufer	chairman
Dr. Borut Bratina	deputy chairman
Elena Breno	member
Emanuele Collini	member
Silvia Rinaldi	member

There were three committees of the supervisory board at the bank at the end of 2017: the Audit Committee, the Risk Committee and the Nomination Committee.

Description of the diversity policy implemented concerning participation in the management and supervisory bodies

The Nomination Committee is responsible for selecting and recommending candidates for members of the Management Bodies to the Supervisory Board, or to the Bank's General Meeting of Shareholders respectively.
When selecting and recommending the candidates, the Nomination Committee shall assure the aim of achieving the diversity within the Management Body, including the appropriate representation of both genders, is being followed as much as possible.

To contribute to appropriate representation of both genders, the Nomination Committee shall take into consideration the following quotas of underrepresented genders:
- Supervisory Board: 1/5 of the total composition, but at least 1 representative of the underrepresented gender;
- Management Board: at least 1 representative of the underrepresented gender.

The management board

As at 31.12.2017 the management board of Banka Intesa Sanpaolo d.d. comprised six members.

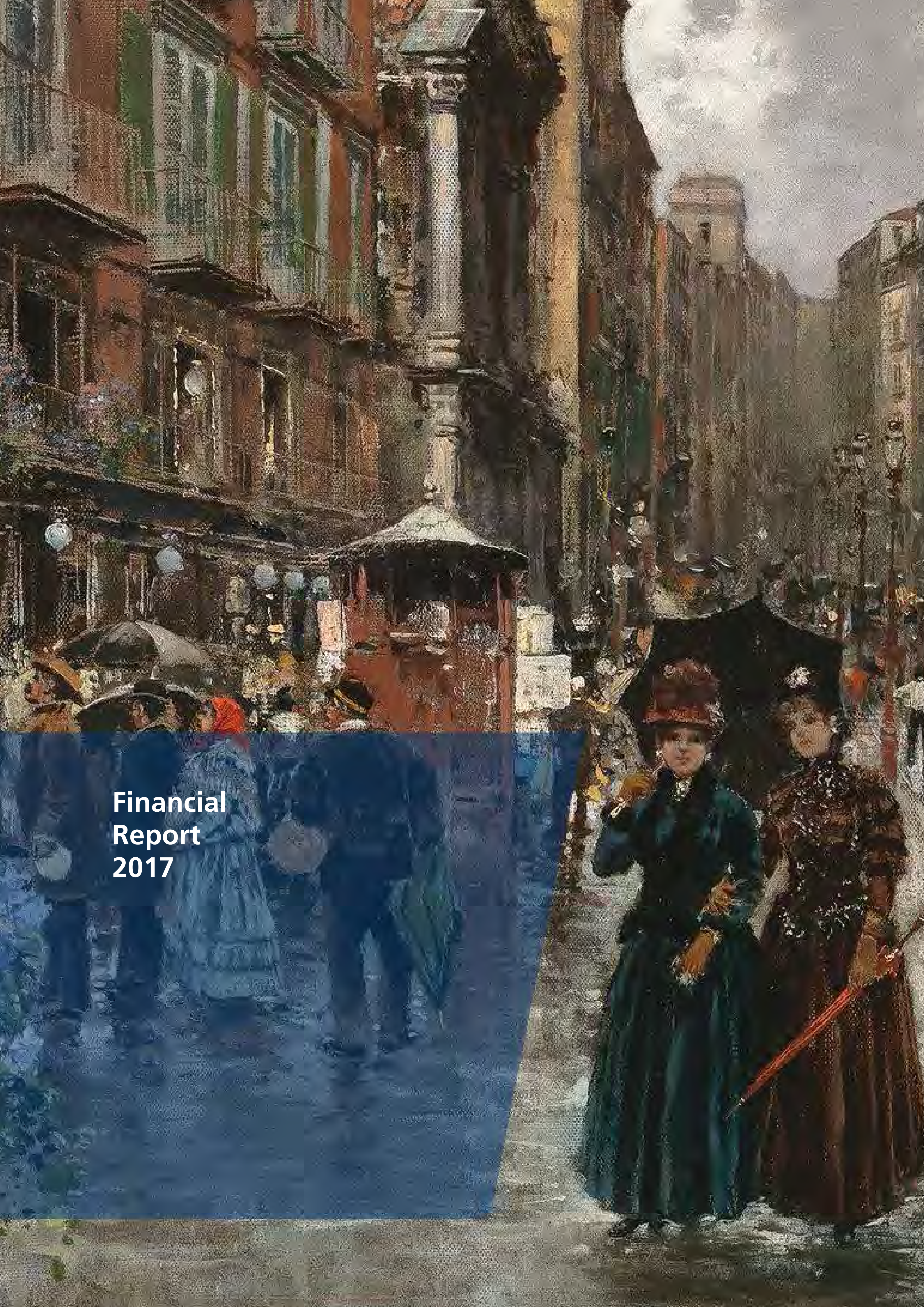
In 2017, changes were made to the composition of the Management Board:
- Mr Maurizio Marson, Member of the Management Board responsible for the operating of the Retail Division, submitted his resignation as a Member of the Management Board due to accepting new assignments in the Intesa Sanpaolo Group. His term of office ended on 31 March 2017. The Supervisory Board appointed Mr Ivan Ivičić as a new Member of the Management Board.
- Based on an agreement on the termination of the employment Agreement for the position of the Deputy Chairman of the Management Board, effective 13 July 2017, the function of Mr Igor Kragelj's as a Deputy Chairman of the Management Board has been terminated. The Supervisory Board appointed Mr Drago Kavšek as a new Member of the Management Board.
- Mr Giancarlo Miranda, Chairman of the Board, submitted his resignation as the Chairman of the Board due to accepting new assignments in the Intesa Sanpaolo Group. His term of office ended on 31 October 2017. The Supervisory Board appointed Mr Jozef Kausich as the new Chairman of the Management Board. His term of office starts on the day Mr Kausich receives a licence by the Europen Central Bank for pursuing the job of a Management Board Member.

Members of the Bank's Management Board as at 31 December 2017:

Irena Džaković	Member
Rado Grdina	Member
Ivan Ivičić	Member
Drago Kavšek	Member
Aleksander Lozej, MSc	Member
Aleksander Milostnik	Member

Supervisory board of Banka Intesa Sanpaolo d. d.

Management board of Banka Intesa Sanpaolo d. d.



Financial Report 2017

Independent auditors' report on financial statements

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Independent Auditor's Report

To the owners of Banka Intesa Sanpaolo d.d.

Report on the Audit of Financial Statements

Opinion

We have audited the financial statements of Banka Intesa Sanpaolo d.d. ("the Bank), which comprise the statement of financial position as of 31 December 2017, the income statement, the statement of other comprehensive income, the statement of cash flows, and the statement of changes in equity for the year then ended, and notes, comprising significant accounting policies and other explanatory information.

In our opinion, the accompanying financial statements give a true and fair view of the financial position of the Bank as at 31 December 2017, and of its financial performance and its cash flows for the year then ended in accordance with the International Financial Reporting Standards as adopted by the European Union ("IFRS as adopted by the EU").

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs) and EU Regulation (EU) No 537/2014. Our responsibilities under those standards are further described in the *Auditor's Responsibility for the Audit of the Financial Statements* section of our report. We are independent of the Bank in accordance with both the International Ethics Standards Board for Accountants Code of Ethics for Professional Accountants (IESBA Code) and the ethical requirements that are relevant to our audit of the financial statements in Slovenia, and we have fulfilled our other ethical responsibilities in accordance with these requirements and the IESBA Code.

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

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.

The Independent Auditor's Report hereof is a translation of the original Independent Auditor's Report in Slovene, issued on the financial statements and the notes thereto in Slovene and is not to be signed. This translation is provided for reference purposes only.

KPMG

Impairment of loans and advances to customers

As at 31 December 2017 gross loans and advances to customers amount to EUR 1,775 million (31 December 2016: EUR 1,731 millions), impairment allowance amount to EUR 100 million (31 December 2016: EUR 104 millions) and impairment loss recognized in the income statement amounts to EUR 19 million (31 December 2016: EUR 22 millions).

We refer to the financial statements: Note 2.4 Financial assets, Note 2.11 Impairment of financial assets, Note 3.3 Credit risk, Note 15 Impairments and Note 22 Loans to non-bank customers.

Key audit matter	How the matter was addressed in our audit
Impairment allowances represent management's best estimate of the losses incurred within the loan portfolios at the reporting date. We focused on this area, as the determination of impairment allowances is associated with significant estimation uncertainty, as it requires management to exercise judgment and develop complex and subjective assumptions about both the timing of recognition of the amounts of any such impairment. Impairment allowances for performing loans and non-performing loans with exposures below EUR 250 thousand are determined on a collective basis ("collective allowances"), with the use of modelling techniques. Collective allowances are predominantly related to mortgage-type loan exposures and reflect both already existing credit losses and losses that have been incurred but are not yet identifiable on an individual exposure level. The loans with similar credit risk characteristics are grouped together based on the Bank's internal classification process that takes into account such risk factors as client credit rating, payment discipline, collateral and others. Historical loss experience and management judgment are also incorporated into the model. The methodology, assumptions and model parameters are reviewed and recalibrated regularly. Impairment allowances for non-performing exposures exceeding EUR 250 thousand, are determined on an individual basis by means of a discounted cash flows technique. The assessment is based on the Bank's knowledge of each individual borrower and often on estimation of the fair value of the related collateral. In majority of cases, discounted cash flows will be from collateral. As there are different types of	Our audit procedures in this area included, among others: • Assessing and testing of controls over the approval, recording and monitoring of loans, including, but not limited to, those over loan risk grade assignments, identification of loss events, determination of loan collateral fair values and the calculation of the impairment allowances; • For collective impairment allowance: - assisted by our own IT specialists, testing the underlying collective impairment models, including backtesting and the assessment of the completeness and accuracy of underlying data, and assessing the key parameters such as the probability of default, loss given default and time period of collateral repossession and realization. - critically assessing the rationale for the changes to model parameters effected in 2017, by reference to our understanding of the business, current economic trends and market practices. • For individual impairment allowance: - for a sample of loans with higher risk characteristics, such as, among others, individually significant, watchlisted, restructured or unsecured exposures as well as non-performing exposures with low provision coverage, critically assessing, by reference to the underlying loan documentation (loan files) and through inquires with the loan officers and credit risk management personnel, the existence of objective evidence of impairment (impairment triggers). - where impairment triggers were identified, challenging the forecasts of future cash flows used in the assessment of loan impairment and

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collateral/properties in different parts of the county, the valuation is inherently difficult and requires increased attention in the audit.	evaluating key assumptions applied, such as discount rates, collateral values (using our own valuation specialists), forecasted business performance as well as, where applicable, collateral sales costs and sales periods. • Critically assessing the reasonableness of the collective impairment allowances, including both the share of the gross non-performing exposure in total gross exposure and the non-performing loans provision coverage, by benchmarking them against the publicly available industry data.

Measurement of land and building

As at 31 December 2017, land and buildings held for own use had a carrying amount of EUR 28,8 million (31 December 2016: EUR 18,7 million), properties which are classified as non-current assets held for sale had a carrying amount of EUR 19,6 million (31 December 2016: EUR 0 million) and properties which are held as inventory had a carrying amount of EUR 5,9 million (31 December 2016: EUR 12 million).

We refer to the financial statements: Note 2.13 Investment properties, Note 2.14 Property, plant and equipment, Note 2.15 Non-current assets and disposal groups classified as held for sale, Note 2.26 Accounting estimates and judgements in applying accounting policies, Note 24 Non-current assets held for sale, Note 25 Property, plant and equipment, Note 26 Investment property and Note 28 Other assets.

Key audit matter	How the matter was addressed in our audit
As discussed in Note 2.14 Property, plant and equipment to the financial statements, in the current year, the Bank changed its accounting policy in respect of land and buildings for own use, whereby it adopted the revaluation model for subsequent measurement of those assets to replace the cost model, as previously applied. Pursuant to the new model, the carrying amount of land and buildings is determined as their fair value at the date of the most recent revaluation less subsequent depreciation and any subsequent impairment losses. Other land and buildings mainly relate to foreclosed assets acquired in lieu of uncollected loans and advances to customers. They are classified by the Bank as either inventories or non-current assets held for sale depending whether or not the relevant criteria for classification as non-current assets held for sale are met. Assets held for sale are carried at lower of their carrying amount and fair value less costs	Our procedures in the area, performed with the assistance of our valuation specialists and external appraisal experts engaged by us, included, among others: • updating our understanding of the Bank's approach to the determination of the fair value and net realizable value, as applicable, of repossessed real estate; • evaluating the appropriateness the Bank's external appraisers' valuation reports, by challenging the key assumptions and judgements used, on a sample of properties held by the Bank as at 31 December 2017. This involved, but was not limited to: – evaluating competence, capabilities and objectivity of the external appraisers engaged by the Bank, obtaining an understanding of the scope of their engagement and any limitations therein; – assessing the valuation methodologies used by the Bank's appraisers against the market practice and the requirements of relevant

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to sell, while inventories are measured at the lower of cost and net realizable value. As at the reporting date, the Bank estimated the respective fair values and net realisable values, as applicable, with the assistance of contracted external appraisers. These experts applied a number of different approaches in producing their estimates. Depending on the property type, these may include either the market approach (based on comparable transactions or the income method (based on the discounted cash flow model). Developing the estimates requires the application of significant judgement and use of subjective assumptions by management, mainly relating to revenue growth discount rates, comparable sales prices and rental rates. Due to the inherent uncertainty in these estimates as well as the magnitude of the balances in question to the Bank's financial statements, we consider this area to be a key audit matter.	financial reporting standards, including the assessment of the internal consistency, inputs and sources used by the appraisers and of the mathematical accuracy of the relevant models; – evaluating the reasonableness of key assumptions applied in the valuation models (including, where applicable, those relating to yields, revenue growth and discount rates) against publically available market data; – where available, independently assessing the prices realised from the observable market transaction for similar assets. • Evaluating the reliability of the Bank's forecasting process by comparing key assumptions it applied in the prior year's estimates of the assets' fair values and net realizable values, as applicable, to the actual outcomes in the current year, and seeking management explanations for significant discrepancies; • Considering the adequacy and appropriateness of the financial statement disclosures about the change in accounting policy in respect of the measurement of non-current assets, as well as about the judgments and assumptions used by the Bank in that respect.

Other Information

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

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

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

With respect to the Business Report, we considered whether the Business Report includes the disclosures required by the Company's Act (hereafter referred to as "the applicable legal requirements").

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

- the information given in the Business Report for the financial year for which the financial statements are prepared, is consistent with the financial statements; and
- the Business Report has been prepared in accordance with the applicable legal requirements.

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In addition, in light of the knowledge and understanding of the Bank and its environment in which it operates, obtained in the course of our audit, we are required to report if we have identified material misstatements in the Business Report and other information that we obtained prior to the date of this auditors report. We have nothing to report in this respect.

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

Management is responsible for the preparation of the financial statements that give a true and fair view in accordance with the IFRS as adopted by the EU, 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 of 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.

Auditor's Responsibility for the Audit of Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with 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 judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal 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 auditors' report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Bank to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

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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 communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

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

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Report on Other Legal and Regulatory Requirements

We were appointed by shareholders of Banka Intesa Sanpaolo d.d. on shareholders meeting dated 30 June 2015 to audit the financial statements of Banka Intesa Sanpaolo d.d. for the year ended 31 December 2017. Our total uninterrupted period of engagement is 6 years, covering the periods ending 31 December 2012 to 31 December 2017.

We confirm that:

- our audit opinion is consistent with the additional report presented to the Audit Committee of the Bank dated 14 February 2018;
- we have not provided any prohibited non-audit services (NASs) referred in Article 5 of EU Regulation (EU) No 537/2014. We also remained independent of the audited entity in conducting the audit;

For the period to which our statutory audit relates, in addition to the audit, we have provided the following services to the Bank which are not disclosed in the Management Report or in the financial statements of the Bank:

- Review of Group reporting package as at 31 March 2017
- Review of Group reporting package as at 30 June 2017
- Review of Group reporting package as at 30 September 2017
- Audit of the report on relations with affiliated companies as at 31 December 2017 in accordance with requirements of Companies act
- Agreed upon procedures in accordance with regulation on the minimum scope and content of the additional audit and the additional auditor's report of compliance with risk management rules at banks and savings banks issued by Bank of Slovenia for as at 31 December 2017.

On behalf of the auditing company

KPMG SLOVENIJA,

podjetje za revidiranje, d.o.o.

Dejan Kurat

Certified Auditor

Barbara Kunc

Certified Auditor

Partner

Ljubljana, 21 February 2018

KPMG Slovenija, d.o.o.
1

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Statement Of Management's Responsibilities

The management is responsible for preparing financial statements for each financial year that present fairly the state of affairs of the Bank as at the end of the financial year and of the profit or loss for that period.

The management confirms that suitable accounting policies have been used and applied consistently and reasonable and prudent judgments and estimates have been made in the preparation of the financial statements for the year ended 31 December 2017. The management also confirms that the financial statements have been prepared on the going concern basis and in accordance with the applicable laws and International Financial Reporting Standards, as adopted by the EU.

The management is responsible for keeping proper accounting records, for taking reasonable steps to safeguard the assets of the Bank and its subsidiaries and to prevent and detect fraud and other irregularities.

In accordance with local regulations, the tax authorities may at any time inspect the Bank's books and records within 5 years subsequent to the reported tax year and may impose additional tax assessments and penalties. The Bank's management is not aware of any circumstances, which may give rise to a potential material liability in this respect.

Koper, February 2018

Financial Statements

1. INCOME STATEMENT

(in thousands of euros)

	Notes	For the year ended 31 December	
		2017	**2016**
Interest income	4	48,634	49,554
Interest expenses	4	(8,011)	(8,026)
Net interest income		**40,623**	**41,528**
Dividend income	5	506	655
Fee and commission income	6	36,301	37,658
Fee and commission expenses	6	(11,254)	(11,860)
Net fee and commission income		**25,047**	**25,798**
Realised gains or losses on financial assets and liabilities not measured at fair value through profit or loss	7	2,642	19,574
Gains or losses from trading	8	874	812
Gains or losses on financial assets and liabilities designated at fair value through profit or loss		14	(48)
Fair value adjustments in hedge accounting	9	(157)	136
Exchange differences		96	(304)
Gains or losses on derecognition of non-financial assets	10	48	1,043
Other operating net income	11	741	(177)
Administrative expenses	12	(41,226)	(40,250)
Depreciation and amortisation	13	(4,333)	(4,692)
Provisions and post-employment benefit obligations	14	(612)	1,123
Impairments	15	(19,306)	(22,239)
Total profit or loss before tax		**4,957**	**22,959**
Tax expense	16	(746)	(2,719)
Total profit or loss after tax		4,211	20,240
Net profit or loss for the financial year		**4,211**	**20,240**
Earnings per share (basic and diluted) (in EUR per share)	17	7.94	38.16

The accompanying notes on pages 46 to 107 are an integral part of the financial statements.

2. STATEMENT OF OTHER COMPREHENSIVE INCOME

(in thousands of euros)

	For the year ended 31 December	
	2017	**2016**
NET PROFIT OR LOSS FOR THE FINANCIAL YEAR AFTER TAX	**4,211**	**20,240**
OTHER COMPREHENSIVE INCOME AFTER TAX	**10,164**	**(4,592)**
ITEMS THAT WILL NOT BE RECLASSIFIED TO PROFIT OR LOSS	**11,176**	**78**
Actuarial gains on defined benefit pensions plans	5	78
Revaluation of properties	13,792	-
Income tax relating to items that will not be reclassified to profit or loss	(2,621)	-
ITEMS THAT ARE OR MAY BE RECLASSIFIED SUBSEQUENTLY TO PROFIT OR LOSS	**(1,012)**	**(4,670)**
Available-for-sale financial assets:	**(1,249)**	**(5,436)**
- fair value gain on available-for-sale securities	1,732	370
- realised gains on available-for-sale financial assets transferred to profit or loss	(2,981)	(5,806)
Income tax relating to items that may be reclassified to profit or loss	237	766
TOTAL COMPREHENSIVE INCOME FOR THE FINANCIAL YEAR AFTER TAX	**14,375**	**15,648**
a) Attributable to owners of the Bank	14,375	15,648

3. STATEMENT OF FINANCIAL POSITION

(in thousands of euros)

	Notes	As at 31 December	
		2017	2016
ASSETS			
Cash, cash balances at central banks and other demand deposits at banks	18	287,084	192,843
Derivatives held for trading	19	60	64
Derivatives – hedge accounting	19	2,471	913
Financial assets designated at fair value through profit or loss		59	136
Available-for-sale financial assets	20	318,702	354,615
Loans and receivables:		1,729,900	1,726,905
- loans to banks	21	41,142	89,516
- loans to non-bank customers	22	1,675,027	1,626,373
- advances	23	13,731	11,016
Fair value changes of the hedged items in portfolio hedge of interest rate risk		114	45
Non-current assets classified as held for sale	24	19,601	-
Property and equipment	25	28,794	18,700
Investment property	26	-	13,985
Intangible assets	27	3,518	4,068
Tax assets		491	-
- current tax assets		491	-
- deferred tax assets	36	-	-
Other assets	28	7,357	13,389
Total assets		**2,398,151**	**2,325,663**
LIABILITIES			
Derivatives held for trading	19	8	-
Derivatives – hedge accounting	19	660	1,402
Financial liabilities measured at amortised cost:		2,091,860	2,017,524
- deposits from banks and central banks	29	10,750	62,700
- deposits from non-bank customers	30	1,971,496	1,839,935
- loans from banks and central banks	31	71,477	87,747
- loans from non-bank customers	32	-	28
- other financial liabilities	33	38,137	27,114
Fair value changes of the hedged items in portfolio hedge of interest rate risk		1,131	341
Provisions:		10,540	10,051
- provisions for liabilities and charges	34	5,431	5,193
- retirement benefit obligations	35	5,109	4,858
Tax liabilities:		3,096	1,603
- current tax liabilities		-	921
- deferred tax liabilities	36	3,096	682
Other liabilities	37	5,627	4,660
Total liabilities		**2,112,922**	**2,035,581**
EQUITY			
Share capital	38	22,173	22,173
Share premium	38	7,499	7,499
Accumulated other comprehensive income	39	16,023	5,859
Reserves from profit	40	229,574	229,362
Treasury shares	38	(49)	(49)
Retained earnings (including net profit for the current year)	40	10,009	25,238
Total equity		**285,229**	**290,082**
Total liabilities and equity		**2,398,151**	**2,325,663**

The accompanying notes on pages 46 to 107 are an integral part of the financial statements.

4. STATEMENT OF CHANGES IN EQUITY

(in thousands of euros)

For the year ended 31 December 2017	Notes	Share capital	Share premium	Accumulated other comprehensive income	Reserves from profit	Retained earnings or loss (including profit from the current year)	Treasury shares (equity deduction item)	Total equity
OPENING BALANCE FOR THE REPORTING PERIOD		**22,173**	**7,499**	**5,859**	**229,362**	**25,238***	**(49)**	**290,082**
Total comprehensive income for the year after tax		-	-	10,164	-	4,211	-	**14,375**
Dividends paid	40	-	-	-	-	(19,228)	-	**(19,228)**
Transfer of net profit to reserves	40	-	-	-	212	(212)	-	**-**
CLOSING BALANCE		**22,173**	**7,499**	**16,023**	**229,574**	**10,009**	**(49)**	**285,229**
DISTRIBUTABLE PROFIT		-	-	-	-	4,000	-	**4,000**

(in thousands of euros)

For the year ended 31 December 2016	Notes	Share capital	Share premium	Accumulated other comprehensive income	Reserves from profit	Retained earnings or loss (including profit from the current year)	Treasury shares (equity deduction item)	Total equity
OPENING BALANCE FOR THE REPORTING PERIOD		**22,173**	**7,499**	**10,451**	**227,654**	**17,956***	**(49)**	**285,684**
Total comprehensive income for the year after tax		-	-	(4,592)	-	20,240	-	**15,648**
Dividends paid	40	-	-	-	-	(11,250)	-	**(11,250)**
Transfer of net profit to reserves	40	-	-	-	1,708	(1,708)	-	**-**
CLOSING BALANCE		**22,173**	**7,499**	**5,859**	**229,362**	**25,238**	**(49)**	**290,082**
DISTRIBUTABLE PROFIT		-	-	-	-	19,228	-	**19,228**

* Retained earnings in the amount of euro 6,009 thousand arose from accounting differences in transition from local accounting standards to IFRS. Under the Management Board's decision this part of retained earnings it is not available for distribution to shareholders.

The accompanying notes on pages 46 to 107 are an integral part of the financial statements.

5. STATEMENT OF CASH FLOWS

(in thousands of euros)

	Notes	For the year ended 31 December	
		2017	2016
CASH FLOWS FROM OPERATING ACTIVITIES			
Total profit or loss before tax		4,957	22,959
Depreciation	13	4,333	4,692
Impairments / (reversal of impairments) of financial assets available-for-sale	15	-	299
Impairments / (reversal of impairments) of loans and receivables	15	18,311	20,385
Impairments of tangible assets, investment property, intangible assets and other assets	15	-	1,555
Net (gains) / losses from exchange differences		(96)	(209)
Net (gains) / losses from sale of tangible assets and investment properties		(48)	(1,043)
Other adjustments to total profit or loss before tax		1,586	(1,123)
Cash flow from operating activities before changes in operating assets and liabilities		**29,043**	**47,515**
(Increases) / decreases in operating assets (excl. cash & cash equivalents)		**35,629**	**(157,960)**
Net (increase) / decrease in financial assets held for trading		4	27
Net (increase) / decrease in financial assets designated at fair value through profit or loss		77	86
Net (increase) / decrease in financial assets available-for-sale		43,106	(27,878)
Net (increase) / decrease in loans and receivables		(10,357)	(124,243)
Net (increase) / decrease in assets-derivatives - hedge accounting		(1,627)	(937)
Net (increase) / decrease in other assets		4,426	(5,015)
Increases / (decreases) in operating liabilities		**63,249**	**47,664**
Net increase / (decrease) in financial liabilities held for trading		8	(1)
Net increase / (decrease) in deposits and loans measured at amortised cost		61,988	45,881
Net increase / (decrease) in liability – derivatives – hedge accounting		48	1,677
Net increase / (decrease) in other liabilities		1,205	107
Cash flow from operating activities		**127,921**	**(62,781)**
Income taxes (paid) / refunded		(2,073)	919
Net cash flow from operating activities		**125,848**	**(61,862)**
CASH FLOWS FROM INVESTING ACTIVITIES			
Receipts from investing activities		**1,243**	**1,434**
Receipts from the sale of property and equipment and investment properties		1,243	1,434
Cash payments on investing activities		**(4,031)**	**(900)**
Cash payments to acquire tangible assets, and investment properties		(4,031)	(552)
Cash payments to acquire intangible assets		-	(348)
Net cash flow from investing activities		**(2,788)**	**534**
CASH FLOWS FROM FINANCING ACTIVITIES			
Cash proceeds from financing activities		**-**	**-**
Cash payments on financing activities		**(19,227)**	**(11,250)**
Dividends paid		(19,227)	(11,250)
Net cash flow from financing activities		**(19,227)**	**(11,250)**
Effects of change in exchange rates on cash and cash equivalents		(4,187)	(513)
Net increase in cash and cash equivalents		**103,833**	**(72,578)**
Opening balance of cash and cash equivalents	42	191,362	264,453
Closing balance of cash and cash equivalents	42	**291,008**	**191,362**

(in thousands of euros)

Operational cash flows of interest and dividends	As at 31 December	
	2017	2016
Interest paid	(8.543)	(11,050)
Interest received	49.399	48,364
Dividends received	506	655

As at 31 December 2017, the Bank had undrawn credit lines and loans already committed of EUR 100,000 thousand (2016: 100,000 thousand).

The Bank has credit lines and other facilities of EUR 100,000 thousand that are available for financing future business operations without any restrictions.

The accompanying notes on pages 46 to 107 are an integral part of the financial statements.

Notes To Financial Statements

1. GENERAL INFORMATION

Banka Intesa Sanpaolo d.d. is a public limited company with the head office at 14 Pristaniška Street, Koper/ Capodistria (hereinafter referred to as Banka Koper d.d. or the Bank). Since 2002, Banka Koper d.d. is member of the Intesa Sanpaolo Group (originally SanpaoloIMI), one of the leading banking groups in Italy. As of January 1 1 2007, the Sanpaolo IMI Group merged with Banca Intesa. Since July 2017, the Bank is also part of Privredna Banka Zagreb banking group, which holds 51% stake.

In accordance with the third paragraph of article 3 and the first paragraph of article 4 of the Regulation on the criteria for determining whether a bank is considered significant (Official Gazette of the Republic of Slovenia, No. 14/15; hereinafter referred to as the Regulation on the criteria), Banka Intesa Sanpaolo d.d. is a significant bank in the Republic of Slovenia. As a significant bank, Banka Intesa Sanpaolo d.d. shall comply with all the requirements specified as mandatory in the relevant provisions laid down in the Banking Act (Official Gazette of the Republic of Slovenia, No. 25/2015; hereinafter referred to as at Banking Act (ZBan-2), i.e. and the Regulation (EU) No. 575/2013 and in the first paragraph of article 1 of the Regulation on the criteria. The Bank shall comply with the following requirements:

- The conditions for the members of the governing body of a significant bank that hold several directorships at the same time (the third paragraph of article 36 of the Banking Act (ZBan-2);
- Establishing a compliance department (the first paragraph of Article 146 of the Banking Act (ZBan-2);
- The quantitative information shall be made available to the public at the level of the bank's members of the management body (the second paragraph of article 450 of the Regulation (EU) No. 575/2013);
- Significant subsidiaries of EU parent financial holding companies or EU parent mixed holding companies and those subsidiaries which are of material significance for their local market shall disclose the information on an individual or sub-consolidated basis (article 13 of the Regulation (EU) No. 575/2013), and namely regarding the bank's own funds (article 437), capital requirements (article 438), capital buffers (article 440), credit risk adjustments (article 442), remuneration policy (article 450), leverage (article 451), and the use of credit risk mitigation techniques (article 453).

The above requirements to make disclosures are disclosed in a separate report named Additional information for the financial year 2017.

The Bank prepares its financial statements as at the last day of the calendar year.

The date of the Management Board statement shall be considered as the date on which the financial statements were approved.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The principal accounting policies adopted for the preparation of the financial statements are set out below:

2.1 BASIS OF PREPARATION

Statement of compliance

The financial statements for 2017 have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU.

Basis of measurement

These financial statements are prepared on the fair value basis for financial assets and liabilities at fair value through profit or loss, financial assets available for sale, derivatives and functional properties used by the Bank. Other financial assets and liabilities, and non-financial assets and liabilities, are stated at amortised or historical cost.

Use of estimates and judgements

The preparation of financial statements in conformity with IFRS as adopted by the EU requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Although these estimates are based on management's best knowledge of current events and actions, actual results ultimately may differ from those estimates.

A more detailed disclosures is shown under chapter 2.11 Impairment of financial assets, 2.25 Accounting estimates and judgments in applying accounting policies and 3.3 Credit risk.

Current list of new EU IFRS Standards, Interpretations and amendments to published Standards (as at 12 December 2017) that are not yet effective, for disclosure in financial statements prepared in accordance with IFRS as adopted by the European Union (EU).

Please note that this document includes the list of standards and interpretations not yet effective to be disclosed in the financial statements of entities with an annual period beginning on 1 January 2017, based on pronouncements that have been published by the IASB and the IFRIC and endorsed by the EU **by 12 December 2017.** For entities that issue financial statements after this date it will be necessary for the client and the engagement team to determine whether any new pronouncements have been issued and/or endorsed by the E.U. after the date of this document.

Please note that there are currently accounting pronouncements that have been published by the IASB and the IFRIC that are effective for periods beginning after 1 January 2018 however at the date of preparing this document those pronouncements had not yet been endorsed by the EU. Reporting in accordance with EU IFRS should provide information about the pronouncements published by the IASB and the IFRIC, but not endorsed by the E.U., to the extent that these pronouncements might be expected to have a material impact on the reporting entity's financial statements in the future as part of its IAS 8.30 disclosures.

The following new Standards, amendments to Standards and Interpretations are not yet mandatorily effective for annual periods beginning on or after 1 January 2017, and have not been applied in preparing these condensed interim consolidated financial statements. The Bank plans to adopt these pronouncements when they become effective.

Standards, Interpretations and amendments to published Standards as adopted by the EU that are not yet effective for annual periods beginning on 1 January 2017

Standard/Interpretation [IAS 8.31 (a), 8.31(c)]	Nature of impending change in accounting policy [IAS 8.31 (b)]	Example wording regarding the possible impact on financial statements [IAS 8.30 (b); 31 (e)]
IFRS 15 Revenue from Contracts with Customers and Clarifications to IFRS 15 Revenue from Contracts with Customers (issued on 12 April 2016) (Effective for annual periods beginning on or after 1 January 2018. Earlier application is permitted.)	The new Standard provides a framework that replaces existing revenue recognition guidance in IFRS. Entities will adopt a five-step model to determine when to recognise revenue, and at what amount. The new model specifies that revenue should be recognised when (or as) an entity transfers control of goods or services to a customer at the amount to which the entity expects to be entitled. Depending on whether certain criteria are met, revenue is recognised: • over time, in a manner that depicts the entity's performance; or • at a point in time, when control of the goods or services is transferred to the customer. IFRS 15 also establishes the principles that an entity shall apply to provide qualitative and quantitative disclosures which provide useful information to users of financial statements about the nature, amount, timing, and uncertainty of revenue and cash flows arising from a contract with a customer. The Clarifications to IFRS 15 clarify some of the Standard's requirements and provide additional transitional relief for companies that are implementing the new Standard. The amendments clarify how to: • identify a performance obligation - the promise to transfer a good or a service to a customer- in a contract; • determine whether a company is a principal (the provider of a good or service) or an agent (responsible for arranging for the good or service to be provided); and • determine whether the revenue from granting a license should be recognised at a point in time or over time. The amendments also provide entities with two additional practical expedients: • An entity need not restate contracts that are completed contracts at the beginning of the earliest period presented (for entities that using the full retrospective method only); • For contracts that were modified before the beginning of the earliest period presented, an entity need not retrospectively restate the contract but shall instead reflect the aggregate effect of all of the modifications that occur before the beginning of the earliest period presented (also for entities recognising the cumulative effect of initially applying the standard at the date of initial application).	Although it has not yet fully completed, its assessment of the potential impact of IFRS 15 on the Entity's financial statements, management does not expect that the new Standard, will have material impact on the Entity's financial statements. The timing and measurement of the Entity's revenues are not expected to change under IFRS 15 because of the nature of the Entity's operations and the types of revenues it earns.
IFRS 9 Financial Instruments (2014) (Effective for annual periods beginning on or after 1 January 2018; to be applied retrospectively with some exemptions. The restatement of prior periods is not required, and is permitted only if information is available without the use of hindsight. Early application is permitted.)	This Standard replaces IAS 39, Financial Instruments: Recognition and Measurement, except that the IAS 39 exception for a fair value hedge of an interest rate exposure of a portfolio of financial assets or financial liabilities continues to apply, and entities have an accounting policy choice between applying the hedge accounting requirements of IFRS 9 or continuing to apply the existing hedge accounting requirements in IAS 39 for all hedge accounting until the standard resulting from the IASB's project in macro hedge accounting is effective. Although the permissible measurement bases for financial assets – amortised cost, fair value through other comprehensive income (FVOCI) and fair value through profit or loss (FVTPL) – are similar to IAS 39, the criteria for classification into the appropriate measurement category are significantly different.	For qualitative and quantitative disclosures please see the note 46.

Standard/Interpretation [IAS 8.31 (a), 8.31(c)]	Nature of impending change in accounting policy [IAS 8.31 (b)]	Example wording regarding the possible impact on financial statements [IAS 8.30 (b); 31 (e)]
	A financial asset is measured at amortized cost if the following two conditions are met: • the assets is held within a business model whose objective is to hold assets in order to collect contractual cash flows; and • its contractual terms give rise, on specified dates, to cash flows that are solely payments of principal and interest on the principal outstanding. In addition, for a non-trading equity instrument, a company may elect to irrevocably present subsequent changes in fair value (including foreign exchange gains and losses) in OCI. These are not reclassified to profit or loss under any circumstances. For debt instruments measured at FVOCI, interest revenue, expected credit losses and foreign exchange gains and losses are recognised in profit or loss in the same manner as for amortised cost assets. Other gains and losses are recognised in OCI and are reclassified to profit or loss on derecognition. The impairment model in IFRS 9 replaces the ' incurred loss' model in IAS 39 with a forward-looking an ' expected credit loss' (ECL) model, which means that a loss event will no longer need to occur before an impairment allowance is recognised. The new impairment model will apply to financial assets measured at amortized cost or FVOCI, except for investments in equity instruments, and to contract assets. Under IFRS 9, loss allowances will be measured on either of the following bases: • 12-month ECLs: these are ECLs that result from possible default events within the 12 months after the reporting date; and • Lifetime ECLs: these are ECLs that result from all possible default events over the expected life of a financial instrument. IFRS 9 includes a new general hedge accounting model, which aligns hedge accounting more closely with risk management. The types of hedging relationships – fair value, cash flow and foreign operation net investment – remain unchanged, but additional judgment will be required. The standard contains new requirements to achieve, continue and discontinue hedge accounting and allows additional exposures to be designated as hedged items. Extensive additional disclosures regarding an entity's risk management and hedging activities are required.	
Amendments to IFRS 4: Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts (Effective for annual periods beginning on or after 1 January 2018; to be applied prospectively)	The amendments address concerns arising from implementing IFRS 9 before implementing the replacement standard that the IASB is developing for IFRS 4. The amendments introduce two optional solutions. One solution is a temporary exemption from IFRS 9, effectively deferring its application for some insurers. The other is an overlay approach to presentation to alleviate the volatility that may arise when applying IFRS 9 before the forthcoming insurance contracts standard.	The Bank is not an insurance provider and therefore does not expect any material impact on the financial statements of the Entity.

Standard/Interpretation [IAS 8.31 (a), 8.31(c)]	Nature of impending change in accounting policy [IAS 8.31 (b)]	Example wording regarding the possible impact on financial statements [IAS 8.30 (b); 31 (e)]
IFRS 16 Leases (Effective for annual periods beginning on or after 1 January 2019. Earlier application is permitted if the entity also applies IFRS 15.)	IFRS 16 supersedes IAS 17 Leases and related interpretations. The Standard eliminates the current dual accounting model for lessees and instead requires companies to bring most leases on-balance sheet under a single model, eliminating the distinction between operating and finance leases. Under IFRS 16, a contract is, or contains, a lease if it conveys the right to control the use of an identified asset for a period of time in exchange for consideration. For such contracts, the new model requires a lessee to recognise a right-of-use asset and a lease liability. The right-of-use asset is depreciated and the liability accrues interest. This will result in a front-loaded pattern of expense for most leases, even when the lessee pays constant annual rentals. The new Standard introduces a number of limited scope exceptions for lessees which include: • leases with a lease term of 12 months or less and containing no purchase options, and • leases where the underlying asset has a low value (' small-ticket' leases). Lessor accounting, however, shall remain largely unchanged and the distinction between operating and finance leases will be retained.	The Bank does not expect that the new Standard, when initially applied, will have material impact on the financial statements because the Bank will not be party to a contractual arrangement that would be in the scope of IFRS 16.

2.2 FOREIGN CURRENCY TRANSLATION

Functional and presentation currency

Items included in the financial statements are measured using the currency of the primary economic environment in which the Bank operates (' the functional currency'). The financial statements are presented in euro, which is the Bank's functional and presentation currency.

Recording foreign currency transactions

Foreign currency transactions are translated into the functional currency using the exchange rate prevailing at the date of transactions. Exchange rate differences resulting from the settlement of such transactions and from the translation of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement. Translation differences on non-monetary items, such as equities at fair value through profit or loss, are reported as part of the fair value gain or loss. Translation differences on non-monetary items, such as equities classified as available-for-sale, are included in the fair value reserve in equity.
Income and expenses arising on foreign currencies are translated at the exchange rate at the date of the transaction. Gains and losses resulting from buying and selling foreign currencies for trading purposes are reported in profit or loss as net gains or losses from trading of foreign currencies.

2.3 RELATED PARTIES

For the purposes of the financial statements, related parties include all entities, that directly or indirectly, through one or more intermediaries, control or are controlled by, or are under common control with, the reporting enterprise. Related parties include parents, subsidiaries, fellow subsidiaries, associates of the reporting entity, members of the key management personnel and directors of the Banks and enterprises over which the key management personnel and directors of the reporting entity are able to exercise significant influence (participation in making financial and operating policy decisions of an enterprise).

2.4 FINANCIAL ASSETS

Classification

a) Financial assets at fair value through profit or loss
This category has two sub-categories: financial instruments held for trading and financial instruments designated at fair value through profit or loss at inception. Financial instruments are classified in this category if acquired principally for the purpose of selling in the short term or if so designated by management. Derivatives are classified as held for trading unless they are designated as hedges.

b) Loans and receivables
Loans and receivables are non-derivative financial instruments with fixed or determinable payments that are not quoted in an active market, other than:
(a) those that the entity intends to sell immediately or within the short term, which are classified as held for trading and those that the entity designates at fair value through profit or loss upon initial recognition;
(b) those that the entity, upon initial recognition, designates as available for sale; or
(c) those for which the holder may not recover substantially all of its initial investment, other than because of credit deterioration

c) Available-for-sale financial assets
Available-for-sale financial assets are non-derivative financial assets that are designated as available for sale or that are not classified as loans and receivables, held-to-maturity investments or financial assets at fair value through profit or loss.

Recognition and measurement

a) Date of recognition
Purchases and sales of financial instruments at fair value through profit or loss, held to maturity and available-for-sale are recognised on the trade date. Loans are recognised when the cash is advanced to the borrowers.

b) Value of recognition and subsequent measurement
Financial assets are initially recognised at fair value plus transaction costs for all financial assets not carried at fair value through profit and loss.
Financial assets at fair value through profit or loss and available-for-sale financial assets are measured subsequently at fair value. Gains and losses arising from changes in the fair value of the financial assets at fair value through profit or loss are presented in the income statement in the period in which they arise. Gains and losses arising from changes in the fair value of available-for-sale financial assets are recognised directly in other comprehensive income, until the financial asset is disposed of, derecognised or impaired, at which time the cumulative gain or loss previously recognised in other comprehensive income is recognised in profit or loss. However, interest calculated using the effective interest method and foreign currency gains and losses on monetary assets classified as available-for-sale are recognised in profit or loss. Dividends on available-for-sale equity instruments are recognised in profit or loss when the entity's right to receive payment is established.
Loans and receivables are carried at amortised cost.

Restructured loans
Due to inability of the client to repay the debt under the originally agreed terms, where possible, the Bank seeks to restructure performing loans or non-performing loans (substandard, doubtful or past due by more than 90 days) rather than start recovery of collateral due to long-lasting procedures, high court costs and in view of the possibility of restoring the credit worthiness of the borrower. Bank restructuring includes one or more activities: extending the payment arrangements and/or reduction of interest rate and/or partial write-off and/or (exceptionally) debt to equity swap. The de-recognition of the previous loan is exercised when terms and condition of the restructured loan significantly deviate from the original one. Once the terms have been renegotiated and annexes are concluded, the loan is no longer considered past due. However, the client remains classified in non-performing category for at least 1 year and only after that period it can be transferred to performing category. Subsequently it will remain in a probation status for at least 2 years. The management continuously reviews renegotiated loans to ensure that all criteria are met and that future payments are likely to occur.

De-recognition of financial instruments
A financial asset is derecognised when the contractual rights to the cash flows from the financial asset expire or the financial asset is transferred and the transfer meets criteria for de-recognition.

A financial asset (or, where applicable a part of a financial asset or part of a group of similar financial assets) is derecognised when:

- The rights to receive cash flows from the asset have expired; or
- The Bank has transferred its rights to receive cash flows from the asset or has assumed an obligation to pay the received cash flows in full without material delay to a third party under an assignment arrangement; and either:
  - The Bank has transferred substantially all the risks and rewards of the asset, or
  - The Bank has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

When the Bank has transferred its rights to receive cash flows from an asset or has entered into an assignment arrangement, and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognised to the extent of the Bank's continuing involvement in the asset. In that case, the Bank also recognises an associated liability. The transferred asset and the associated liability are measured on a basis that reflects the rights and obligations that the Bank has retained.

Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Bank could be required to repay.

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires. Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a de-recognition of the original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognised in income statement.

Fair value measurement principles

The fair value of financial instruments is based on their quoted market price at the reporting date. If a quoted market price is not available, the fair value of the instruments is estimated using discounted cash flow techniques or pricing models.
Where discounted cash flow techniques are used, estimated future cash flows are based on the best estimates and the discount rate is a market related rate at the reporting date for an instrument with similar terms and conditions. Where pricing models are used, inputs are based on market related measures at the reporting date, where possible, but where this is not feasible, the best information available is used.

Since the application of IFRS 13 – Fair value measurement, the inputs used to measure fair value, should be presented when classifying financial instruments in the three levels of fair value hierarchy:

- **Level 1 inputs:** Fair value measured using (unadjusted) quoted prices in active markets for identical assets or liabilities.
- **Level 2 inputs:** Fair value measured using inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices from similar assets) or indirectly (i.e. derived from prices of similar instruments).
- **Level 3 inputs:** Fair value measured using inputs for the asset or liability that are not based on observable market inputs.

More detailed disclosure is shown under chapter 3.9 Fair value of assets and liabilities.

2.5 OFFSETTING OF FINANCIAL ASSETS AND LIABILITIES

Financial assets and liabilities are offset and the net amount reported in the statement of financial position when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or to realise the asset and settle the liability simultaneously.

2.6 DERIVATIVE FINANCIAL INSTRUMENTS

Derivative financial instruments fall into the following categories: forward-based, swap-based and option-based., are measured initially at fair value. Subsequent to initial recognition all derivatives are measured considering changes in fair value. To determine their fair value, derivative financial assets and financial liabilities are measured using quoted prices, discounted cash flow models or pricing models, as appropriate. All derivatives are carried at their fair value as assets when favourable to the Bank, and as liabilities when unfavourable to the Bank.

Certain derivative financial instruments that provide effective economic hedges and are not qualified for hedge accounting under the specific accounting rules, are therefore accounted for as derivative financial instruments held for trading purposes.

The best evidence of the fair value of a derivative financial instrument at initial recognition is the transaction price (the fair value of the consideration given or received) unless the fair value of that instrument is evidenced by comparison with other observable current market transactions of the same instrument (without modification or repackaging) or based on a valuation technique whose variables include only data from observable markets. When such evidence exists, the Bank recognises profits/losses on Day 1; if not, profits/losses are not recognised on Day 1, but if and when such evidence becomes available or when the derivative is derecognised.

De-recognition of the derivatives occurs only when through a legal transaction that transfers ownership of a financial instrument to the buyer, the seller has also transferred substantially all the risks and future rewards of ownership of the financial instrument.

2.7 HEDGE ACCOUNTING

The Bank uses derivative financial instruments to manage its exposures to interest rate risk. Such derivative financial instruments are initially recognised at fair value on the date on which they are entered to and are subsequently re-measured at fair value. Derivatives are carried as financial assets when the fair value is positive and as financial liabilities when the fair value is negative.

For the purpose of hedge accounting, hedges could refer to:

- Fair value hedge – a hedge of exposure to changes in fair value of a recognised asset or liability or an unrecognised firm commitment;
- Cash flow hedge – a hedge of the exposure to variability in cash flows that is either attributable to a particular risk associated with a recognised asset or liability or a highly probable forecast transaction;
- Hedge of a net investment in a foreign currency.

At the inception of a hedge relationship, the Bank formally designates and documents the hedge relationship to which the Bank wishes to apply hedge accounting and the risk management objective and strategy for undertaking the hedge. The documentation includes identification of the hedging instrument, the hedged item or transaction, the nature of the risk being hedged and how the Bank will assess the effectiveness of changes in the hedging instrument's fair value in offsetting the exposure to changes in the hedged item's fair value or cash flows attributable to the hedged risk. Such hedges are expected to be highly effective in achieving offsetting changes in fair value or cash flows and are tested regularly throughout their life to determine that they actually have been highly effective throughout the financial reporting periods for which they are designated.

The Bank uses fair value hedge to cover exposure to changes in the fair value attributable to the different risk categories of assets and liabilities in the statement of financial position, or a portion of these or to cover portfolios of financial assets and liabilities.

2.8 INTEREST INCOME AND EXPENSE

Interest income and expense are recognised in profit or loss for all interest-bearing instruments on an accrual basis using the effective interest method based on the actual purchase price. Interest income includes coupons earned on fixed income investments and accrued discounts and premium on securities. Once a financial asset or group of similar financial assets has been written down as a result of an impairment loss, interest income is recognised using the rate of interest used to discount the expected estimated future cash payments and receipts for the purpose of measuring the impairment loss.

The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant lifetime of financial instrument. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Bank estimates cash flows considering all contractual terms of the financial instrument (e.g., prepayment options, call options and similar options) but does not consider future credit losses. The calculation includes all fees and margins paid or received between parties to the contract that are an integral part of the effective interest rate, such as transaction costs and all other premiums or discounts.

2.9 FEE AND COMMISSION INCOME

Fees and commissions are generally recognised as the services are provided. Fees and commissions consist mainly of fees charged on payment services, credit cards, services and fund management on behalf of legal entities and citizens, together with commissions from guarantees. For loan commitments the bank charged the client for small administrative expenses for loan elaboration, which cover just the process costs. Subsequently the loan management fee is collected promptly (each month for loan, each trimester for guaranties). These fees cover process costs as well. Fees receivable that represent a return for services provided are in income statement netted of tax on financial services.

2.10 SALE AND REPURCHASE AGREEMENTS

Securities sold subject to sale and repurchase agreements ("repos") continue to be recognised in the financial statements of the temporary seller, with the counterparty liability included in deposits from banks or customers as appropriate. Securities sold, subject to sale and repurchase agreements are reclassified in the financial statements as pledged assets when the transferee has the right by contract or custom to sell or re-pledge the collateral. Securities purchased under agreements to resell ("reverse repos") are recorded as loans and advances to other banks or customers, as appropriate.

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

2.11 IMPAIRMENT OF FINANCIAL ASSETS

a) Loans and other assets carried at amortised cost

The Bank assesses at each reporting date whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or group of financial assets is impaired and impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (' a loss event') and that loss event (or events) has an impact on the estimated future cash flows.

The Bank first assess whether objective evidence of impairment exists for financial assets that are individually significant. If the Bank determines that no objective evidence of impairment exists for an individually assessed financial asset it includes the asset in a group of financial assets with similar credit risk characteristic and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment.

If there is objective evidence that an impairment loss on loans and receivables or held to maturity investment has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the financial asset's original effective interest rate (in case of a variable interest rate, the last effective interest rate is taken). The carrying amount of the asset is reduced through the adjustment account and the amount of the loss is recognised in the income statement.

The calculation of present value of the estimated future cash flows of collateralised financial assets reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

For the purpose of collective evaluation of impairment, financial assets are grouped on the basis of similar credit risk characteristics (on the basis of the Bank's internal classification process that considers all relevant factors).
Future cash flows for the group of individually significant financial assets that are evaluated for impairment are estimated on the basis of the contractual cash flows and historical loss experience for assets with credit risk

characteristics similar to those in the group. The methodology and assumptions used for estimating future cash flows are reviewed regularly.

If the amount of the impairment subsequently decreases due to an event occurring after the write down, the reversal of loss is credited as a reduction of the adjustment account for loan impairment.

When a loan is uncollectible, it is written off against the related provision for loan impairment. In the case that the provision for loan impairment does not exist, additional provision s recognised directly in the income statement under gains less losses from financial assets and liabilities not recognised at fair value through profit or loss. Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off are shown as income in income statement.

b) Assets carried at fair value

At each reporting date the Bank assesses whether there is objective evidence that a financial asset or group of financial assets is impaired. In the case of equity investments classified as available-for-sale, a significant or prolonged decline in the fair value is considered when the investment is below its cost value. In line with Intesa Sanpaolo Group accounting policies, a significant decrease is when the financial instrument's fair value decreases by more than 30% below its average initial carrying amount. A prolonged decline in the asset's fair value generally occurs when the fair value of a financial instrument has been below its average initial carrying amount for at least 24 months. If any such evidence exists for available-for-sale financial assets, the cumulative loss – measured as the difference between the initial carrying amount and current fair value, less any impairment loss on that financial asset previously recognised in profit or loss – is removed from other comprehensive income and recognised in the income statement. Impairment losses on equity instruments recognised in the income statement are not reversed through the income statement but always recognised as increase in other comprehensive income. If, in a subsequent period, the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss is reversed through the income statement.

2.12 INTANGIBLE ASSETS

Intangible assets encompass licences for computer software, patents, copyrights and other industrial property rights acquired, and development expenditures, are carried in the statement of financial position at cost less any accumulated amortisation and any accumulated impairment losses.

Expenditure on research and development and maintaining computer software is recognised in profit or loss as the expense is incurred. In circumstances when expenditure is directly associated with the development of computer software that will probably generate expected future economic benefits exceeding costs, expenditures are recognised as intangible assets. Directly attributable costs are capitalised as software development.

The amortisation method used to allocate the depreciable amount of an asset on a systematic basis over its useful life is the straight-line method. Amortisation begins when the asset is available for use.

The Bank reviews the amortisation period and the amortisation method for an intangible asset with a finite useful life at each financial year-end.

Intangible assets	Estimated useful lives in 2017	Estimated useful lives in 2016
Licence fees	4	4
Development expenditure	5	5
Computer software	4	4

The main IT system (Bančno okence) is internally developed and included within Development expenditure. For this type of intangible fixed assets the estimate useful life is 5 year.

Gains and losses arising on de-recognition should be calculated as the difference between the asset's net disposal proceeds and its carrying amount and should be recognised in the income statement. Intangible assets are assessed for impairment whenever there is an indication that the intangible asset may be impaired. The assessment for impairment is carried out at least on yearly bases.

2.13 INVESTMENT PROPERTY

Investment property is property (land or a building) held to earn rentals or for capital appreciation or both, rather than for use in the supply of services in the ordinary course of business.

An investment property is measured initially at its cost. The costs included in the initial measurement, comprises its purchase price and any directly attributable expenditure.

After initial recognition, the Bank carries investment at cost less accumulated depreciation and accumulated impairment losses, if any.

Investment property items are depreciated over their useful lives and are submitted to valuation by an independent appraiser. The Bank applies the same depreciation method and depreciation rates as for the buildings it uses in the ordinary course of business (note 2.14).

2.14 PROPERTY, PLANT AND EQUIPMENT

Tangible fixed assets are land, buildings, manufacturing plant and equipment. An item of property, plant and equipment that qualifies for recognition as an asset shall be initially measured at its cost. The cost of an item of property, plant and equipment comprises its purchase price after deducting trade discounts, including import duties and non-refundable purchase taxes, directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating (cost of transport, installation …) and the cost of its dismantlement, removal and restoration. The cost of interest related to the acquisition of an item of property, plant and equipment is included in the cost of acquiring that item and capitalised.

The Bank measures a property, plant and equipment item acquired in exchange for a non-monetary asset or a combination of monetary and non-monetary assets at fair value.

The Bank assesses annually whether there is any indication that an asset may be impaired. If there is an indication that an asset may be impaired, the recoverable amount of the asset is determined. The recoverable amount is the higher of the fair value less costs to sell and the value in use. If the recoverable amount exceeds the carrying amount, it is an indication that the asset is not impaired.

The Bank recognises subsequent costs in the carrying amount of an item of property, plant and equipment when it is probable that future economic benefits associated with the item will flow to the Bank. The costs of day-to-day servicing (repairs and maintenance) are recognised in profit or loss as incurred.

Depreciation charges are calculated by using the straight-line method. The depreciation rates are determined to allocate the value of items of property, plant and equipment over their estimated useful lives to expenses.

Assets in the course of transfer or construction are not depreciated until they are brought into use.
The residual value and the useful life of an asset is reviewed on a regular basis and, if expectations differ from previous estimates, the change(s) is accounted for as a change in an accounting estimate.

Property, plant and equipment	Estimated useful lives in 2017	Estimated useful lives in 2016
Buildings	16.6-40	16.6-40
Other investment in intangibles	20	10
Equipment	5	5
Motor vehicles	5	5
Computers and software	4	4

Any gain or loss on disposal of an item of property, plant and equipment determined as the difference between the proceeds and the carrying amount are recognised in profit or loss, determining operating profit.

Change of accounting policy to evaluate functional property, investment property and artistic heritage

At the end of 2017, the Intesa Sanpaolo Group changed its accounting policies for evaluation of real estate and works of art in its balance sheet. The currently adopted cost criterion for the assessment of this property was replaced by revaluation model. In accordance with the Group's rules, Banka Intesa Sanpaolo d.d., as its subsidiary member, has changed its policy too.

The change in accounting policy is the result of the Group's awareness of the great historical and artistic value of its real estate and its intentions to more effectively manage real estate and cultural and historical assets, which the Group accumulated over decades from approximately 250 banks throughout the whole Italian territory. In this view, the purpose of the valuation of real estate at fair value is to be understood as a voluntary choice, with the aim to provide readers of the financial statement a more credible and relevant representation of financial information.

However the fact this was a voluntary choice, which, according to the provisions of IAS 8, would require an adjustment for the effect of the changed accounting policy for the comparative period, the Group did not calculate them. In this context, it referred to the provisions of IAS 8.17 which states that any change in the valuation method should be carried out on the basis of IAS 16, which permits, that retroactive effects not need be calculated (IAS.16.23).

Considering the change in accounting policy was implemented at the end of 2017, the depreciation for 2017 was still calculated in accordance with the cost model. The revaluation of real estate was carried out in accordance with IAS 16.35, which requires the adjustment of the carrying amount of the asset to a new fair value, by using elimination approach, which states the accumulated depreciation is eliminated against the gross carrying amount of the asset. This results the fair value of the property as at December 31 2017 is equal to its cost (historical) value. The change in accounting policy for functional properties resulted with higher net carrying amount of EUR 12.818 thousand as at 31 December 2017, compared to the net carrying amount of functional properties which would be reported in accordance with previous model.

2.15 NON-CURRENT ASSETS AND DISPOSAL GROUPS CLASSIFIED AS HELD FOR SALE

The Group classifies a non-current asset as held for sale (or disposal groups comprising assets and liabilities) assets that are expected to be recovered primarily through sale rather than through continuing use. This condition is regarded as met only when the sale is highly probable and the asset (or disposal group) is available for immediate sale in its present condition. Management must be committed to the sale and the sale should be expected to be completed within one year from the date of classification.

Immediately before classification as held for sale, the assets (or components of a disposal group) are remeasured in accordance with the Group's accounting policies. Thereafter, the assets (or disposal group of assets and liabilities) are measured at the lower of their carrying amount and fair value less cost to sell.

A non-current asset classified as held for sale is no longer depreciated. Impairment losses on initial classification as held for sale and subsequent gains or losses on remeasurement are recognised in income statement. Gains are not recognised in excess of any cumulative impairment loss. Any impairment loss on a disposal group first is allocated to goodwill, and then to the remaining assets and liabilities on a pro-rata basis, except that no loss is allocated to financial assets and deferred tax assets, which continue to be measured in accordance with the Group's accounting policies.

At reclassification back, on change of intent or if the conditions required by IFRS 5 cease to be applicable, the Group does not restate comparative information in the balance sheet. Upon reclassification the valuation is adjusted in accordance with relevant standards, as if the reclassification had not occurred.

2.16 ACCOUNTING FOR LEASES

Determining whether an arrangement is, or contains a lease, is based on the substance of the arrangement and requires an assessment of whether the fulfilment of the arrangement is dependent on the use of a specific asset or assets and the arrangement conveys a right to use the asset.

The Bank as lessee

Leases which do not transfer to the Bank substantially all the risks and rewards incidental to ownership of the leased items are operating leases. Lease payments under operating lease are recognised as an expense in profit or loss on a straight line basis over the lease term. Contingent rents are charged as expenses in the periods in which they are incurred.

A finance lease is a lease that transfers substantially all the risks and rewards incidental to ownership to the lessee. An item of property, plant and equipment acquired by way of finance lease is recorded as an asset and a liability at the lower of the fair value of the asset and the present value of the minimum lease payments at the commencement of the lease term, less accumulated depreciation and any impairment losses. An item of property, plant and equipment acquired under a finance lease is depreciated over the useful life of the asset. If there is no reasonable certainty that the lessee will obtain ownership of the leased asset by the end of the lease term, the leased assets shall be fully depreciated over the shorter of the lease term and its useful life.

The Bank as lessor

When assets are leased under an operating lease, the Bank recognises rental income in the income statement on a straight-line basis over the period of the lease.

When assets are leased out under a finance lease, the present value of the lease payments is recognised as a receivable. Income from finance leasing transactions is apportioned systematically over the primary lease period, reflecting a constant periodic return on the lessor's net investment outstanding.

2.17 CASH AND CASH EQUIVALENTS

For the purpose of the cash flow statement, cash and cash equivalents comprise cash on hand and balances held with central banks except for obligatory reserves, securities held for trading, loans to banks and debt securities not held for trading with original maturity up to 90 days.

2.18 FINANCIAL LIABILITIES

Loans received deposits repayable and debt securities issued are recognised in the statement of financial position in the amount of the funds received less direct transaction costs. The loans received, deposits repayable and debt securities issued are measured at amortised cost and the difference between the initial amount and the end amount is transferred to the income statement using the effective interest method.

2.19 PROVISIONS

Provisions are recognised in respect of present obligations arising from past events where it is probable that outflows of resources embodying past economic benefits will be required to settle the obligation; and they can be reliably estimated.

2.20 FINANCIAL GUARANTEES

Financial guarantees are contracts that require the Bank to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payments when due in accordance with the terms of a debt instrument. Financial guarantees are given to banks, financial institutions and other bodies on behalf of customers to secure loans, overdrafts and other banking facilities.

Financial guarantee liabilities are initially recognised in the financial statements at their fair value on the date the guarantee is given. Subsequent to initial recognition, the Bank's liabilities under such guarantees are measured at the higher of the initial measurement, less amortisation calculated to recognise in the income statement the fee income earned on a straight line basis over the period, and the best estimate of the expenditure required to settle any financial obligation arising as the result of the guarantees at the reporting date. These estimates are determined based on experience of similar transactions and history of past losses, supplemented by the management's judgment.

2.21 INCOME TAX

Current income tax has been calculated in accordance with the local tax law and using the tax rate of 19%.
Deferred income tax is calculated for all taxable temporary differences using the tax rate of 19%. Temporary differences are differences between the carrying amount of an asset or liability in the statement of financial position and its tax base. The tax rates (and tax laws) that have been enacted by the end of the reporting date are

used to determine deferred income tax. The principal temporary differences arise from the valuation of financial instruments including derivatives, the valuation of real estates and provisions for retirement benefit obligations. A deferred tax asset shall be recognised for the carry forward of unused tax losses and unused tax credits to the extent that it is probable that future taxable profit will be available against which the unused tax losses and unused tax credits can be utilised.

2.22 EMPLOYEE BENEFITS

Employee benefits include jubilee benefits, retirement indemnity bonuses and other long-service benefits. According to Slovenian legislation, employees retire after 40 years of services, when, if fulfilling certain conditions, they are entitled to a termination benefit paid out as a lump sum. Valuations of these obligations are carried out by independent qualified actuaries, by using the book reserve method.

The Bank's obligation for the current service cost of providing pension benefits and the increment in the present value of the defined benefit obligation due to the approaching beginning of the defined benefit liability (interest cost) was assessed. The increase in the benefit scheme liabilities in excess of the above two assessments shall be recognised as the actuarial gain or loss.

The defined benefit scheme liabilities are measured on an actuarial basis using the projected unit credit method, which measures actuarial liabilities in accordance with the expected wage/salary increase from the valuation date until the foreseen retirement of the employed person. The wage/salary increase comprises promotion and inflation-related rise.

Under IAS19, the calculated current scheme liabilities are discounted using the rates equivalent to the market yields at the balance-sheet date on high-quality corporate bonds that are denominated in the currency in which the benefits will be paid by the employer. Since there is no deep market in such bonds in the Republic of Slovenia, the discount rate is determined by reference to market yields on government bonds.

For the calculation of actuarial gains and losses, the following assumptions have been used:
- The discount rate of 1.47 % (2016: 1.02%), and
- Future salary increases of 1.62 % p.a. for 2018 and 1.8 % p.a. from 2019 onwards (2016: nil).

2.23 SHARE CAPITAL

Dividends on ordinary shares
Dividends payable to the holders of ordinary shares lower the equity in the period in which the declaration of the dividend is approved by Bank's owners.

Treasury shares
If the Bank repurchases its own equity instruments (treasury shares), the cost of the shares it has reacquired is deducted from equity. In case that the Bank subsequently sells its treasury shares, the consideration received is recognised directly in equity.

2.24 FIDUCIARY ACTIVITIES

The Bank acts as an intermediary on behalf and for account of customers who want to underwrite units of investment funds. A fee is charged for this service. These assets are not shown in the statement of financial position.

2.25 COMPARATIVE INFORMATION

Except as disclosed in Note 2.14, the same accounting policies as for the reporting period have been applied for the comparative information for the prior reporting period.

2.26 ACCOUNTING ESTIMATES AND JUDGEMENTS IN APPLYING ACCOUNTING POLICIES

The Bank makes estimates and assumptions about uncertain events, including estimates and assumptions about the future. Such accounting assumptions and estimates are regularly evaluated, and are based on historical experience and other factors such as the expected flow of future events that can be rationally assumed in the existing circumstances, but nevertheless necessarily represent sources of estimation uncertainty. The estimation of impairment losses in the Bank's credit risk portfolio and, as part of this, the estimation of the fair value of real estate collateral represents the major source of estimation uncertainty. This and other key sources of estimation uncertainty, that have a significant risk of causing a possible material adjustment to the carrying amounts of assets and liabilities within the next financial year, are described below.

a) Impairment losses on loans and advances
The Bank reviews its portfolios of loans and advances to assess whether there is an evidence of impairment on an ongoing basis.

The Bank first assesses whether evidence of impairment exists individually for assets that are individually significant, corporate exposures with total balance exceeding EUR 250 thousand, and collectively for assets that are not individually significant (retail). Those assets which are not identified as specifically impaired are subsequently included in the basis for collective impairment assessment, on the basis of similar credit risk characteristics.

Impairment allowance on assets individually assessed is based on the management's best estimate of the present value of the cash flows that are expected to be received. In estimating these cash flows, management makes judgements about a debtor's financial situation and net realizable value of any underlying collateral. Each impaired asset is assessed on its merits, and the workout strategy and estimate of cash flows considered recoverable are independently approved by the Credit Risk function.

Collective impairment for the group of homogenous assets that are not individually significant is established using statistical methods based on the historical loss rate experience. Management applies judgement to ensure that the estimate of loss arrived at on the basis of historical information is appropriately adjusted to reflect the current economic conditions. Loss rates are regularly benchmarked against actual loss experience.

In addition to losses on an individual basis, the Bank continuously monitors and recognizes impairments which are known to exist at the reporting date, but which have not yet been identified. In estimating unidentified impairment losses for collectively assessed portfolios, the Bank seeks to collect reliable data on appropriate loss rates based on historical experience related to and adjusted for current conditions, and the emergence period for the identification of these impairment losses. The accuracy of the allowance depends on the model assumptions and parameters used in determining the collective allowance.

b) Impairment of available-for-sale equity investments
The Bank determines that available-for-sale equity investments are impaired when there has been a significant or prolonged decline in the fair value below its cost. In this respect, the Bank regards a decline in fair value in excess of 20% to be significant and a decline in quoted market price that persisted for 9 months or longer to be prolonged. In making this judgement, the Bank evaluates among other factors, the nominal volatility in the share price. In addition, impairment may be appropriate when there is evidence of deterioration in the financial health of the investee, industry and sector performance, changes in technology, and operational and financing cash flows.

c) Fair value of functional properties
As disclosed in Note 2.14 the Bank changed its accounting policy for valuation of functional properties from cost to fair value model. In assessing the fair values the Bank has engaged an external appraiser. The management considers that the fair values of functional properties are appropriate.

d) Impairment of real estate inventory obtained for the repayment of loans collateralised by pledging real estate
The Bank occasionally acquires real estate in settlement of certain loans and advances. Real estate is stated at the lower of the cost of the related loans and advances and the current fair value of such assets. Gains or losses on disposal are recognised in the income statement. The Bank assessed that there are no indications of impairment at the reporting date.

e) Fair value of financial instruments
If a market for a financial instrument is not active, or, if for any reason, fair value cannot be reasonably measured

by market price, the Bank establishes fair value using a valuation technique (except for certain unquoted equity securities). Valuation techniques include using recent arm's length transactions between knowledgeable, willing parties (if available), reference to the current fair value of other instruments that are substantially the same, discounted cash flow analyses and option pricing models. The chosen valuation technique makes maximum use of market inputs, relies as little as possible on estimates specific to the Bank, incorporates all factors that market participants would consider in setting a price, and is consistent with accepted economic methodologies for pricing financial instruments. Inputs to valuation techniques reasonably represent market expectations and measures of the risk-return factors inherent to the financial instrument.

f) Non-current assets and disposal groups classified as held for sale
The Bank classifies a non-current asset as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use. This condition is regarded as met only when the sale is highly probable and the asset (or disposal group) is available for immediate sale in its present condition. Management must be committed to the sale and the sale should be expected to be completed within one year from the date of classification.

Immediately before classification as held for sale, the assets (or components of a disposal group) are remeasured in accordance with the Bank's accounting policies. Thereafter, the assets (or disposal group of assets and liabilities) are measured at the lower of their carrying amount and fair value less cost to sell.

A non-current asset classified as held for sale is no longer depreciated. Impairment losses on initial classification as held for sale are included in the income statement, as well as gains and losses on subsequent measurement.

3. RISK MANAGEMENT ORGANISATION

The risk management policies and their implementation in the Bank's operational processes are of high importance for a sound business activity. The Bank has harmonised its risk management process with the risk management framework of the parent Group Intesa Sanpaolo. Therefore, risk management is governed in accordance with the Group best practices, which require a strong institution-wide risk culture involving Bank's management at all levels, and an independent risk management function.

The risk management process is divided in several stages, starting with the risk identification and measurement, which allows the Bank to understand the different types of risk, to measure its potential impact and to recognise in advance possible trends that can significantly change its business environment. The second step is the management of risk, whereby the Bank has to undertake strategic decisions on the type and the level of risk to be assumed, to establish whether to mitigate, diversify or reduce risk exposure and to establish risk limits in line with the Bank's risk capacity and risk appetite. Once risk has been assumed, it shall be properly overseen, which means monitoring risk tolerance limits and reporting to the Bank's governing bodies.

The most important risks in terms of Bank's total exposure are credit risk, interest rate risk, liquidity risk and operational risk.

3.1 CORPORATE RISK MANAGEMENT AND ORGANIZATIONAL STRUCTURE

3.1.1 Corporate risk management

The following structures take part in the risk governance process:

The Supervisory Board approves the strategic directions and risk management policies and reviews the efficiency and adequacy of the overall risk management process within the Bank.

The Risk Committee is an advisory body to the Supervisory Board, which provides advice regarding the Bank's current and future propensity to assume risk and provides assistance in the supervision of senior management with respect to the implementation of the risk management strategy.

The Audit Committee is an advisory body to the Supervisory Board with responsibility to give recommendations and advice to the Board in particular on matters relating to evaluation of the adequacy and efficiency of the Bank's entire system of internal controls over financial reporting including oversight of exposure to risk.

The Management Board is responsible for the approval and implementation of risk management policies and internal controls; it establishes organisational and other conditions for the execution of risk policies and controls.

The Asset and Liability Committee (ALCO) evaluates the exposure to financial risks and give guidance about measures necessary to manage financial exposures.
Credit Risk Governance Committee defines and update credit risk strategic guidelines and credit management policies based on the constant credit portfolio monitoring.

Credit Committee is the highest permanent decision-making committee of the Bank regarding performing counterparties, whose main responsibility consists in adopting credit decisions in line with the issued strategic guidelines and credit policies.

Problem Assets Committee is the highest permanent decision-making committee of the Bank regarding risky and non-performing counterparties, whose main responsibility consists in taking the necessary measures in order to prevent and mitigate credit losses connected with risky and deteriorated assets.

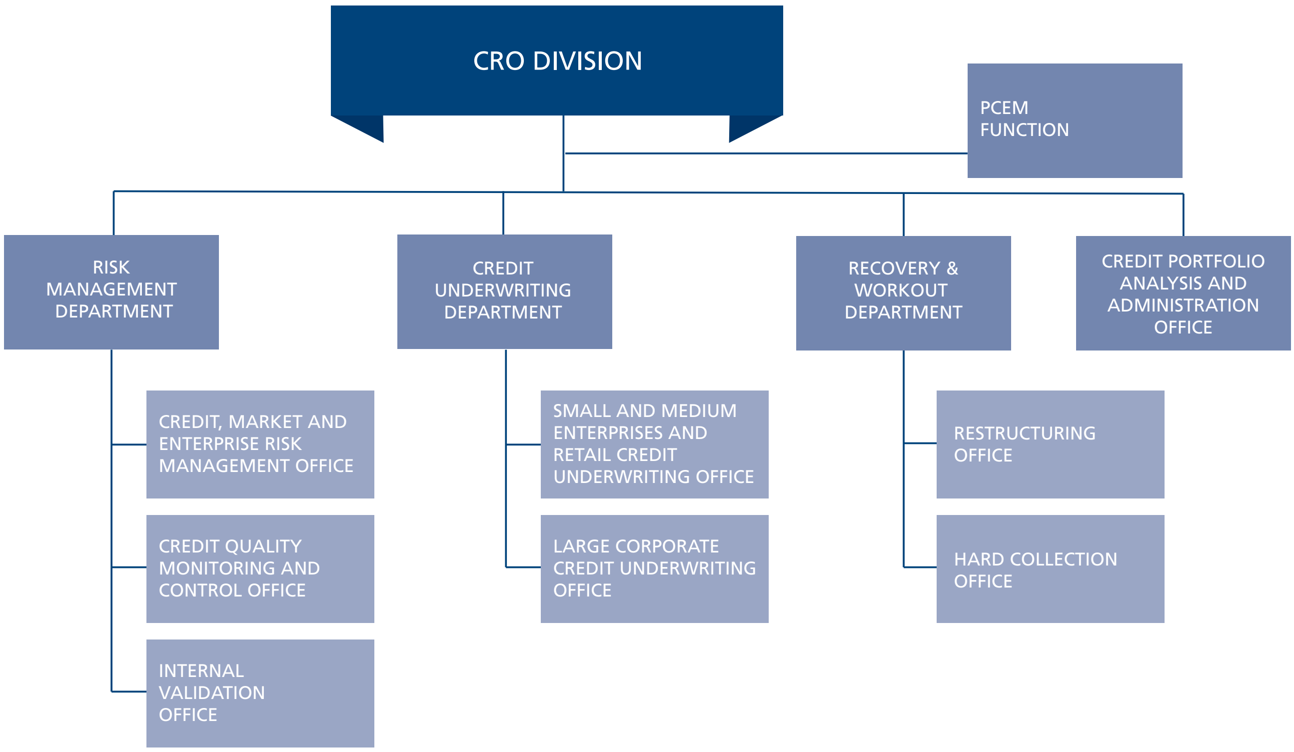
The Internal Audit Department evaluates and reviews processes, procedures, guidelines, policies and all operating activities performed by the Bank with the aim to evaluate the efficiency and effectiveness of the internal controls system and risk management system.

The Compliance and AML Department assesses and manages compliance risk in relation to domestic or international rules and internal acts, and mitigate activities that could damage the reputation of the Bank.

3.1.2. The organisational structure of Risk Division

The Risk Division (CRO area) is responsible for the risk management processes of the Bank. The person in charge of the Risk Division is a Member of the Management Board.

The organisation chart of the Risk Division:



The roles of organisational units within the Risk Division

Under the **Risk Management Department** are organized three offices, which have specific responsibilities related to second level risk control activities:

- **Credit market and enterprise risk management office** is responsible for risk policies, risk methodologies and reporting on risk exposures. In addition the Office monitors internal risk limits and external regulatory constraints, including the minimum capital adequacy ratios.

- **Credit Quality Monitoring and Control Office** is performing second level controls and monitoring activities over the credit portfolio, in terms of quality, composition and considerable changes.

- **The Validation Office** is in charge of evaluating the compliance of the internal systems of risk measurement and management with the regulatory requirements and their alignment with ISP Group guidelines. The Validation Office is responsible for the evaluation of the internal systems of all risk profiles (to be used for both regulatory and internal management purposes) in all the phases of the internal systems lifecycle, also supporting the Supervisory Authorities in their review activities.

  With specific regard to the credit risk, the role of Validation Office is to evaluate the adequacy and suitability of the internal rating systems, from both a design point of view (analysis of the methodological choices with regard to the regulatory requirements and internal and external best practices) and a performance point of view (back-testing analysis and periodical model monitoring). The validation analysis consists also of independent re-performance of the rating and development of alternative methodologies to be used as a benchmark.

Proactive credit exposure management contributes to the implementation of an early warning system, designed to activate the necessary measures against the identified clients by defining and agreeing with business functions the most proper action plans.

The **Credit Underwriting Department** analyses and approves loans and credit facilities to individual borrowers. There are two offices that operate within the framework of the Department: Small, Medium Enterprises and Retail Credit Underwriting Office and the Large Corporate Credit Underwriting Office.

The **Recovery and Workout Department** analyses and approves credit proposals for non-performing clients, participates in loan restructuring and in designing other measures in relation to borrowers with positive recovery perspective (going concern business) as much as in relation to obligors in legal enforcement status (gone concern business), seeking for the loss reduction and efficient recovery.

Credit portfolio analysis and administration office performs administrative controls in credit processes in order to verify the completeness of loan documentation before disbursement and performs credit portfolio analysis aimed at identifying negative trends and/or potential issues in the process, requiring further investigations by competent structures.

3.2 CAPITAL ADEQUACY AND OWN FUNDS (CAPITAL) MANAGEMENT

The Bank's capital includes common equity (mainly paid up capital and retained earnings) and eligible capital instruments, which have similar loss absorption characteristics as common shares. The function of the capital is to ensure long-term stability of the Bank and safeguard Bank's stakeholders.

The Bank meets the minimum capital requirement, as requested by the EU Regulation on prudential requirements for credit institutions (Capital Requirements Regulation or CRR). The CRR prescribes the minimum capital requirement, which is calculated according to the binding rules for the determination of risk- weighted assets. In addition, the CRR defines the general guidelines on the self-directed internal assessment of risk and capital requirement (Internal capital adequacy assessment process or ICAAP).

3.2.1 Compliance with the regulatory capital requirement

The regulatory capital requirement is calculated in line with CRR Regulation and is determined as a ratio between the Bank's capital and risk-weighted assets. Capital requirements have to be set aside for credit, market and operational risk. Banks have to meet the CET1 minimum capital requirement of 4.5% or higher, and the minimum own funds requirement of 8%. The Bank's capital is composed of the Common Equity Tier 1 capital and to less extent of Tier 2 capital. As of 31 December 2017, the Bank`s capital amounts to 271.53 million euros, whereas the CET1 ratio was 17.43%. The capital ratio was adequate and above the minimum capital requirement as defined by regulation, as well as with regard to the Pillar II framework, that is the internal assessment of capital requirement of the Bank (ICAAP) and the supervisory review process (SREP) evaluation of Pillar II.

The Bank maintains the minimum capital adequacy and the minimum amount of capital by regularly reporting the capital position to the highest governance bodies and by providing annual and strategic capital planning. A capital growth corresponding to the increase of risk capital activities was provided with proper retention of profits within the capital reserves.

(in thousands of euros)

Capital adequacy as at 31 December 2017	Risk weighted amount		Capital	
	2017	2016	2017	2016
Credit risk exposures of banking book				
Exposures to state and central bank	7,813	9,015	625	721
Exposures to local municipalities	12,154	10,894	972	872
Exposures to public sector	2,930	2,547	234	204
Exposures to development banks	-	-	-	-
Exposures to institutions	22,344	29,129	1,788	2,330
Exposures to enterprises	135,172	553,647	10,814	44,292
Exposures to equity	-	3,878	-	310
Exposures to retail banking	554,638	555,175	44,371	44,414
Past due exposures	27,064	101,777	2,165	8,142
Exposures to highly risk exposures	23,032	2	1,843	-
Exposures to investments funds	1,334	40,088	107	3,207
Exposures to other assets	-	49,505	-	3,960
Exposures to corporates-other IRB	362,435	-	28,995	-
Exposures to corporates-SME IRB	192,367	-	15,389	-
Exposures to equity IRB	17,636	-	1,411	-
Exposures to other assets IRB	62,132	-	4,971	-
Total	**1,421,051**	**1,355,657**	**113,685**	**108,452**
Credit risk weighted assets	1,421,051	1,355,657	113,685	108,452
Market risk weighted assets	701	965	56	77
Operational risk weighted assets	136,120	121,502	10,890	9,720
Total risk weighted assets	**1,557,872**	**1,478,124**	**124,631**	**118,249**
Regulatory capital				
Share capital	22,173	22,173		
Share premium	7,499	7,499		
Treasury shares	(49)	(49)		
Legal reserves	15,260	15,260		
Statutory reserves	214,054	214,053		
Treasury shares fund reserves	49	49		
Retained earnings due to transition to IFRS	6,009	6,009		
Accumulated other comprehensive income	16,023	5,859		
Less intangible assets	(3,517)	(4,068)		
Other transitional adjustments				
Unrealised gains/losses on government bonds	(4,594)	(5,584)		
Unrealised gains/losses on other shares	(229)	(339)		
Deferred tax assets that rely on future profitability and do not arise from temporary differences	-	-		
Requirements from prudent valuation of debt securities	(182)	(175)		
Recognised impairments for credit risk during the year	(3,265)	(3,513)		
IRB shortfall of provisions to expected losses	(1,549)	-		
Total qualifying Tier 1 capital	**267,682**	**257,174**		
IRB Excess of provisions over expected losses	**3,635**	**-**		
Total qualifying Tier 2 capital	**3,635**	**-**		
Total regulatory capital	**271,317**	**257,174**		
Capital Adequacy ratio (%)	**17.42**	**17.40**		

3.2.2 Risk Appetite Framework Limits

With the Risk Appetite Framework (RAF) Limits have been established a system of risk metrics that represents risk amounts the Bank is willing to assume. The RAF limits represent the highest level of aggregate risk representation with break down to capital adequacy, liquidity and local specific risk limits. Alongside the limits the Risk Appetite Framework establishes controls and procedures in case of limit breach and the roles regarding the definition and approval of RAF limits. The RAF limits also define the target amount of Available financial resources (internally assessed available capital sources) through the target AFR/ECAP ratio (Available Financial Resources/ICAAP capital charges excluding stress test).

3.3 CREDIT RISK

Credit risk is the risk of financial loss arising from a debtor's failure to repay its financial obligations. Credit risk is, by scope and business strategic orientation, the most important risk for the Bank.

The credit risk is associated with financial assets measured at amortised cost (loans and other claims). For such assets the credit risk is evaluated with accurate credit risk analysis and corresponding credit classification of the borrower. Credit risk of derivative contracts is measured at replacement cost. The replacement cost is made up of the positive value of the deal, which represents a positive difference between the settlement price and the contractual price of the instrument, increased for the add-on, accommodating for a potential increase of positive value. The replacement cost is made up of the positive value of the deal, which represents a positive difference between the settlement price and the contractual price of the instrument, increased for the add-on, accommodating for a potential increase of positive value.
The Bank's credit risk related portfolio at the end December 2017 amounted to EUR 2.595 million of which 93% is classified as performing. Total risk portfolio includes all asset and off-balance sheet items, which are subject to credit risk according to the Bank of Slovenia methodology.

Intesa Sanpaolo Bank's credit risk related portfolio as at 31 December 2017

(in thousands of euros)

Counterparties	Total gross credit risk portfolio	Total credit risk portfolio, excluding debt securities	Share in %	Performing	Share in %	Non-performing	Share in %	Impairment losses on performing portfolio	Coverage rate of performing portfolio	Impairment losses on non performing portfolio	Coverage rate of non-performing portfolio
1	2	3	4	5	6	7	8	9	10=9/5	11	12=11/7
Central bank and government bodies	602,002	302,267	12%	302,267	12%	-	0%	40	0%	-	0%
Corporate entities	1,489,113	1,487,633	57%	1,327,755	55%	159,878	93%	12,643	1%	84,554	53%
Banks	96,409	91,081	4%	91,081	4%	-	0%	14	0%	-	0%
Private individuals	714,040	714,040	28%	701,240	29%	12,800	7%	1,132	0%	6,582	51%
Total	**2,901,564**	**2,595,021**	**100%**	**2,422,343**	**100%**	**172,678**	**100%**	**13,829**	**1%**	**91,136**	**53%**

Intesa Sanpaolo Bank's credit risk related portfolio as at 31 December 2016

(in thousands of euros)

Counterparties	Total risk portfolio	Total credit risk portfolio, excluding debt securities	Share in %	Performing	Share in %	Non-performing	Share in %	Impairment losses on performing portfolio	Coverage rate of performing portfolio	Impairment losses on non performing portfolio	Coverage rate of non-performing portfolio
1	2	3	4	5	6	7	8	9	10=9/5	11	12=11/7
Central bank and government bodies	517,109	205,964	8%	205,964	9%	-	0%	43	0%	-	0%
Corporate entities	1,484,032	1,465,567	59%	1,299,697	57%	165,870	91%	17,686	1%	84,067	51%
Banks	164,622	138,102	6%	138,102	6%	-	0%	32	0%	-	0%
Private individuals	663,619	663,619	27%	648,040	28%	15,579	9%	1,050	0%	7,553	48%
Total	**2,829,382**	**2,473,252**	**100%**	**2,291,803**	**100%**	**181,449**	**100%**	**18,811**	**1%**	**91,620**	**50%**

Analyses by type of collateral

(in thousands of euros)

	2017		2016	
	Net loans	Fair value of collateral	Net loans	Fair value of collateral
Real estate	506,619	1,677,185	478,589	1,557,240
Bank guarantees	42,212	56,017	44,983	60,933
Personal guarantees	228,396	615,254	235,665	634,857
Debt securities	9,544	22,708	12,750	36,150
Government guarantees	230,728	257,404	254,064	280,998
Other collateral	69,516	194,523	90,679	263,033
Deposits	1,828	3,911	2,134	4,422
Insurance company guarantees	103,261	126,807	105,167	126,303
Total collateralised net loans	**1,192,104**	**2,953,809**	**1,224,031**	**2,963,936**
Unsecured	482,926	-	402,342	-
Total net loans to non-bank customers	**1,675,030**	**-**	**1,626,373**	**-**

In general loans can be secured with one or more types of collateral. The Bank's decision when collateral is acceptable depends on the obligor's credit worthiness and the type, amount and maturity of lending facilities. The value of collateral is monitored and periodically revalued as its fair value changes. Securities and collective investment units are revalued weekly, whereas real estate and movable property collateral are revalued yearly.

Credit risk measurement

The Bank`s credit portfolio includes cash exposures, commitments to lend and off-balance sheet commitments. The credit exposures arising from derivative contracts are reported at replacement cost.

(in thousands of euros)

Maximum exposure to credit risk	Maximum exposure	
	2017	2016
Credit risk exposures relating to on-balance sheet assets are as follows:		
Loans to banks	41,142	89,516
Loans to non-bank customers:	1,675,725	1,625,367
- Loans to individuals:	584,658	532,978
- overdrafts	21,897	24,822
- credit cards	16,504	17,568
- term loans	114,327	100,758
- mortgages	425,010	381,980
- finance leases	6,920	7,850
- Loans to sole proprietors	48,619	51,825
- Loans to corporate entities	1,042,448	1,040,564
Advances	13,731	11,016
Available for sale financial assets:	302,891	340,111
- debt securities	302,891	340,111
Other assets	271,402	191,773
Credit risk exposures relating to off-balance sheet items are as follows:		
Guarantees	170,918	176,498
Credit commitments and other credit related liabilities	320,790	284,670
At 31 December	**2,796,599**	**2,718,951**

The maximum exposure to credit risk represents the worst case scenario of credit risk exposure to the Bank at 31 December 2017 and 2016, without taking into account any collateral held or other attached credit enhancements. For off-balance-sheet assets, the exposures set out above are based on net carrying amounts as reported in the statement of financial position.

Credit Classification

The Bank`s credit portfolio is classified in 5 basic credit risk categories in accordance with the classification rules of the Bank of Slovenia. Exposures to obligors with the highest credit worthiness or exposures guaranteed by the state are classified in the A category, whereas the exposures to obligors with the lowest credit worthiness are classified in the E category. The credit ranking is supported by the probability that the obligor will not be able to repay the obligations. The credit assessment takes into account the financial standing of the obligor, the cash-flow availability to service the debt and payment regularity record. The performing obligors are classified into credit grades A, B or C.

Obligors with internal rating calculated by statistical model are classified in 15 credit rating grades.

The bank has been developing internal ratings for all major obligor segments. The internal rating system is based on a statistical analysis of the default probability assigned to each obligor rating grade. Currently, internal ratings are assigned to Corporate and Small business obligors, while for the other segments the internal rating models are in development stage. The statistical models are designed to contain the debtor's financial data, behavioural data and qualitative information, which jointly contributes to the final obligor's credit classification. The classification attribution process is supported by the system, which has required controls that are driving the logical process of the classification attribution.

The obligor's classification is compliant with the European Banking Authority requirements, which has established rules for the classification of exposures to performing or non-performing categories. The non-performing obligors are further broken-down into the following categories: past due, unlikely to pay and doubtful. The work-out strategy for non-performing obligors depends on whether the Bank evaluates the borrower as going concern or gone concern, with the later expecting that the financial difficulties cannot be resolved.

Credit portfolio of non-bank customers by classification (on and off-balance exposures)

	2017				2016			
	Gross exposure	Loans and advances (%)	Impairments	Coverage with impairments (%)	Gross exposure	Loans and advances (%)	Impairments	Coverage with impairments (%)
Performing	2,035,317	90	8,868	0.4	1,903,943	87	9,761	0.5
Watch list	56,670	3	4,759	8.4	108,572	5	8,822	8.1
Unlikely to pay	95,592	4	37,136	38.8	64,670	3	24,181	37.4
Doubtful	76,000	3	53,083	69. 8	115,478	5	66,259	57.4
Total	**2,263,579**	**100**	**103,846**	**4.6**	**2,192,663**	**100**	**109,023**	**5.0**

Impairment provisions for credit risk

The amount of impairment provisions for credit risk is commensurate with the credit standing of the borrower and collateral received in pledge. Provisions are calculated using collective or individual approach. Credit risk losses are calculated individually for obligors, whose total exposure exceeds 250,000 euros and are classified as unlikely to pay or doubtful. The Individual approach is carried out with the estimation of all expected cash-flows for each obligor individually that can be recovered from the obligor's own assets or earnings and through the execution of collateral. The expected cash-flow has to be discounted using the original contract's interest rate.

Under the collective provisioning methodology, provisions are calculated by estimating the expected loss as a result of a multiplication of the probability of default (PD rate), the expected loss given such default (LGD rate) and the expected exposure at the time of default (EAD). Loss estimation parameters are updated annually.

For the Corporate and Small business segment the probability of default is determined using the internal rating, whereas for other obligor segments the expected loss is estimated with calculation of annual migration rates between classification categories (Annual Default Rate). The estimation is done using the average of 5-year historical series.

Loss Given Default rates are estimated by groups of exposures of different obligors segments secured with the same type of collateral. The recovery rate is estimated using the ratio between the net present values of recoveries, less costs, and credit exposures at default (the work-out method). The estimation is made based on 6-year historical series of recovery data.

Loans that are considered genuinely unrecoverable are written off after all available legal actions have been taken. In cases where the amount of impairment is excessive due to improvement in the economic position of the obligor, the previously recognised impairment is reversed by debiting the loan losses adjustment account and crediting the income statement.

Large exposures

In order to limit the risk of large exposure, the Bank monitors the single-name credit concentration risk. The largest allowed exposure to a single borrower and connected entities is limited by CRR Regulation and should not exceed 25 per cent of the Bank's regulatory capital. In case of exposure to banks or banking groups the maximum allowed exposure is EUR 150 million.

Financial instrument`s breakdown by country risk

Country risk

(in thousands of euros)

As at 31 December 2017	Slovenia	EU	*Of which Italy*	Other Europe	Rest of world	Total
Cash, cash balances at Central Banks and other demand deposits at banks	252,094	33,739	*30,860*	-	1,251	**287,084**
Financial assets held for trading	10	50	*50*	-	-	**60**
Financial assets designated at fair value through profit or loss	-	59	*59*	-	-	**59**
Available for sale financial assets	173,160	142,901	*131,786*	-	2,641	**318,702**
Loans and receivables:	1,595,831	72,570	*20,284*	45,058	16,441	**1,729,900**
- loans to banks	5,978	15,164	*15,164*	20,000	-	**41,142**
- loans to non-bank customers	1,579,799	56,109	*5,116*	25,058	14,061	**1,675,027**
- advances	10,054	1,297	*4*	-	2,380	**13,731**
Derivatives – hedge accounting	-	2,471	-	-	-	**2,471**
Contingent liabilities and commitments	**476,509**	**7,390**	***994***	**772**	**35**	**484,706**
Total exposures	**2,497,604**	**259,180**	***184,033***	**45,830**	**20,368**	**2,822,982**

(in thousands of euros)

As at 31 December 2016	Slovenia	EU	*Of which Italy*	Other Europe	Rest of world	Total
Cash, cash balances at Central Banks and other demand deposits at banks	153,558	33,687	*31,359*	146	5,452	**192,843**
Financial assets held for trading	-	64	*64*	-	-	**64**
Financial assets designated at fair value through profit or loss	-	136	*136*	-	-	**136**
Available for sale financial assets	254,567	98,899	*98,869*	-	1,149	**354,615**
Loans and receivables:	1,577,924	93,622	*82,254*	31,252	24,107	**1,726,905**
- loans to banks	3,815	85,701	*77,717*	-	-	**89,516**
- loans to non-bank customers	1,567,165	6,608	*4,448*	31,189	21,411	**1,626,373**
- advances	6,944	1,313	*89*	63	2,696	**11,016**
Derivatives – hedge accounting	-	913	-	-	-	**913**
Contingent liabilities and commitments	**450,771**	**5,350**	***3,647***	**1,116**	**29**	**457,266**
Total exposures	**2,436,820**	**232,671**	***216,329***	**32,514**	**30,737**	**2,732,742**

3.4 ANALYSIS OF PAST DUE FINANCIAL INSTRUMENTS

Past due financial instruments relate only to loans and advances portfolio, meanwhile other financial instrument portfolios do not record delays.

Loans and advances are summarised as follows:

Loans and advances by maturity (past due)

(in thousands of euros)

	31 December 2017		31 December 2016	
	Loans and advances to customers	Loans and advances to banks	Loans and advances to customers	Loans and advances to banks
Neither past due nor impaired	1,604,968	41,146	1,551,905	89,532
Past due but not impaired	3,157	-	2,991	-
Impaired	167,095	-	175,848	-
Gross	**1,775,220**	**41,146**	**1,730,744**	**89,532**
Impairment losses on loans and advances	(100,193)	(4)	(104,371)	(16)
Net	**1,675,027**	**41,142**	**1,626,373**	**89,516**

Neither past due nor impaired loans are considered to be of a sound credit quality. The Bank is closely monitoring the clients with occasional delay in repayment.

Loans and advances to customers by maturity and portfolio quality

(in thousands of euros)

31 December 2017	Individuals							
	Overdrafts	Credit Cards	Term loans	Mortgages	Finance leases	Sole proprietors	Corporate entities	Total loans and advances to customers
Neither past due nor impaired	21,457	15,776	112,989	421,205	6,292	45,628	981,621	1,604,968
Not past due but impaired	312	17	620	2,439	(86)	1,324	87,013	91,639
Past due but not impaired	151	600	135	169	47	161	1,894	3,157
Past due and impaired	633	693	2,469	4,364	902	7,584	58,811	75,456
Gross	**22,553**	**17,086**	**116,213**	**428,177**	**7,155**	**54,697**	**1,129,339**	**1,775,220**
Impairment losses on loans and advances	(655)	(582)	(1,885)	(3,865)	(235)	(6,079)	(86,892)	(100,193)
Net	**21,898**	**16,504**	**114,328**	**424,312**	**6,920**	**48,618**	**1,042,447**	**1,675,027**

Loans under "not past due but impaired" relate mainly to restructured loans.

Loans and advances to customers by maturity and portfolio quality

(in thousands of euros)

31 December 2016	Individuals							
	Overdrafts	Credit Cards	Term loans	Mortgages	Finance leases	Sole proprietors	Corporate entities	Total loans and advances to customers
Neither past due nor impaired	24,224	16,739	99,200	378,383	7,097	48,216	978,046	1,551,905
Not past due but impaired	72	13	689	3,190	270	1,311	57,722	63,267
Past due but not impaired	170	662	162	207	64	215	1,511	2,991
Past due and impaired	1,372	868	2,729	5,349	706	9,188	92,369	112,581
Gross	**25,838**	**18,282**	**102,780**	**387,129**	**8,137**	**58,930**	**1,129,648**	**1,730,744**
Impairment losses on loans and advances	(1,016)	(714)	(2,022)	(4,143)	(287)	(7,105)	(89,084)	(104,371)
Net	**24,822**	**17,568**	**100,758**	**382,986**	**7,850**	**51,825**	**1,040,564**	**1,626,373**

Ageing of past due loans and advances to customers by type of customer, product and portfolio quality

(in thousands of euros)

31 December 2017	Individuals										
	Overdrafts		Credit cards		Term loans		Mortgages		Finance leases		Total individuals
	Not impaired	Impaired	Not impaired	Impaired	Not impaired	Impaired	Not impaired	Impaired	Not impaired	Impaired	
Past due up to 30 days	134	3	514	13	119	32	139	17	36	5	1,012
Past due 30 - 60 days	13	1	69	12	13	13	20	12	9	4	166
Past due 60 - 90 days	4	-	17	8	3	14	7	10	2	5	70
Past due over 90 days	-	629	-	660	-	2,410	3	4,325	-	888	8,915
Total	**151**	**633**	**600**	**693**	**135**	**2,469**	**169**	**4,364**	**47**	**902**	**10,163**

(in thousands of euros)

31 December 2017	Sole proprietors		Corporate entities		Total
	Not impaired	Impaired	Not impaired	Impaired	
Past due up to 30 days	96	28	1,804	350	2,278
Past due 30 - 60 days	61	34	83	579	757
Past due 60 - 90 days	4	6	7	497	514
Past due over 90 days	-	7,516	-	57,385	64,901
Total	**161**	**7,584**	**1,894**	**58,811**	**68,450**

Decrease of past due loans and advances in 2017 is mainly due to write-offs. Write-offs of non-performing loans amounted to EUR 22,798 thousand (2016: EUR 57,243 thousand).

Ageing of past due loans and advances to customers by type of customer, product and portfolio quality

(in thousands of euros)

31 December 2016	Individuals										Total individuals
	Overdrafts		Credit cards		Term loans		Mortgages		Finance leases		
	Not impaired	Impaired	Not impaired	Impaired	Not impaired	Impaired	Not impaired	Impaired	Not impaired	Impaired	
Past due up to 30 days	135	7	566	7	124	61	159	134	49	8	1,250
Past due 30 - 60 days	25	1	79	12	16	57	28	21	13	8	260
Past due 60 - 90 days	8	3	17	7	22	10	19	127	2	8	223
Past due over 90 days	2	1,361	-	842	-	2,601	1	5,067	-	682	10,556
Total	**170**	**1,372**	**662**	**868**	**162**	**2,729**	**207**	**5,349**	**64**	**706**	**12,289**

(in thousands of euros)

31 December 2017	Sole proprietors		Corporate entities		Total
	Not impaired	Impaired	Not impaired	Impaired	
Past due up to 30 days	144	32	1,266	338	1,780
Past due 30 - 60 days	68	95	170	602	935
Past due 60 - 90 days	3	79	75	86	243
Past due over 90 days	-	8,982	-	91,343	100,325
Total	**215**	**9,188**	**1,511**	**92,369**	**103,283**

The breakdown of the gross amount of individually impaired loans and advances by class, along with the fair value of related collateral held by the Bank as security, is as follows:

Loans and advances individually impaired

(in thousands of euros)

31 December 2017	Individuals	Sole proprietors	Corporate entities	Total
Individually impaired loans	2,352	1,935	125,776	130,063
Fair value of collateral	2,683	2,682	122,563	127,928

(in thousands of euros)

31 December 2016	Individuals	Sole proprietors	Corporate entities	Total
Individually impaired loans	2,746	1,468	127,762	131,976
Fair value of collateral	3,494	1,936	171,363	176,793

In 2017, the Bank received EUR 16,796 thousand from the sale of pledged collateral.

3.5 LIQUIDITY RISK

Liquidity risk is defined as the risk of not being able to meet payment obligations as they fall due, due to difficulties to finance liquidity needs, or convert marketable assets into cash, including potential losses incurred due to forced trades. In order to manage liquidity risk, the Bank monitors liquidity ratio levels and mandatory reserves on a daily basis in order to maintain adequate liquidity position.

The minimum liquidity to be maintained by banks is defined by the Bank of Slovenia Regulation on the minimum requirements for ensuring an adequate liquidity position (Ur. l. RS, št. 50/15, 44/16 and 79/16), establishing a minimum liquidity ratio for assets and liabilities with maturity up to one month.

The liquidity position of the Bank is monitored with two additional ratios, the LCR (Liquidity Coverage Ratio) and NSFR (Net Stable Funding Ratio). The ratios have been introduced globally as principal liquidity measures necessary to ensure a minimum short-term liquidity as well long-term balanced funding of banks. Beside the mentioned indicators, the Bank as well calculates the so-called 'Stress LCR', which is meant for monitoring the Bank's liquidity position in uncertain (stress) situation. It measures the LCR over a 3 month period. All indicators are calculated in accordance with the Delegated Act regulation (2015/61), which came into force in 2016. LCR and NSFR indicators are regularly reported to ALCO and Audit Committee.

Liquidity ratios

	31.12.2017	31.12.2016	31.12.2015
LCR	238%	246%	329%
NSFR	147%	139%	139%

The LCR and NSFR ratios through the past period were stable, showing no significant movement and compliant with the regulatory limit. In 2017 the Bank adopted a new Liquidity policy in line with the new Group guidelines on liquidity risk, where the internal limits for LCR and NSFR are defined. Both are set at 90%. The regulatory limit in force in 2017 was 80% for LCR, NSFR became a minimum standard by 1 January 2018. The LCR and NSFR ratio as of 31 December 2017 are stable and high above the limits and stand at the same level, compared to previous year. The liquidity buffer is comprised entirely out of level 1 assets, mostly withdrawable central bank reserves and government bonds. Total expected cash inflows are capped to 75% of total expected cash outflows.

The Treasury and ALM Department manages at the operating level the liquidity with daily cash-flow planning and maintains an adequate amount of eligible assets as collateral necessary for refinancing with the ECB.
The measures aimed at managing a liquidity crisis are defined with the Contingent Liquidity Plan, establishing early warning indicators and roles and actions to be considered in adverse financial circumstances.

Maturities of assets and liabilities - Non-derivative cash flows by contractual maturities

(in thousands of euros)

As at 31 December 2017	Contractual maturity						
	Carrying amount	Gross nominal Inflow/(outflow)	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years
ASSETS							
Cash, cash balances at Central Banks and other demand deposits at banks	287,084	287,084	268,029	-	-	-	19,055
Financial assets designated at fair value through profit or loss	59	59	-	-	59	-	-
Available for sale financial assets	318,702	318,702	620	21,464	65,413	122,961	108,244
Loans and receivables:	1,729,900	1,741,856	116,391	88,550	338,545	644,205	554,165
- loans to banks	41,142	41,142	17,475	16,669	6,998	-	-
- loans to non-bank customers	1,675,027	1,686,983	91,235	65,831	331,547	644,205	554,165
- advances	13,731	13,731	7,681	6,050	-	-	-
Total assets	**2,335,745**	**2,347,701**	**385,040**	**110,014**	**404,017**	**767,166**	**681,464**
LIABILITIES							
Financial liabilities measured at amortised cost:	2,091,860	2,091,860	1,685,807	101,514	225,513	65,346	13,680
- deposits from banks and central banks	10,750	10,750	2,454	-	1,037	7,259	-
- deposits from non-bank customers	1,971,496	1,971,496	1,650,567	93,708	192,488	33,537	1,196
- loans from banks and central banks	71,477	71,477	1,788	885	31,770	24,550	12,484
- other financial liabilities	38,137	38,137	30,998	6,921	218	-	-
Total liabilities	**2,091,860**	**2,091,860**	**1,685,807**	**101,514**	**225,513**	**65,346**	**13,680**
Net liquidity gap	**243,885**	**255,841**	**(1,300,767)**	**8,500**	**178,504**	**701,820**	**667,784**

(in thousands of euros)

As at 31 December 2016	Contractual maturity						
	Carrying amount	Gross nominal Inflow/(outflow)	Up to 1 month	1-3 months	3-12 months	1- 5 years	Over 5 years
Total assets	2,274,499	2,290,652	319,943	141,753	288,705	879,120	661,131
Total liabilities	2,017,524	2,017,524	1,500,158	125,517	268,191	104,311	19,347
Net liquidity gap	**256,975**	**273,128**	**(1,180,215)**	**16,236**	**20,514**	**774,809**	**641,784**

The negative net liquidity gap in the 1 month time bucket should be viewed with additional consideration of specific liquidity profile of some balance sheet items, particularly sight deposits, which balances during 2017 kept increasing. Although sight deposits can be withdrawn at any time, they are considered (for liquidity management purposes) to be largely stable. This is demonstrated by the LCR treatment of sight deposits, whereby the run-off factor is 5%, representing the percentage of sight deposits deemed volatile in one month horizon. Moreover, on the assets side the available for sale financial assets include ECB eligible bonds, which are treated as liquidity reserves entering in the 1 month maturity bucket. The stable part of sight deposits and ECB eligible bonds counterbalance the 1 month net liquidity gap. The proof of this statement is positive LCR ratio (calculated on the base of 30 days).

Maturities of assets and liabilities - Derivative cash flows by contractual maturity

(in thousands of euros)

As at 31 December 2017	Carrying amount	Nominal Inflow/(outflow)	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years
			Contractual maturity				
DERIVATIVE ASSETS							
Derivatives held for trading:							
FX Forward	**10**	**(595)**	**(222)**	**(323)**	**(50)**	**-**	**-**
- Inflow	-	-	-	-	-	-	-
- Outflow	-	(595)	(222)	(323)	(50)	-	-
Interest rate cap	**50**	**(104)**	**-**	**-**	**1**	**529**	**(634)**
- Inflow	-	61,172	-	-	3	12,663	48,506
- Outflow	-	(61,276)	-	-	(2)	(12,134)	(49,140)
Total	**60**	**(699)**	**(222)**	**(323)**	**(49)**	**529**	**(634)**
DERIVATIVE LIABILITIES							
Derivatives held for trading:							
FX Forward	**8**	**596**	**222**	**324**	**50**	**-**	**-**
- Inflow	-	596	222	324	50	-	-
- Outflow	-	-	-	-	-		
Total	**8**	**596**	**222**	**324**	**50**	**-**	**-**
Net liquidity gap	**-**	**(103)**	**-**	**1**	**1**	**529**	**(634)**

(in thousands of euros)

As at 31 December 2016	Carrying amount	Nominal Inflow/(outflow)	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years
			Expected maturity				
Total derivative held for trading assets	64	(143)	-	-	27	498	(668)
Total derivative held for trading liabilities	-	2	-	-	(4)	(3)	9
Net liquidity gap	**-**	**(141)**	**-**	**-**	**23**	**495**	**(659)**

(in thousands of euros)

As at 31 December 2017	Carrying amount	Nominal Inflow/(outflow)	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years
			Contractual maturity				
DERIVATIVE ASSETS							
Derivatives held for hedge accounting:							
IRS	2,471	2,363	(617)	(90)	(1,163)	(2,118)	6,351
- Inflow	-	16,849	-	208	506	3,411	12,724
- Outflow	-	(14,486)	(617)	(298)	(1,669)	(5,529)	(6,373)
Total	**2,471**	**2,363**	**(617)**	**(90)**	**(1,163)**	**(2,118)**	**6,351**
DERIVATIVE LIABILITIES							
Derivatives held for hedge accounting:							
IRS	660	(669)	(439)	(197)	(164)	(1,552)	1,683
- Inflow	-	6,471	103	89	595	1,867	3,817
- Outflow	-	(7,140)	(542)	(286)	(759)	(3,419)	(2,134)
Total	**660**	**(669)**	**(439)**	**(197)**	**(164)**	**(1,552)**	**1,683**
Net liquidity gap	**-**	**1,694**	**(1,056)**	**(287)**	**(1,327)**	**(3,670)**	**8,034**

(in thousands of euros)

As at 31 December 2016	Carrying amount	Nominal Inflow/(outflow)	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years
			Contractual maturity				
Total derivative held for hedge accounting assest	913	(1,193)	38	4	48	(285)	(998)
Total derivative for hedge accounting liabilities	1,402	1,468	398	169	384	4,217	(3,700)
Net liquidity gap		**275**	**436**	**173**	**432**	**3,932**	**(4,698)**

Cash flows of interest rate caps, interest options and interest rate swaps represent fairly the difference between contractual price and market price of derivatives.
The increase of cash-flows from derivatives in 2017 is a result of new IRS contracts made with the aim of providing interest rate hedge on loans extended with fixed contractual interest rate.

Contractual maturities of off-balance sheet items*

(in thousands of euros)

As at 31 December 2017	Contractual maturity			
	No later than 1 year	1-5 years	Over 5 years	Total
Documentary and commercial letters of credit	160	-	-	160
Guarantees	103,760	47,736	20,065	171,561
Credit commitments	248,052	66,606	-	314,658
Total	**351,972**	**114,342**	**20,065**	**486,379**

(in thousands of euros)

As at 31 December 2016	Contractual maturity			
	No later than 1 year	1-5 years	Over 5 years	Total
Total	**374,217**	**65,759**	**20,158**	**460,134**

** Items presented in the above table include performing items which are presented in gross amount and non-performing exposures which are presented in net amount.*

3.6 BANKING BOOK EQUITY RISK

Equity risk is defined as the risk of unexpected losses arising from positions in available-for sale equity investments (shares or equity participations).
The Bank acquired these equity investments mainly with the repossession of financial collaterals arising from lending activity. These investments are managed pursuing the target of disposal in order to recover the relative credit exposures. During 2017 Cinkarna Celje, d.d. shares were sold and additional Hoteli Bernardin, d.d. shares were acquired due to the repossession.

3.7 MARKET RISK

Market risk mainly arises from trading activities. The Bank only performs trading activities with the aim to respond to the demand of its customers and these activities mostly consist of buying and selling currency and derivative contracts.

The operational risk arising from trading activities is managed on the basis of a clear division between the front and back-office operations, which assures adequate controls and segregation of functions.

The Bank has established internal market risk limits on Fixed income VaR indicator, FX VaR indicator,open position by currencies and on credit sensitivity (CR01) of Italian government bonds.

3.7.1 Derivative instruments

The Bank takes on derivative transactions only for the purpose of serving customers requests. Since the Bank is not willing to assume any financial risk embedded in derivative contracts (position risk or change in the fair value of a derivative due to change in the value of the underlying asset), each single transaction is fully hedged back-to-back by immediately executing an offsetting transaction with another bank. The Bank assumes only the counterparty risk in these transactions, i.e. risk of substituting the original contract with other counterparty. The counterparty credit risk for the purpose of internal credit risk monitoring is determined as an amount equal to replacement cost, which is calculated as the highest value between the positive fair value of the instrument and a percentage of the nominal amount equivalent to the counterparty credit risk. The credit counterparty risk percentage is determined with internal model developed by the Group and applied according to the type and maturity of derivative contract.

3.7.2 Currency Risk

When there is an open position in a particular currency, the Bank is exposed to currency risk. The open currency position in a particular foreign currency is the difference between assets and liabilities denominated in that currency. For the purpose of measuring currency risk, the Bank takes into account the overall position composed of assets and liabilities denominated in that currency, FX spot transactions and currency derivatives.

The Bank measures and monitors currency risk on a daily basis:

- as a notional open position for a particular currency, and
- as Value-at-Risk (VAR) indicator for the global currency position.

The Value-at-Risk is a statistical estimation of a maximum loss at the 99 per cent confidence level over a 1-day period. The Value-at-Risk measure is proportional to the currencies open position and to the exchange rate volatility.

The average utilisation of FX Var limit in 2017 was low at 6.08 and the average utilization of Fixed income Var limit was 23.45%.

Bank VAR by risk type

(in million of euros)

	12 months to 31 December 2017			12 months to 31 December 2016		
	Average	High[1]	Low[1]	Average	High[1]	Low[1]
Foreign exchange risk (trading and non-trading portfolio)	2	9	1	3	8	1
Bond risk (banking book)	400	669	231	708	1,082	335
Total VAR	**402**	**678**	**232**	**711**	**1,090**	**336**

Currency risk

A currency is considered "significant"if the aggregate liabilities denominated in that currency amount to 5% or more of the bank's total liabilities. Currently no currency is exceeding this threshold.

(in thousands of euros)

As at 31 December 2017	EUR	USD	Other	Total
ASSETS				
Cash and balances with central banks and other demand deposits at banks	265,268	5,225	16,591	287,084
Financial assets held for trading:	50	10	-	60
- derivative financial instruments	50	10	-	60
Financial assets designated at fair value through profit or loss	59	-	-	59
Available for sale financial assets	276,998	41,704	-	318,702
Loans and receivables:	1,699,177	21,156	9,567	1,729,900
- loans to banks	28,079	7,596	5,467	41,142
- loans to non-bank customers	1,657,368	13,559	4,100	1,675,027
- advances	13,730	1	-	13,731
Derivatives – hedge accounting	2,267	204	-	2,471
Total assets	**2,243,819**	**68,299**	**26,158**	**2,338,276**
LIABILITIES				
Financial liabilities held for trading:	-	8	-	8
- derivative financial instruments	-	8	-	8
Financial liabilities measured at amortised cost:	1,996,537	69,061	26,262	2,091,860
- deposits from banks and central banks	10,740	-	10	10,750
- deposits from non-bank customers	1,889,968	55,393	26,135	1,971,496
- loans from banks and central banks	58,184	13,293	-	71,477
- loans from non-bank customers	-	-	-	-
- other financial liabilities	37,645	375	117	38,137
Derivatives – hedge accounting	629	31	-	660
Total liabilities	**1,997,166**	**69,100**	**26,262**	**2,092,528**
Net balance sheet position	**246,653**	**(801)**	**(104)**	**245,748**
Part of contingent liabilities and commitments sensitive to currency risk	**315,819**	**216**	**86**	**316,121**

(in thousands of euros)

As at 31 December 2016	EUR	USD	Other	Total
Total assets	2,165,836	82,588	27,052	2,275,476
Total liabilities	1,908,869	83,416	26,641	2,018,926
Net balance sheet position	**256,967**	**(828)**	**411**	**256,550**
Part of contingent liabilities and commitments sensitive to currency risk	**279,568**	**3,112**	**30**	**282,710**

1 Highest and lowest 99% VaR calculated for one-day observation period for the 12-month period as indicated in the table.

3.7.3 Interest rate risk

The table below summarises the Bank's exposure to interest rate risk. The assets and liabilities are recorded at carrying value, while the residual maturity is presented by contractual maturity for fixed-rate positions and by next contractual re-pricing date for floating rate positions.

Since for the fixed interest rate positions it is assumed that after contractual expiring will be reinvested or refinanced according to then prevailing market conditions, they were also included in the table herein below presenting the sensitivity to interest rate risk.

Interest rate risk

(in thousands of euros)

As at 31 December 2017	Carrying amount	Up to 1 month	1-3 months	3-12 months	1- 5 years	Over 5 years	Non- interest bearing
ASSETS							
Cash and balances with central banks and other demand deposits at banks	287,084	214,816	-	-	-	19,055	53,213
Financial assets held for trading:	60	5	54	1	-	-	-
- derivative financial instruments	60	5	54	1	-	-	-
Financial assets measured at fair value through profit or loss	59	-	-	-	-	-	59
Available for sale financial assets	318,702	10,707	21,464	126,574	61,800	82,346	15,811
Loans and receivables:	1,729,900	169,233	217,284	1,011,880	103,826	199,055	28,622
- loans to banks	41,142	19,144	15,000	6,998	-	-	-
- loans to non-bank customers	1,675,027	150,089	202,284	1,004,882	103,826	199,055	14,891
- advances	13,731	-	-	-	-	-	13,731
Derivatives – Hedge accounting	2,471	1,967	276	228	-	-	-
Total assets	**2,338,276**	**396,728**	**239,078**	**1,138,683**	**165,626**	**300,456**	**97,705**
LIABILITIES							
Financial liabilities held for trading:	8	5	3	-	-	-	-
- derivative financial instruments	8	5	3	-	-	-	-
Financial liabilities measured at amortised cost:	2,091,860	1,670,457	147,773	200,860	33,437	1,196	38,137
- deposits from banks and central banks	10,750	2,454	-	8,296	-	-	-
- deposits from non-bank customers	1,971,496	1,650,694	93,708	192,461	33,437	1,196	-
- loans from banks and central banks	71,477	17,309	54,065	103	-	-	-
- other financial liabilities	38,137	-	-	-	-	-	38,137
Derivatives – Hedge accounting	660	578	82	-	-	-	-
Total liabilities	**2,092,528**	**1,671,040**	**147,858**	**200,860**	**33,437**	**1,196**	**38,137**
Total interest repricing gap		**(1,274,312)**	**91,220**	**937,823**	**132,189**	**299,260**	

(in thousands of euros)

As at 31 December 2016	Carrying amount	Up to 1 month	1-3 months	3-12 months	1- 5 years	Over 5 years	Non- interest bearing
Total assets	2,275,476	352,718	222,371	1,217,893	199,034	202,011	81,449
Total liabilities	2,018,926	1,504,892	180,253	268,995	36,094	1,578	27,114
Total interest repricing gap		**(1,152,174)**	**42,118**	**948,898**	**162,940**	**200,433**	

The Bank measures the following sources of interest rate risk:

- Repricing risk, stemming from a different interest rate adjustment of assets and liabilities to market interest rate changes. For fixed rate contracts the interest rate can be adjusted to market rate only at maturity, while floating rate contracts are adjusted according to contract revision of the interest rate and adjustment to market reference rate;
- Basis risk arises from imperfect correlation between different types of interest rates, which are relevant market rate reference for floating rate contracts;
- Yield curve risk, refers to changes in the slope and shape of the yield curve;
- Optionality risk, refers to optionality embedded in the Group's assets, liabilities and off-balance sheet instruments.

Interest rate risk is measured from two perspectives: it is analysed through the impact of market rate change on net present value of future cash flows and, on the other hand, it is viewed through the impact of market rate changes on net interest income and therefore on the Bank's annual financial results.

Accordingly, the following data are reported to the ALCO:
- Sensitivity of net interest income to a yield curve parallel shift of +/-50 bps over a 1-year time horizon;
- Sensitivity of economic value or net present value of future cash flows to a yield curve parallel shift of +/- 100 bps and +/- 200 bps;

The measurement of Interest rate risk is further improved by using the following models:
- Sight model: Assets without contractual maturities are classified into specific time buckets based on their estimated sensitivity on changes in interest rates.
- Prepayment model based on the probability that some of the loans outstanding will be paid off earlier than originally scheduled. Consequently, the planned cash flows of the outstanding loans are modified for the level of prepayment rate.
- Excepted loss model: cash flows of outstanding loans are modified for the probability of default rate originating from credit risk.
- Fund Transfer Pricing model: the entire spread on loans above the reference rate is divided into cost of funding and commercial spread. For interest-sensitive cash flows only the spread representing cost of funding is taken.

Sensitivity of net interest income of the Bank as of 31.12.2017

(in million of euros)

		+50 b.p.			+100 b.p.			-50 b.p.			-100 b.p.		
		Sight	Term	Total	Sight	Term	Total	Sight	Term	Total	Sight	Term	Total
Total		**0.59**	**5.05**	**5.64**	**0.35**	**10.10**	**10.45**	**(1.09)**	**(4.63)**	**(5.72)**	**(2.18)**	**(8.81)**	**(10.99)**
Asset		**1.36**	**5.08**	**6.44**	**2.75**	**10.18**	**12.93**	**(1.35)**	**(4.66)**	**(6.01)**	**(2.69)**	**(8.88)**	**(11.57)**
Sight Loans		1.36		**1.36**	2.75		**2.75**	(1.35)		**(1.35)**	(2.69)		**(2.69)**
Securities	FX		0.20	**0.20**		0.41	**0.41**		(0.20)	**(0.20)**		(0.41)	**(0.41)**
	FL		0.22	**0.22**		0.45	**0.45**		(0.20)	**(0.20)**		(0.28)	**(0.28)**
Loans	FX		0.60	**0.60**		1.20	**1.20**		(0.60)	**(0.60)**		(1.20)	**(1.20)**
	FL		4.06	**4.06**		8.12	**8.12**		(3.66)	**(3.66)**		(6.99)	**(6.99)**
Other Financial Assets	FX		0.00	**0.00**		0.00	**0.00**		0.00	**0.00**		0.00	**0.00**
	FL		0.00	**0.00**		0.00	**0.00**		0.00	**0.00**		0.00	**0.00**
Liabilities		**(0.77)**	**(1.46)**	**(2.23)**	**(2.40)**	**(2.93)**	**(5.33)**	**0.26**	**1.46**	**1.72**	**0.51**	**2.94**	**3.45**
Sight Deposits		(0.77)		**(0.77)**	(2.40)		**(2.40)**	0.26		**0.26**	0.51		**0.51**
Securities Issued	FX		0.00	**0.00**		0.00	**0.00**		0.00	**0.00**		0.00	**0.00**
	FL		0.00	**0.00**		0.00	**0.00**		0.00	**0.00**		0.00	**0.00**
Debts	FX		(1.14)	**(1.14)**		(2.28)	**(2.28)**		1.14	**1.14**		2.29	**2.29**
	FL		(0.32)	**(0.32)**		(0.65)	**(0.65)**		0.32	**0.32**		0.65	**0.65**
Other Financial Liabilities	FX		0.00	**0.00**		0.00	**0.00**		0.00	**0.00**		0.00	**0.00**
	FL		0.00	**0.00**		0.00	**0.00**		0.00	**0.00**		0.00	**0.00**
Derivatives			**1.43**	**1.43**		**2.85**	**2.85**		**(1.43)**	**(1.43)**		**(2.87)**	**(2.87)**

Cash flows slotted into time buckets according to their maturity or repricing date as of 31.12.2017

(in million of euros)

		Total	0-18m	18m-3Y	3Y-5Y	5Y-10Y	10Y-15Y	>15Y
Total		**417**	**523**	**(101)**	**(64)**	**34**	**5**	**19**
Asset		**2.493**	**1.939**	**88**	**133**	**208**	**75**	**51**
Sight Loans		293	293	-	-	-	-	-
Securities	FX	235	108	5	43	78	-	-
	FL	72	71	1	-	-	-	-
Loans	FX	574	224	62	68	108	66	46
	FL	1.318	1.242	20	21	22	9	4
Other Financial Assets	FX	-	-	-	-	-	-	-
	FL	-	-	-	-	-	-	-
Liabilities		**(2.057)**	**(1.711)**	**(175)**	**(139)**	**(31)**	**-**	**-**
Sight Deposits		(1.582)	(1.257)	(160)	(134)	(30)	-	-
Securities Issued	FX	-	-	-	-	-	-	-
	FL	-	-	-	-	-	-	-
Debts	FX	(392)	(372)	(15)	(4)	(1)	-	-
	FL	(83)	(82)	-	-	-	-	-
Other Financial Liabilities	FX	-	-	-	-	-	-	-
	FL	-	-	-	-	-	-	-
Derivatives		**(19)**	**295**	**(13)**	**(58)**	**(142)**	**(70)**	**(32)**

Sensitivity of net interest income of the Bank as of 31.12.2016

(in million of euros)

		+50 b.p.			+100 b.p.			-50 b.p.			-100 b.p.		
		Sight	Term	Total	Sight	Term	Total	Sight	Term	Total	Sight	Term	Total
Total		**(0.82)**	**4.37**	**3.55**	**(4.02)**	**8.77**	**4.75**	**(0.72)**	**(4.03)**	**(4.75)**	**(1.46)**	**(7.47)**	**(8.93)**
Asset		**0.93**	**5.31**	**6.24**	**1.92**	**10.64**	**12.56**	**(0.90)**	**(4.96)**	**(5.86)**	**(1.80)**	**(9.34)**	**(11.14)**
Sight Loans		0.93		0.93	1.92		1.92	(0.90)		(0.90)	(1.80)		(1.80)
Securities	FX		0.16	0.16		0.33	0.33		(0.16)	(0.16)		(0.33)	(0.33)
	FL		0.22	0.22		0.45	0.45		(0.20)	(0.20)		(0.28)	(0.28)
Loans	FX		0.55	0.55		1.09	1.09		(0.55)	(0.55)		(1.09)	(1.09)
	FL		4.38	4.38		8.77	8.77		(4.05)	(4.05)		(7.64)	(7.64)
Other Financial Assets	FX		0.00	0.00		0.00	0.00		0.00	0.00		0.00	0.00
	FL		0.00	0.00		0.00	0.00		0.00	0.00		0.00	0.00
Liabilities		**(1.75)**	**(1.90)**	**(3.65)**	**(5.94)**	**(3.79)**	**(9.73)**	**0.18**	**1.90**	**2.08**	**0.34**	**3.81**	**4.15**
Sight Deposits		(1.75)		(1.75)	(5.94)		(5.94)	0.18		0.18	0.34		0.34
Securities Issued	FX		0.00	0.00		0.00	0.00		0.00	0.00		0.00	0.00
	FL		0.00	0.00		0.00	0.00		0.00	0.00		0.00	0.00
Debts	FX		(1.50)	(1.50)		(3.00)	(3.00)		1.50	1.50		3.01	3.01
	FL		(0.40)	(0.40)		(0.79)	(0.79)		0.40	0.40		0.80	0.80
Other Financial Liabilities	FX		0.00	0.00		0.00	0.00		0.00	0.00		0.00	0.00
	FL		0.00	0.00		0.00	0.00		0.00	0.00		0.00	0.00
Derivatives			**0.96**	**0.96**		**1.92**	**1.92**		**(0.97)**	**(0.97)**		**(1.94)**	**(1.94)**

Cash flows slotted into time buckets according to their maturity or repricing date as of 31. 12. 2016

(in million of euros)

		Total	0-18m	18m-3Y	3Y-5Y	5Y-10Y	10Y-15Y	>15Y
Total		**396**	**499**	**(100)**	**(47)**	**27**	**9**	**8**
Asset		**2.404**	**1.942**	**101**	**120**	**153**	**49**	**39**
Sight Loans		205	205	-	-	-	-	-
Securities	FX	273	124	43	51	55	-	-
	FL	73	71	1	-	-	-	-
Loans	FX	427	207	32	42	71	39	34
	FL	1.426	1.335	24	26	26	10	5
Other Financial Assets	FX	-	-	-	-	-	-	-
	FL	-	-	-	-	-	-	-
Liabilities		**(1.995)**	**(1.649)**	**(175)**	**(139)**	**(32)**	**-**	**-**
Sight Deposits		(1.397)	(1.073)	(160)	(134)	(30)	-	-
Securities Issued	FX	-	-	-	-	-	-	-
	FL	-	-	-	-	-	-	-
Debts	FX	(494)	(474)	(15)	(4)	(2)	-	-
	FL	(103)	(101)	(1)	-	(1)	-	-
Other Financial Liabilities	FX	-	-	-	-	-	-	-
	FL	-	-	-	-	-	-	-
Derivatives		**(13)**	**206**	**(25)**	**(28)**	**(94)**	**(41)**	**(31)**

Due to lasting negative levels for the market interest rates, the Bank follows specific rules that allow adequate cash flow representation based on actual contractual interest rates and relevant yield curve shifts. The Bank is applying 0% floors on contractual interest rates for customer's sight deposits when according to shift scenario the rates drop below zero rate in order to replicate actual circumstances on the market. In addition for representation of sight deposits a model, which estimates the partial and delayed changes in customer rates compared to changes in market interest rates is used. In order to control quantitatively the Bank's interest margin risk, a limit of EUR -7.5 mln has been set up for a +/- 50bp interest rates change. The impact on Bank's interest margin due to market interest rate 50 bp quick jump according to data end of 2017 would be positive EUR 5.6 mln, while in case of an instantaneous 50 bp drop the impact would be negative EUR 5.7 mln. The largest part of the margin sensitivity arises from the floating rate loans to customer exposure class.

The impact of 100 bps interest rate parallel shift on net present value of the Bank' interest-bearing assets and liabilities, as at 31 December 2017

(in million of euros)

Currency	Total	0-18m	18m-3Y	3Y-5Y	5Y-10Y	10Y-15Y	>15Y
EUR	**5.42**	(1.90)	2.93	4.01	0.63	1.21	(1.46)
USD	**(0.03)**	(0.03)	0.00	0.00	0.00	0.00	0.00
CHF	**(0.02)**	0.01	0.00	(0.02)	0.00	0.00	0.00
Other	**0.00**	0.00	0.00	0.00	0.00	0.00	0.00
Total Shift	**5.37**	**(1.92)**	**2.93**	**3.99**	**0.63**	**1.21**	**(1.46)**
Limit	**9.0**						
Utilization %	**59.67%**						

In the table is presented the interest rate risk exposure of the Bank in terms of shift sensitivity (EVE- economic value of equity), which measures the change of net present value of future cash-flows, as a result of parallel shift of market yield curve by 100 b.p. Each time-bucket shows the impact of interest rate change on net present value of cash-flows, distributed by time tenors according to residual time to the next repricing. The most significant exposure is in EUR currency, while the risk for other currencies is less material. The total exposure limit for +100 bps shift sensitivity amounts to 9.0 million EUR, while the actual exposure at reference date is 5.4 million EUR. For the EVE measure a 0% floor assumption on market rates for negative shocks is in place. The main generators of interest rate risk are medium – long term assets with fixed interest rates (eg. housing loans, debt financial instruments), which are hedged by interest rate swaps. On liabilities side, the highest portion of shift sensitivity derives from the sight deposits, where sight deposits are slotted to time buckets up to 10 years according to the sight deposit model.

In addition to the total exposure limit, limits for specific time buckets for a +100bp change in interest rates are set:

(in million of euros)

Time bucket	Limit	Exposure
0–18 months	+/- 7.0	(1.92)
from 19 months–5 years	+/- 8.0	6.92
>5 years	+/- 8.0	(0.37)

The impact of 100 bps interest parallel rate shift on net present value of the Bank's interest-bearing assets and liabilities, as at 31 December 2016

(in million of euros)

Currency	Total	0-18m	18m-3Y	3Y-5Y	5Y-10Y	10Y-15Y	>15Y
EUR	**6.19**	(1.02)	2.57	2.91	0.97	0.54	0.22
USD	**0.24**	(0.04)	0.10	0.13	0.05	0.00	0.00
CHF	**0.18**	0.05	0.06	0.07	0.01	(0.01)	0.00
Other	**0.06**	0.01	0.02	0.02	0.01	0.00	0.00
Total Shift	**6.67**	**(1.00)**	**2.75**	**3.13**	**1.04**	**0.53**	**0.22**
Limit	**9.0**						
Utilization %	**74.06%**						

The impact of +200 bps interest parallel rate shift on net present value of the Bank's interest-bearing assets and liabilities, as at 31 December 2017

(in million of euros)

Currency	Total	0-18m	18m-3Y	3Y-5Y	5Y-10Y	10Y-15Y	>15Y
EUR	**11.15**	(3.56)	6.10	7.79	1.19	2.24	(2.61)
USD	**(0.07)**	(0.06)	0.00	(0.01)	0.00	0.00	0.00
CHF	**(0.04)**	(0.01)	0.00	(0.02)	(0.01)	0.00	0.00
Other	**0.00**	0.00	0.00	0.00	0.00	0.00	0.00
Total Shift	**11.04**	**(3.63)**	**6.10**	**7.76**	**1.18**	**2.24**	**(2.61)**
Reg,Capital (Sept 16)	**257.1**						
15% of Reg. Capital	**4.29%**						

The impact of +200 bps interest parallel rate shift on net present value of the Bank's interest-bearing assets and liabilities, as at 31 December 2016

(in million of euros)

Currency	Total	0-18m	18m-3Y	3Y-5Y	5Y-10Y	10Y-15Y	>15Y
EUR	**11.75**	(2.80)	5.42	5.81	1.85	1.02	0.45
USD	**0.45**	(0.09)	0.20	0.25	0.09	0.00	0.00
CHF	**0.34**	0.06	0.11	0.15	0.04	(0.01)	(0.01)
Other	**0.11**	0.02	0.03	0.04	0.02	0.00	0.00
Total Shift	**12.65**	**(2.81)**	**5.76**	**6.25**	**2.00**	**1.01**	**0.44**
Reg,Capital (Sept 15)	**257.88**						
20% of Reg. Capital	**4.91%**						

The 200 bp shift is a standard measure defined by Banking supervisor that treats an impact thereof on Economic value that exceeds 20% Tier I capital as outlying excessive risk exposure. As of 31.12.2017 the sensitivity reached 4.29% of Tier I capital.

The table below summarises the effective annual interest rate for monetary financial instruments not carried at fair value through profit or loss by major currency:

The effective annual interest rate of individual financial instruments

	2017			2016		
	EUR	USD	Other	EUR	USD	Other
Assets						
Cash and balances at central banks and other demand deposits at banks	1.00	1.00	1.00	1.00	1.00	1.00
Loans and advances to banks	(0.02)	5.79	1.10	0.01	3.08	0.89
Loans and advances to non-bank customers	2.19	4.29	1.02	2.29	3.72	1.02
Available for sale financial assets	1.45	4.28	-	2.18	4.28	-
Liabilities						
Deposits from banks and central banks	-	-	0.60	0.03	-	0.60
Deposits from non-bank customers	0.07	0.09	0.01	0.13	0.10	0.01
Other borrowed funds	1.57	3.17	-	1.71	2.61	-

3.8 OPERATIONAL RISK

Operational risk is defined as the risk of direct or indirect loss resulting from inadequate or failed internal processes, systems, human behaviour or mistakes or from external events. The definition also includes legal risk, representing the risk of ineffective legal execution or defective legal documentation, as well as compliance risk, which is the risk of failure to comply with laws, rules, regulations, agreements and practices. However, the definition excludes strategic and reputational risk.

The objectives of operational risk management are to:
- Protect assets, preserve and safeguard material and intellectual Bank's assets.
- Control and proactively monitor processes to ensure that significant risks are swiftly identified.
- Comply with requirements and processes established with internal rules and external regulations.

The process of operational risk management comprises the identification, measurement or evaluation, control and monitoring of operational risk. The process of operational risk measurement and management is assisted by the risk mitigation tool developed by the parent company designed to support the carrying out of the following activities:
- Loss data collection,
- Business environment evaluation,
- Scenario analysis,
- Mitigation actions management, and
- Monitoring and reporting.

The systematic loss data collection makes it possible to perform immediate analysis of loss event causes and to adopt corrective actions. This procedure supports the compliance with general operational risk management standards.

First level operational risk management is carried out by the person directly responsible for operations in each organisational unit. The Risk Management Department, which is responsible for the operational loss data collection and the self-assessments activity with the involvement of the Level 1 organisational units, is in charge of second level operational risk management processes. The self-assessment activity is necessary to explore the level of the Bank's exposure to operational risk and to evaluate the risk appetite measure.

The Risk Management Department assisted by the Operational Risk Group (composed of the persons responsible from the most important first-level organisational units), reports on a quarterly basis to the Management Board and proposes remedial actions.

3.9 FAIR VALUE OF ASSETS AND LIABILITIES

Fair value of assets and liabilities

(in thousands of euros)

	2017			2016		
	Carrying value	Fair value	Unrecognised gain/loss	Carrying value	Fair value	Unrecognised gain/loss
ASSETS						
Cash, cash balances at central banks and other demand deposits at banks	287,084	287,084	-	192,843	192,843	-
Financial assets held for trading	60	60	-	64	64	-
Financial assets designated at fair value through profit or loss	59	59	-	136	136	-
Available for sale financial assets	318,702	318,702	-	354,615	354,615	-
Derivatives-hedge accounting	2,471	2,471	-	913	913	-
Loans and receivables:	1,729,900	1,730,794	894	1,726,905	1,729,175	2,270
- loans to banks	41,142	41,142	-	89,516	89,516	-
- loans to non-bank customers	1,675,027	1,675,921	894	1,626,373	1,628,643	2,270
- advances	13,731	13,731	-	11,016	11,016	-
Other assets	7,357	7,357	-	13,389	13,389	-
Total assets	**2,345,633**	**2,346,527**	**894**	**2,288,865**	**2,291,135**	**2,270**
LIABILITIES						
Financial liabilities held for trading	8	8	-	-	-	-
Financial liabilities measured at amortised cost:	2,091,860	2,091,302	(558)	2,017,524	2,017,243	(281)
- deposits from banks and central banks	10,750	10,799	49	62,700	62,807	107
- deposits from non-bank customers	1,971,496	1,971,488	(8)	1,839,935	1,839,915	(20)
- loans from banks and central banks	71,477	70,878	(599)	87,747	87,380	(367)
- loans from non-bank customers	-	-	-	28	27	(1)
- other financial liabilities	38,137	38,137	-	27,114	27,114	-
Derivatives-hedge accounting	660	660	-	1,402	1,402	-
Other liabilities	5,627	5,627	-	4,660	4,660	-
Total liabilities	**2,098,155**	**2,097,597**	**(558)**	**2,023,586**	**2,023,305**	**(281)**

Fair value of financial instruments not measured at fair value

The following methods and assumptions have been made in estimating the fair value of financial instruments:

- There are no significant differences between carrying value and fair value of cash, cash balances at central banks and other demand deposits at banks given the short maturity of such assets.

- Loans to non-bank customers are presented net of impairment allowance. The estimated fair value of these loans represents the discounted amount of the estimated future cash flows expected to be received. Expected future cash flows are discounted at current market rates. Valuation of non-performing loans includes estimation of loan receivable and collateral cash-flows. Loans to non-bank customers classified as Level 2 include short term performing loans with original maturity less than 1 year, excluding credit card receivables and overdraft loans.

- The estimated fair value of fixed-interest term deposits is based on the expected cash flows discounted using current market rates. For demand deposits and deposits with no defined maturity, the fair value is determined to be the amount payable on demand. The value of customer relationships has not been taken into account. Deposits and loans received are mainly classified as Level 2 in the fair value hierarchy, since the parameters used in valuation are market observable. Majority of loans and deposits from banks carry floating interest rates, which are linked to market and repriced regularly. As such, the management believes that their carrying values approximate their fair values.

Fair value of financial instruments

Derivatives

Accounting for derivatives at fair value is performed on the basis of observable market inputs. Derivative financial instruments subject to valuation are: interest rate swaps, interest rate caps, foreign exchange swaps, forward foreign exchange contracts. The fair value of derivatives is determined with the support of Murex, a system developed by the parent company. The system takes input data from the money market official quotations and from Reuters system. The fair value of interest rate swaps is the net present value of future cash flows, based upon spot and forward money market interest rates. The fair value of more complex derivatives such as caps is calculated by the parent company and is measured using the Black's Model with SABR volatility.

Hedge accounting

The Bank's interest rate policy course is to hedge in accordance with hedge accounting rules the interest rate risk assumed on each single large financial investments and loan clusters with similar characteristics and fixed rate remuneration (housing loans). For single large financial investments a micro fair value hedge is applied, while for housing loans the Bank engage in a macro fair value hedge. The loans eligible for hedging are chosen at the time of disbursement as having medium/long term contractual maturity and fixed rate remuneration. The identified loans are hedged with interest rate swap derivative contracts, conceding the transformation of fixed contractual rate to rate floating according to market benchmark, i.e. Euribor. The interest rate risk is hedged using the fair value method and the effectiveness of the hedging relationship is regularly measured by calculating the prospective and retrospective effectiveness tests. For the prospective test the Bank measures the relation between interest rate sensitivity of the derivative instrument and sensitivity of the hedged item. In the retrospective test the 'Dollar offset method" is used, where the fair value changes of derivative instrument is compared to the fair value change of the hedged item. The ratio between the changes of value for two items has to be within 80% and 125% range.

For the macro fair value hedges two effectiveness tests are additionally carried out. The sensitivity test (first level test) is aimed at the verification that the sensitivity of the portfolio, subject to hedging and distributed by time buckets, is greater (in absolute terms) than the sensitivity of the hedging derivative instrument. The fair value capacity test (second level) is on the other hand necessary to assess the hedge effectiveness from a view of a dynamic management of the portfolio. The test verifies that the portfolio subject to hedging contains assets with sensitivity profile and expected fair value variations on hedged risk that is matching the hedging derivative.
According to the efficiency tests, as of 31 December 2017, all interest rate hedges were effective.
As of 31 December 2017 the Bank had 33 interest rate swap (IRS) contracts, 15 of which underwritten in 2017. 15 IRS contract are designated to hedge interest rates arising from fixed rate debt financial instruments, 11 for fixed rate housing loans and 7 for large individual loans.

Hedged item	Nominal amount (in mln EUR)		Number of IRS contracts	
	2017	2016	2017	2016
Fixed income bond-micro hedge	132.2	78.5	15	9
Housing loans packages-macro hedge	97.8	37	11	4
Individual loans-micro hedge	104.4	89	7	3
Total	**334.4**	**204.5**	**33**	**16**

The cumulative fair value of all Bank`s IRS contracts` as of 31 December 2017 amounted to 1,8 mln EUR.

Financial instruments available for sale

Currently, the Bank's portfolio containing available-for-sale financial assets (AFS) is composed of bonds and shares. Both instruments are measured at fair value.

The fair value of level 1 bonds is derived from their quoted market prices. In case the bonds are not liquid, the fair value is determined by discounting future cash flows. The discounting rate is the yield to maturity of a liquid comparable bond. Such bonds are marked as fair value level 2.

The fair value of shares listed on the active stock market is their market value, whereas for the non-listed shares or illiquid shares, the fair value is determined using the internal valuation model. The internal valuation is carried out by applying the price multiples method. The difference between the model and market valuation when shares are quoted on illiquid market (currently only 1 such position), as at 31 December 2017 amounted to 754 thousand euros.

The basis for the calculation under the above method are the available market valuations of comparable enterprises, in connection with financial ratios and multiples of their traded shares in the valuation of non-traded or illiquid shares. A condition for the application of the method is the availability of at least two comparable enterprises with listed shares. The latter shall be comparable by industry, market capitalisation, size and geographical location.

Information on financial ratios (price multiples) for comparable enterprises shall be obtained from independent sources, such as the Ljubljana Stock Exchange, Reuters, etc.

The share value is based on the following price multiples of comparable enterprises:
- EV/S (enterprise value / sales);
- EV/EBITDA (enterprise value / EBIT + depreciation);
- P/E (price-to-earnings);
- P/BV (price / book value);

The basis for the estimation are the financial statements of the comparable enterprises:
- balance sheet (for the preceding 3 financial years);
- income statement (for the preceding 3 financial years).

The final value is computed as the average of the multiples, whereby multiples considered as inadequate, are omitted.

Breakdown of financial instruments measured at fair value into fair value hierarchy levels

(in thousands of euros)

	2017				2016			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Asset								
Derivatives	-	60	-	**60**	-	64	-	**64**
Available-for-sale financial assets:	294,477	22,584	1,641	**318,702**	327,575	25,113	1,927	**354,615**
- debt	283,670	19,221	-	**302,891**	316,177	23,934	-	**340,111**
- equities*	10,807	3,363	1,641	**15,811**	11,398	1,179	1,927	**14,504**
FVTPL – equities	59	-	-	**59**	136	-	-	**136**
Loans and receivables	-	175,385	1,554,515	**1,729,900**	-	183,532	1,543,373	**1,726,905**
Liabilities								
Derivatives	-	8	-	**8**	-	-	-	**-**
Financial liabilities, measured at amortised cost	-	1,728,450	363,410	**2,091,860**	-	1,586,634	430,890	**2,017,524**

** Fair value of investments in National Bank Resolution Fund included within Level 1 is determined by Bank of Slovenia regarding volume of assets of each bank. These investments are not quoted.*

Movement of financial instrument included in level 3

(in thousands of euros)

	At January 2017	Purchase/Sales	Unrealized gains/losses recorded in revaluation reserve	Realized gains/losses recorded in P&L	Transfers out of level 3	At 31 December 2017
Asset						
AFS equities	1,927	**(42)**	426	20	(690)	**1,641**

Movement of financial instrument included in level 3

(in thousands of euros)

	At January 2016	Purchase/Sales	Transfers out of level 3	Transfers into level 3	At 31 December 2016
Asset					
AFS equities	8,945	**(8,728)**	**-**	**1,710**	**1,927**

As of 31 December 2017, the Bank held in the investment portfolio 23 bonds measured at fair value (Available for Sale), out of which 3 are measured with marked to model approach (level 2), while 20 were measured on market prices (level 1). As for equity portfolio all positions were valued with a marked to model approach, due to illiquidity or because the investments are not quoted on the stock exchange.

4. NET INTEREST INCOME

(in thousands of euros)

	2017	2016
Interest income		
Central bank deposits	-	2
Loans and advances (including finance leases):	43,322	43,240
- to banks	227	227
- to other customers	43,095	43,013
Investment securities (AFS)	3,574	4,903
Derivatives – hedge accounting	1,640	1,375
Other	98	34
Total	**48,634**	**49,554**
Interest expense		
Financial liabilities measured at amortised cost:		
- Bank deposits and borrowings	30	15
- Other customers	1,833	3,475
- Other borrowed funds	1,407	1,871
Derivatives - hedge accounting	3,055	1,702
Other	1,686	963
Total	**8,011**	**8,026**
Total	**40,623**	**41,528**

Within other interest income the Bank realised from financial liabilities EUR 37 thousand (2016: 8 thousand) as the consequences of negative interest rate.
Interest income includes EUR 7,267 thousand (2016: EUR 5,965 thousand) of interest income on impaired loans.
Within other interest expense the Bank realised from financial assets EUR 1,686 thousand (2016: 959 EUR thousand) as the consequences of negative interest rate.

5. DIVIDEND INCOME

(in thousands of euros)

	2017	2016
Investment securities	489	638
Dividends from FVPL shares	17	17
Total	**506**	**655**

6. NET FEE AND COMMISSION INCOME

(in thousands of euros)

	2017	2016
Fee and commission income		
From current bank account management	4,002	3,903
From payment services	10,432	10,460
From credit card business	8,564	8,572
From interbanking operations	4,512	5,836
From loans granted	4,537	4,145
From guarantees given	1,255	1,404
From safe renting	92	86
From pension fund management	503	493
Depositary services	530	994
From payment systems management	1,553	1,526
From brokering of loans and insurance contract on behalf of others	321	239
Total	**36,301**	**37,658**
Fee and commission expense		
For security trading	74	61
For loan brokerage on behalf of others	79	113
For custody services	206	384
For credit card processing	7,453	8,263
For payment transactions	3,013	2,888
Commitment fee for unused credit lines	429	151
Total	**11,254**	**11,860**
Total	**25,047**	**25,798**

7. REALISED GAINS AND LOSSES OF FINANCIAL ASSETS AND LIABILITIES NOT MEASURED AT FAIR VALUE THROUGH PROFIT OR LOSS

(in thousands of euros)

	2017	2016
Loss/income due to sale of investment securities*	4,988	19,680
Loss of loans and other assets	(2,346)	(106)
Total	**2,642**	**19,574**

** From released revaluation reserve due to sale of shares and maturity of bonds EUR 3,587 thousand (2016: EUR 6,446 thousand).*

In 2017 the Bank sold two equity investments from which realised a gain of EUR 356 thousand.
Loss on loans and other assets consist of EUR 2,313 thousand loss on loans, and EUR 33 thousand on loss on other assets. The Bank provides for all positions that are not covered by collateral if the client is in bankruptcy procedure or in case of mortgage loans when the bank does not receive any repayment from collateral for more than 4 years.

8. GAINS AND LOSSES OF FINANCIAL ASSETS AND LIABILITIES HELD FOR TRADING

(in thousands of euros)

	2017	2016
Trading of derivatives	(8)	(24)
Currency trading	882	836
Total	**874**	**812**

9. FAIR VALUE ADJUSTMENTS IN HEDGE ACCOUNTING

(in thousands of euros)

	2017	2016
Net effect on derivatives used as hedging instruments	2,824	(36)
Net effect on hedged items*	(2,981)	172
Total	**157**	**136**

** Within correction of revaluation reserve for the hedged fair value amount of bonds for EUR 606 thousand (2016: EUR 535 thousand).*

Derivatives used as hedge instruments and the nature of hedged items are additionally explained in note 20 and in note 3.9. Fair value of assets and liabilities (in paragraph hedge accounting).

10. GAINS AND LOSSES ON DERECOGNITION OF NON-FINANCIAL ASSETS

(in thousands of euros)

	2017	2016
Profit on sale of property and equipment	39	1,043
Net income realised from sale of investment property	9	-
Total	**48**	**1,043**

11. OTHER OPERATING NET INCOME

(in thousands of euros)

	2017	2016
Rents	3,275	3,107
Proceeds from the sale of repossessed leased assets	428	(186)
Taxes	(371)	(383)
Membership fees	(86)	(82)
Contribution to European Banking Resolution Fund	(266)	(577)
Contribution to European Deposit Guarantee Scheme	(1,696)	(1,589)
Maintenance expenses arising onleased assets	(160)	(173)
Expenses from investment property under the operating lease	(388)	(307)
Other	5	13
Total	**741**	**(177)**

From rent contracts arises that the future rent revenues will amount to EUR 22,580 thousand (2016: EUR 19,100 thousand), as follows:

(in thousands of euros)

2017			2016		
Up to 1 year	1 to 5 years	Over 5 years	Up to 1 year	1 to 5 years	Over 5 years
2,258	9,032	11,290	1,910	7,640	9,550

12. ADMINISTRATIVE EXPENSES

(in thousands of euros)

	2017	2016
Staff cost	**28,494**	**27,957**
Salaries	19,217	18,892
Social security	3,003	3,022
Contributions to the pension scheme	1,724	1,692
Other	4,550	4,351
Other administrative expenses	**12,732**	**12,293**
Material costs	1,895	2,027
IT costs	3,101	2,889
Rents	1,581	1,507
Professional services	1,911	1,471
Advertising and marketing	518	509
Consulting, auditing, legal and notarial fees*	221	351
Maintenance, governance and security of tangible fixed assets	1,079	1,092
Postal services and rent of communication lines	1,471	1,619
Insurance	369	371
Travel costs	55	47
Education, scholarships and tuition fees	141	146
Bank's supervision	390	264
Total	**41,226**	**40,250**

** Of which audit of the Bank's financial statements EUR 111 thousand (2016: EUR 109 thousand). Other staff costs relates to holiday accruals and bonuses.*

13. DEPRECIATION AND AMORTISATION

(in thousands of euros)

	2017	2016
Amortisation	1,293	1,309
Depreciation	3,040	3,383
Total	**4,333**	**4,692**

14. PROVISIONS AND POST-EMPLOYMENT BENEFIT OBLIGATIONS

(in thousands of euros)

	2017	2016
Provisions for off-balance sheet exposures	997	1,858
Provisions for legal proceedings and future contract obligations	(1,239)	(300)
Retirement and long service bonuses	(370)	(435)
Total	**(612)**	**1,123**

The movement of provisions and post-employment benefit obligations is shown in note 34 and 35.

15. IMPAIRMENTS

(in thousands of euros)

	2017	2016
Impairments on assets measurement at amortised cost:		
- banks	17	32
- loans to other customers	18,295	20,175
- impairments of other assets	20	178
Impairments on AFS securities (shares)	-	299
Impairments on land seized for repayment of loans	-	1,033
Impairments on investment property	-	522
Impairments of real estate at fair value, classified in accordance with IAS 16	974	-
Total	**19,306**	**22,239**

16. TAX EXPENSE (INCOME) RELATED TO PROFIT OR LOSS FROM CONTINUING OPERATIONS

(in thousands of euros)

	2017	2016
Current tax expense	715	1,009
Deferred tax (note 37)	31	1,710
Total	**746**	**2,719**
Profit before tax	**4,957**	**22,959**

Further information about deferred income tax is presented in note 36.
The tax on the Bank's profit before tax differs from the theoretical amount that would arise using the basic tax rate as follows:

(in thousands of euros)

	2017	2016
Prima facie tax calculated at a tax rate of 19% (2016: 17%)	942	3,903
Income from already taxed released provisions	-	-
Income form already taxed dividends	(99)	(111)
Income from sale of equity investments	-	(944)
Expenses not deductible for tax purposes:		
- staff costs not assessable for tax	169	148
- other non-tax deductible expenses	41	81
Actuarial losses recognised trough other comprehensive income	-	7
Tax reliefs	(307)	(284)
Effect of tax rate increase from 17% to 19%	-	(81)
Total income tax	**746**	**2,719**
Effective tax rate	***15,0%***	***11,8%***

For 2017 the income tax rate was 19% (2016: 17%) as prescribed by law.

In accordance with local regulations, the Financial Administration may at any time inspect the Bank's books and records within the 5 years subsequent to the reported tax year and may impose additional tax assessments and penalties. The Bank's management is not aware of any circumstances which may give rise to a potential material liability in this respect.

17. EARNINGS PER SHARE

(in thousands of euros)

	2017	2016
Net profit for the year	4,211	20,240
Weighted average number of ordinary shares in issue	530,398	530,398
Basic and diluted profit per share (in EUR per share)	**7.94**	**38.16**

Basic earnings per share is calculated by dividing the net profit attributable to shareholders by the weighted average number of ordinary shares in issue during the year, excluding the average number of ordinary shares purchased by the Bank and held as treasury shares (961 lots). There are no dilutive potential ordinary shares, there are no share options schemes.

18. CASH, CASH BALANCES AT CENTRAL BANKS AND OTHER DEMAND DEPOSITS AT BANKS

(in thousands of euros)

	2017	2016
Cash in hand	16,803	16,114
Balances with central banks	233,871	136,466
Other sight deposits	36,419	40,279
Gross cash, cash balances at central banks and other demand deposits at banks	**287,093**	**192,859**
Impairment	(9)	(16)
Net cash, cash balances at central banks and other demand deposits at banks	**287,084**	**192,843**
From this: mandatory reserve liability to central banks	19,055	17,449

The Bank is required to maintain a mandatory reserve with the central bank (Bank of Slovenia), relative to the volume and structure of its customer deposits. The current requirement of the Bank of Slovenia regarding the calculation of the amount to be held as mandatory reserve is 1% of time deposits and issued debt securities with maturities up to two years.

The Bank maintains sufficient liquid assets to fully comply with the central bank requirements.

19. DERIVATIVE FINANCIAL INSTRUMENTS

The majority of derivative contracts is entered into for the purpose of interest-rate risk management. A derivative instrument is entered into as an economic hedge where its terms and conditions are a mirror image of the terms and conditions of the hedged financial instruments. In addition, the Bank also uses fair value hedge accounting techniques, where interest rate swaps hedges long-term financial assets (bonds and loans) with fixed interest rate.

The notional amounts of certain types of financial instruments provide a basis for comparison with instruments recognised on the statement of financial position but do not necessarily indicate the amounts of future cash flows involved or the current fair value of these instruments and, therefore, do not indicate the Bank's exposure to credit or price risks. The derivative instruments become favourable (assets) or unfavourable (liabilities) as a result of fluctuations in the reference rate or index relative to their terms. The aggregate contractual or notional amount of derivative financial instruments, the extent to which instruments are favourable or unfavourable and, thus the aggregate fair values of derivative financial assets and liabilities can fluctuate significantly from time to time. The notional amount and fair values of derivative instruments held for trading and designated as hedges are set out in the following tables:

Derivative financial instruments

(in thousands of euros)

As at 31 December 2017	Notional amount	Fair value	
		Assets	Liabilities
HFT derivatives			
Foreign exchange rate			
Forwards-sale	595	10	-
Forwards-purchase	596	-	8
Interest rate			
Interest rate cap (CALL)	4,970	50	-
Interest rate cap (PUT)	-	-	-
Total held for trading derivatives		**60**	**8**
Hedging derivatives			
Interest rate swaps (IRS) – micro hedge	236,617	1,375	516
Interest rate swaps (IRS) – macro hedge	97,796	1,096	144
Total derivative for hedge accounting		**2,471**	**660**

(in thousands of euros)

As at 31 December 2016	Notional amount	Fair value	
		Assets	Liabilities
Interest rate			
Interest rate cap (CALL)	6,028	64	-
Interest rate cap (PUT)	800	-	-
Total held for trading derivatives		**64**	**-**
Hedging derivatives			
Interest rate swaps (IRS) – micro hedge	185,384	565	1,363
Interest rate swaps (IRS) – macro hedge	35,912	348	39
Total derivative for hedge accounting		**913**	**1,402**

In financial environment of low interest rates the Bank promoted its commercial activities by lunching long term loans fix interest rates. To overcome the interest rate risk interest rate swaps were made.

20. AVAILABLE-FOR-SALE FINANCIAL ASSETS

(in thousands of euros)

	2017	2016
Government securities:		
- listed	298,671	310,730
Other debt securities:		
- listed	4,220	29,381
Equity securities:		
- listed	948	1,525
- unlisted	4,250	2,353
Investment in National Bank Resolution Fund	10,613	10,626
Total securities available-for-sale	**318,702**	**354,615**

The Bank adopted its own valuation model in cases where investments are not listed or measures such investments at cost less impairments.
In order to comply with the requirements of the National Bank Resolution Fund, Slovenian government bonds in the amount of EUR 11.3 million are encumbered.

Movement

(in thousands of euros)

	2017 AFS	2016 AFS
At beginning of the year	**354,615**	**330,088**
Additions	76,082	128,421
Impairment	-	(299)
Interest accrual	3,682	6,060
Expired coupons	(8,258)	(9,288)
Disposals (sale and redemption)	(103,740)	(101,452)
Gains/losses from changes in fair value	1,731	370
Exchange differences	(5,410)	715
At end of year	**318,702**	**354,615**

21. LOANS TO BANKS

(in thousands of euros)

	2017	2016
Placements with other banks	41,146	89,532
Gross loans to banks	**41,146**	**89,532**
Impairment	(4)	(16)
Net loans to banks	**41,142**	**89,516**

As at 31 December 2017 no placements with other banks are shown under Pledged assets (2016: nil).

22. LOANS TO NON-BANK CUSTOMERS

(in thousands of euros)

	2017	2016
Loans to individuals:	**591,185**	**542,166**
- Overdrafts	22,552	25,838
- Credit cards	17,086	18,281
- Term loans	116,214	102,780
- Mortgages	428,177	387,128
- Financial leases	7,156	8,139
Loans to sole proprietors	**54,696**	**58,930**
Financial leases	7,959	10,655
Other loans	46,737	48,275
Loans to corporate entities	**1,129,339**	**1,129,648**
Financial leases	43,285	56,341
Other loans	1,086,054	1,073,307
Gross loans and advances	**1,775,220**	**1,730,744**
Less provision for impairment	(100,193)	(104,371)
Net loans and advances	**1,675,027**	**1,626,373**

Movement in provisions for impairment losses on loans to retail customers as follows

(in thousands of euros)

	Loans to individuals					
	Overdrafts	Credit cards	Term loans	Mortgages	Finance leases	Total loans to individuals
As at 31 December 2015	**954**	**769**	**1,557**	**3,573**	**430**	**7,283**
Provision for loan impairment	530	697	992	2,560	371	5,150
Amounts recovered during the year	(413)	(752)	(469)	(1,989)	(514)	(4,137)
Included in income statement	117	(55)	523	571	(143)	1,013
Write off	(55)	-	(58)	(1)	-	(114)
As at 31 December 2016	**1,016**	**714**	**2,022**	**4,143**	**287**	**8,182**
Provision for loan impairment	337	595	618	2,152	183	3,885
Amounts recovered during the year	(258)	(620)	(454)	(2,127)	(235)	(3,694)
Included in income statement	79	(25)	164	25	(52)	191
Write off	(440)	(107)	(301)	(303)	-	(1,151)
As at 31 December 2017	**655**	**582**	**1,885**	**3,865**	**235**	**7,222**

Movement in provisions for impairment losses on loans to corporate customers as follows

(in thousands of euros)

	Sole proprietors	Corporate entities
As at 31 December 2015	**7,068**	**126,531**
Provision for loan impairment	2,957	49,365
Amounts recovered during the year	(2,903)	(30,257)
Included in income statement	54	19,108
Write off	(17)	(56,555)
As at 31 December 2016	**7,105**	**89,084**
Provision for loan impairment	1,882	40,667
Amounts recovered during the year	(1,923)	(22,522)
Included in income statement	(41)	18,145
Write off	(985)	(20,337)
As at 31 December 2017	**6,079**	**86,892**

In 2017 the Bank continued with the non-performing reduction plan, which is also in line with Bank of Slovenia Regulation criteria for write-offs in the assessment of credit risk losses.

Customer loan portfolio by economic sector

(in thousands of euros)

	2017	2016
Non-financial entities	**821,215**	**872,063**
- transport and storage	264,762	259,589
- manufacturing	193,502	196,304
- wholesale and retail trade	119,887	135,889
- information and communication	62,895	66,462
- accommodation and service activities	34,621	27,709
- construction	31,479	52,199
- other non-financial entities	114,069	133,911
Government	62,244	63,929
Other public entities	189,828	184,555
Financial entities	55,356	8,120
Individuals	591,185	542,166
Sole proprietors	54,697	58,931
Non-profit institutions serving households	695	980
Gross loans and advances to customers	**1,775,220**	**1,730,744**
Less provision for impairment	(100,193)	(104,371)
Net loans and advances to customers	**1,675,027**	**1,626,373**

At the end of 2017 the share of loans to non-bank customers on the domestic market amounted to 95%, the remaining share of 3.2 related to the EU market, and 2.3% to other markets respectively.

Analysis of financial leases by residual maturity:

(in thousands of euros)

	2017	2016
Future minimum lease payments (financial leases):		
Not later than 1 year	18,899	25,031
Later than 1 year and not later than 5 years	28,804	35,010
Later than 5 years	10,697	15,094
	58,400	**75,135**
Impairment	**(4,227)**	**(5,013)**
Present value of future minimum lease payments:		
Not later than 1 year	16,966	23,225
Later than 1 year and not later than 5 years	27,693	33,296
Later than 5 years	9,514	13,601
	54,173	**70,122**

Forborne exposures as at 31.12.2017

(in thousands of euros)

	General governments	Non-financial corporations	Households	Total
Performing exposures	-	6,710	585	7,295
Instruments with modifications in their terms and conditions	-	56,148	2,599	58,747
Refinancing	-	33,338	1,020	34,358
Total gross carrying amount	**-**	**96,196**	**4,204**	**100,400**
Performing	-	(516)	(26)	(542)
Instruments with modifications in their terms and conditions	-	(24,610)	(1,638)	(26,248)
Refinancing	-	(12,960)	(725)	(13,685)
Accumulated impairment, accumulated changes in fair value due to credit risk and provisions	**-**	**(38,086)**	**(2,389)**	**(40,475)**
Performing exposures	-	6,194	559	6,753
Instruments with modifications in their terms and conditions	-	31,538	961	32,499
Refinancing	-	20,378	295	20,673
Net carrying amount	**-**	**58,110**	**1,815**	**59,925**

In 2017 the Bank restructured loans in the amount of 9,322 thousands EUR (2016: EUR 27,914 thousands).

Forborne exposures as at 31.12.2016

(in thousands of euros)

	General governments	Non-financial corporations	Households	Total
Performing exposures	-	47,816	1,097	48,913
Instruments with modifications in their terms and conditions	2,513	64,154	2,348	69,015
Refinancing	-	9,646	1,109	10,755
Total gross carrying amount	**2,513**	**121,616**	**4,554**	**128,683**
Performing	-	(4,871)	(50)	(4,921)
Instruments with modifications in their terms and conditions	(281)	(25,563)	(1,116)	(26,960)
Refinancing	-	(4,501)	(688)	(5,189)
Accumulated impairment, accumulated changes in fair value due to credit risk and provisions	**(281)**	**(34,935)**	**(1,854)**	**(37,070)**
Performing exposures	-	42,945	1,047	43,992
Instruments with modifications in their terms and conditions	2,232	38,591	1,232	42,055
Refinancing	-	5,145	421	5,566
Net carrying amount	**2,232**	**86,681**	**2,700**	**91,613**

Forbearance measures are concessions made to a borrower facing or about to face financial difficulties by agreeing to change agreed contractual terms and conditions, so as to make them for the borrower more favourable than those that would be granted under normal conditions. Forbearance measures are conceded in order to maximize collection and minimize the risk of default. A forborne exposure can be performing or non-performing and related to retail or corporate customers.

According to the Bank regulations, individual loan contracts are flagged as exposures with forbearance measures for the purpose of evidencing the portfolio of forborne exposures, i.e., exposures which meet the above described definition. The forborne flag is therefore an additional element for classification of credit exposures for the purpose of credit portfolio monitoring and reporting. Taking into account the internal rules for the performing and non-performing exposures classification, rules governing the forborne exposures did not have a significant impact on the Bank's income statement.

Loans and advances are further analysed as a part of the statement of financial position in the accompanying notes: Analysis of past due financial instruments 3.4, Currency Risk Note 3.7.2., Interest Rate Risk Note 3.7,3., Liquidity Risk Note 3.5., Fair value Note 3.9., and Related Party Transactions Note 44.

23. ADVANCES

(in thousands of euros)

	2017	2016
Commissions receivables	351	391
Cheques	1	9
Receivables	446	646
Claims to Europay	5,448	5,334
Claims relating to interbank settlement for Visa card	4,500	3,000
Claims due to recovery procedures	1,063	1,342
Other	1,520	863
Gross advances	**14,837**	**12,392**
Impairments	(1,106)	(1,376)
Net advances	**13,731**	**11,016**

Movement in provisions for impairment on other assets:

(in thousands of euros)

As at 31 December 2015	**1,233**
Additional provision for impairment	251
Amounts recovered during the year	(73)
Included in income statement	178
Write off of impairment	(35)
As at 31 December 2016	**1,376**
Additional provision for impairment	397
Amounts recovered during the year	(377)
Included in income statement	20
Write off of impairment	(290)
As at 31 December 2017	**1,106**

24. NON-CURRENT ASSETS HELD FOR SALE

By the end of the year 2017, PBZ group decided to dispose all non-core business real estates.
In addition, all actions taken to close the deal and management's commitment indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn. Therefore, the assets were classified as non-current assets held for sale and are presented separately in the balance sheet. The proceeds of the disposal are estimated to exceed the net carrying amount of the relevant assets and, accordingly, no impairment loss was recognized on the classification of these assets as held for sale.

(in thousands of euros)

	2017
Transfer from property and equipment	600
Transfer from investment property	19,001
Net carrying amount	**19,601**

25. PROPERTY, PLANT AND EQUIPMENT

(in thousands of euros)

	Land and buildings	Hardware equipment	Other equipment	Total
Movement in year 2016				
Opening net book amount	**18,344**	**781**	**2,398**	**21,523**
Additions	6	344	206	556
Disposals	-	-	(315)	(315)
Depreciation charge	(1,920)	(378)	(766)	(3,064)
Closing net book amount	**16,430**	**747**	**1,523**	**18,700**
As at 31 December 2016				
Cost	51,365	5,734	12,426	69,525
Accumulated depreciation	(34,935)	(4,987)	(10,903)	(50,825)
Net book amount as at 31 December 2016	**16,430**	**747**	**1,523**	**18,700**

(in thousands of euros)

	Land and buildings	Hardware equipment	Other equipment	Total
Movement in year 2017				
Opening net book amount	**16,430**	**747**	**1,523**	**18,700**
Additions	227	204	334	765
Disposals	-	-	(218)	(218)
Depreciation charge	(1,851)	(305)	(515)	(2,671)
Transfer to non-current assets held for sale	(600)	-	-	(600)
Closing net book amount before valuation	**14,206**	**646**	**1,124**	**15,976**
Valuation gain	13,792	-	-	13,792
Valuation loss	(974)	-	-	(974)
Closing net book amount	**27,024**	**646**	**1,124**	**28,794**
As at 31 December 2017				
Cost	29,369	5,662	10,745	45,776
Accumulated depreciation	(2,345)	(5,016)	(9,621)	(16,982)
Net book amount as at 31 December 2017	**27,024**	**646**	**1,124**	**28,794**

In 2017 there was no property, plant and equipment pledged (2016; nil).

In addition to its own premises, the Bank hired premises at 30 locations. Future minimum lease payments under lease contracts amount to EUR 5,600 thousand, of this:

(in thousands of euros)

2017			2016		
Up to 1 year	1 to 5 years	Over 5 years	Up to 1 year	1 to 5 years	Over 5 years
560	2,240	2,800	555	2,220	2,775

26. INVESTMENT PROPERTY

The Privredna banka Zagreb Group decided to start a sale procedure for all real estate that is not necessary for its core banking activity. The sale is meant to be completed by the end of 2018, which meets the criteria for classifying these real estate into Non-current assets held for sale. In this regard, the management's commitment was also given and certain measures were also taken to realize the sales plan within the 12-month period, therefore it is unlikely that the sales plan would not be executed or to be withdrawn. Due to these circumstances, the Bank has transferred all investment property (27 premises) to non-current assets held for sale.

Movement in investment property

(in thousands of euros)

	2017	2016
At beginning of the year	**13,985**	**14,127**
Depreciation	(369)	(319)
Transfer from property in use	-	-
Transfer to property in use	-	-
Transfer to inventory	-	(476)
Additions	3.461	1,251
Transfer from assets seized as collateral on stock	2.936	-
Disposals	(1,012)	(76)
Impairments	-	(522)
Transfer to non-current assets held for sale	(19,001)	-
At end of year	**-**	**13,985**

Income from investments property carries rents of EUR 1,726 thousand (2016: EUR 1,379). In 2017, Bank`s maintenance costs for rented property investments amounted to EUR 388 thousand (2016: EUR 316 thousand). The fair value of investment property per 31 December 2016 was estimated at EUR 14,231 thousand. The fair value of investment property immediately before reclassification to non-current assets held for sale is estimated at EUR 23,017 thousand.

27. INTANGIBLE ASSETS

(in thousands of euros)

	Development	Licenses	Software and other	Total
Movement in year 2016				
Opening net book amount	3,058	775	638	4,471
Additions	557	186	162	905
Amortisation	(814)	(303)	(192)	(1,309)
Closing net book amount	**2,801**	**658**	**608**	**4,067**
As at 31 December 2016				
Cost	13,841	3,188	4,030	21,059
Accumulated amortisation	(11,040)	(2,530)	(3,422)	(16,992)
Net book amount as at 31 December 2016	**2,801**	**658**	**608**	**4,067**
Movement in year 2017				
Opening net book amount	**2,801**	**658**	**608**	**4,067**
Additions	654	18	72	744
Amortisation	(844)	(234)	(215)	(1,293)
Closing net book amount	**2,611**	**442**	**465**	**3,518**
As at 31 December 2017				
Cost	14,495	2,829	3,732	21,056
Accumulated amortisation	(11,884)	(2,387)	(3,267)	(17,538)
Net book amount as at 31 December 2017	**2,611**	**442**	**465**	**3,518**

The Bank has not pledged any intangible fixed assets.

The Bank does not have any intangible fixed assets in management.

In 2017, the Bank has not recognized any expenditure related to development in the income statement. All development expenditure in 2017 was capitalized as intangible fixed assets, out of which staff expenses amounted to EUR 337 thousand.

28. OTHER ASSETS

(in thousands of euros)

	2017	2016
Accruals	728	837
Inventory	4	18
Taxes and contributions	527	414
Fixed assets from seized collateral on stock	5,995	12,095
Prepayments and bails	25	25
Total	**7,357**	**13,389**

Fixed assets from seized collateral related mainly to assets subject of leasing contracts.
Decrease in fixed assets from seized collaterals stems mainly from sell in amount of EUR 5.709 thousand and from transfer of part of the repossessed assets in amount of EUR 2.936 Thousand to investment properties and subsequently to non-current assets classified as held for sale in accordance with IFRS 5, considering that these are planned to be disposed of at the portfolio level for the whole Privredna banka Zagreb (the parent company) group.

29. DEPOSITS FROM BANKS AND CENTRAL BANKS

(in thousands of euros)

	2017	2016
Demand deposits	1,307	1,037
Term deposits	9,443	61,663
Total	**10,750**	**62,700**

30. DEPOSITS FROM NON-BANK CUSTOMERS

(in thousands of euros)

	2017	2016
Individuals		
- demand deposits	883,007	803,282
- term deposits	499,349	530,197
Sole proprietors		
- demand deposits	74,476	68,234
- term deposits	2,436	2,838
Corporate customers		
- demand deposits	461,188	374,005
- term deposits	51,040	61,379
Total	**1,971,496**	**1,839,935**

As at 31 December 2017, deposits in the amount of EUR 12,857 thousand have been pledged for covering potential credit risk on assets (2016: EUR 15,667 thousand).

31. LOANS FROM BANKS AND CENTRAL BANKS

The Bank repaid its obligations regularly. At the date of the financial statements, there are no obligations which are overdue.

(in thousands of euros)

	2017		2016	
	Short term	Long term	Short term	Long term
In local currency	-	58,184	-	66,853
In foreign currency	-	13,293	-	20,894
Total	-	**71,477**	**-**	**87,747**
	71,477		**87,747**	

32. LOANS FROM NON-BANK COSTUMER

(in thousands of euros)

	2017	2016
	Long term	Long term
Financial leases	-	28
Total	**-**	**28**

The residual maturity of the financial liability is shown in note 3.5. - Liquidity risk.

33. OTHER FINANCIAL LIABILITIES

(in thousands of euros)

	2017	2016
Unpaid commissions	136	133
Liabilities form credit card business	6,918	5,870
Not yet process payment*	20,189	10,698
Unpaid dividend	118	118
Creditors	1,137	2,042
Salaries	2,103	2,020
Deferred income	6,734	5,834
Other	802	399
Total	**38,137**	**27,114**

** The rise of unprocessed payment transactions is a consequence of longer closure of payment systems during New Year holidays.*

34. PROVISIONS FOR LIABILITIES AND CHARGES

The Bank also makes credit risk provisions for off-balance sheet items. The above credit risk provisions recorded by Banka Intesa Sanpaolo d.d. refer to contractual commitments for issued guarantees and letters of credits and irrevocable contractual commitments for granted, but undrawn loans. The same principles as for provisions for on-balance sheet items are applied.

(in thousands of euros)

	2017	2016
Provisions for off-balance sheet liabilities	3,652	4,653
Legal proceedings due to employees	1,779	540
Total	**5,431**	**5,193**

As at 31 December 2017, the Bank was involved in several legal proceedings against it. Contingent liabilities in this respect are estimated in the amount of EUR 4,163 thousand. To this end, on the basis of its best estimation on the outcome of the legal proceedings, the Bank established provisions in the amount of EUR 1,179 thousand.

Movement in provisions:

(in thousands of euros)

	2017	2016
At beginning of year	**5,193**	**6,754**
Additional provision	4,368	5,706
Amounts recovered during the year	(4,126)	(7,264)
Included in income statement under provisions	242	(1,558)
Repayment of the premiums for National Saving Housing Scheme	(4)	(3)
At end of year	**5,431**	**5,193**

35. RETIREMENT BENEFIT OBLIGATIONS

(in thousands of euros)

	2017	2016
Retirement severance pay and long service bonuses	4,268	4,152
Provision for redundancies	841	706
	5,109	**4,858**

Movements:

(in thousands of euros)

	2017	2016
At beginning of year	**4,858**	**4,600**
Additional provisions	370	435
Charged to income statement	370	435
Actuarial losses	(5)	(78)
Utilised provisions	(114)	(99)
At end of year	**5,109**	**4,858**

36. DEFERRED INCOME TAXES

Deferred tax liabilities:

(in thousands of euros)

	2017	2016
Non-current assets held for sale	2	2
Valuation of tangible fixed assets	2,621	-
Available-for-sale financial assets	1,365	1,574
Total	**3,988**	**1,576**

Deferred tax assets:

(in thousands of euros)

	2017	2016
Retirement and other employee benefits	426	422
Loan impairments on financial and operating leasing	130	164
Available-for-sale financial assets	331	303
Other - depreciation above tax prescribed rate	5	5
Total	**892**	**894**
Net deferred taxes	**3.096**	**682**

Movement in deferred taxes (offsetting of assets and liabilities)

(in thousands of euros)

	2017	2016
At beginning of year	682	(262)
Deferred taxes charged in income statement	31	1,710
AFS financial assets (fair value measurement)	(237)	(924)
Valuation of tangible fixed assets	2,620	-
Actuarial losses	-	7
Effect of tax rate increase from 17% to 19%	-	151
At end of year	**3,096**	**682**

Deferred taxes charged in income statement:

(in thousands of euros)

	2017	2016
Retirement and other employee benefits	4	13
Impairment on AFS financial assets	-	36
Other	-	(1)
Loan impairments on financial and operating leasing	(35)	(325)
Tax reliefs, that can be carried forward	-	(134)
Tax loss	-	(1,380)
Effect of tax rate increase from 17% to 19%		
- Employees benefits	-	38
- Impairment on AFS financial assets	-	25
- Loan impairments on financial and operating leasing	-	17
- Other	-	1
Total	**(31)**	**(1,710)**

37. OTHER LIABILITIES

(in thousands of euros)

	2017	2016
Accruals	1,951	1,647
Prepayments received	2,329	2,195
Taxes and contributions	1,347	818
Total	**5,627**	**4,660**

38. SHARE CAPITAL

(in thousands of euros)

	Number of shares	Ordinary shares	Share premium	Treasury shares
As at 31 December 2015	531,359	22,173	7,499	(49)
As at 31 December 2016	531,359	22,173	7,499	(49)
As at 31 December 2017	531,359	22,173	7,499	(49)

The share capital of the Bank is divided into 531,359 ordinary shares. Each share has an equal proportion in the share capital of the Bank and its participating value in the share capital as well. The proportion of each share in the share capital of the Bank is determined on the basis of the number of the issued shares.

39. ACCUMULATED OTHER COMPREHENSIVE INCOME

(in thousands of euros)

	2017	2016
Revaluation reserves:		
- Debt securities	4,386	6,037
- Equity securities	1,020	382 -
- Tangible fixed assets	11,172	-
Actuarial losses	(555)	(560)
Total	**16,023**	**5,859**

(in thousands of euros)

Movement	Revaluation reserves
As at 31 December 2015	**10,451**
Valuation of available-for-sale securities	
Equity securities	**(2,439)**
- Fair value adjustment, net of tax	359
- Disposals	(2,875)
- Impairment	86
- Effect of tax rate increase	(9)
Debt securities	**(2,231)**
- Fair value adjustment, net of tax	(52)
- Disposals	(2,474)
- Valuation of hedge items transferred to profit or loss	444
- Effect of tax rate increase	(149)
Other comprehensive income	**78**
Actuarial loss	71
Effect of tax rate increase	7
As at 31 December 2016	**5,859**

(in thousands of euros)

	Revaluation reserves
As at 31 December 2016	**5,859**
Valuation of available-for-sale securities	
Equity securities	**638**
- Fair value adjustment, net of tax	888
- Disposals	(250)
Debt securities	**(1,651)**
- Fair value adjustment, net of tax	515
- Disposals	(2,657)
- Valuation of hedge items transferred to profit or loss	491
Other comprehensive income	**11,177**
Actuarial loss	5
Effect of tax rate increase	11,172
As at 31 December 2017	**16,023**

40. RESERVES FROM PROFIT AND RETAINED EARNINGS

(in thousands of euros)

	2017	2016
Legal reserves	15,471	15,260
Statutory reserves	214,054	214,053
Retained earnings	10,009	25,238
Treasury share`s reserves	49	49
Total	**239,583**	**254,600**

(in thousands of euros)

Movement	Legal reserves	Statutory reserves	Retained earnings	Treasury reserves	Total reserves
As at 31 December 2015	**14,248**	**213,357**	**17,956**	**49**	**245,610**
Net profit for the financial year	-	-	20,240	-	20,240
Dividends	-	-	(11,250)	-	(11,250)
Transfer to statutory reserves	-	696	(696)	-	-
Transfer to legal reserves	1,012	-	(1,012)	-	-
As at 31 December 2016	**15,260**	**214,053**	**25,238**	**49**	**254,600**
Net profit for the financial year	-	-	4,211	-	4,211
Dividends	-	-	(19,228)	-	(19,228)
Transfer to statutory reserves	-	1	(1)	-	-
Transfer to legal reserves	211	-	(211)	-	-
As at 31 December 2017	**15,471**	**214,054**	**10,009**	**49**	**239,583**

Legal reserves

In accordance with the Articles of Association of Banka Intesa Sanpaolo d.d., the Bank forms legal reserves in the amount adequate to ensure that the sum of its legal reserves and those capital reserves that shall be added to the legal reserves pursuant to the law governing the required amount of legal reserves equals twice the amount of the Bank's share capital.

Statutory reserves

The Bank, according to its Statute, creates statutory reserves until they achieve an amount which is fifteen times that of the Bank's registered capital stock. In each financial year, a part of the net profit that remained after any losses carried forward, legal reserves and reserves for own shares have been covered, can be allocated to statutory reserves.

41. DIVIDENDS PER SHARE

Dividends payable are not accounted for until they have been ratified by the Annual General Meeting. By the date the financial statements were authorised by the Management Board no dividends were proposed or declared. For 2016, the Bank disbursed for dividends EUR 19,227 thousand i.e. EUR 36.25 per share.

(in thousands of euros)

Distribution of the profit of the year	2017	2016
Net profit for the period	4,211	20,240
Allocation of the profit to the legal reserves (5%)	(211)	(1,012)
Net profit of the period available for distribution	**4,000**	**19,228**
Total net profit available for distribution at the AGM	**4,000**	**19,228**

42. CASH AND CASH EQUIVALENTS

(in thousands of euros)

	2017	2016
Cash and balances with central bank*	268,029	175,394
Loans and advances to banks	22,979	15,968
Total	**291,008**	**191,362**

** The figure Cash and balances with central bank differs from those in Statement of financial position due to mandatory reserve liability to central bank (note 19).*

43. CONTINGENT LIABILITIES AND COMMITMENTS

Capital commitments, At 31 December 2017, the Bank had no capital commitments (2016: nil).

Credit related commitments, Guarantees and standby letters of credit, which represent irrevocable assurances that the Bank will make payments in the event that a customer cannot meet its obligations to third parties, are exposed to credit risk, as loans. Documentary and commercial letters of credit, which are written undertakings by the Bank on behalf of a customer authorising a third party draw funds from the Bank up to a stipulated amount under specific terms and conditions, are secured by the underlying shipments of goods to which they relate and therefore have significantly less risk, also because the Bank do not generally expect the third party to draw funds under such agreements.

With respect to credit risk on commitments to extend credit, the Bank is potentially exposed to losses in an amount equal to the total unused commitments. However, the likely amount of losses is not easy to quantify and is considerably less than the total unused commitments since most commitments to extend credit are contingent upon customers fulfilment of specific credit standards which need to be met before the carrying out of the drawing. The Bank monitors the term to maturity of credit commitments because longer-term commitments generally have a greater degree of credit risk than shorter-term commitments. The total outstanding contractual amount of commitments to extend credit does not necessarily represent future cash requirements, since many of these commitments will expire or terminate without being funded.

The following table indicates the contractual amounts of the Bank's off-balance sheet position by type of instrument.

(in thousands of euros)

	2017	2016
Documentary and commercial letters of credit	160	160
Guarantees	173,629	179,948
Credit commitments:	314,570	281,811
- original maturity up to 1 year	125,527	113,835
- original maturity over 1 year	189,043	167,976
	488,359	**461,919**
Provisions for off-balance sheet liabilities:		
Guarantees	(2,872)	(3,610)
Credit commitments	(781)	(1,043)
Total	**484,706**	**457,266**

44. RELATED PARTY TRANSACTIONS

(in thousands of euros)

	Directors and employees with managerial contract		Management board and their direct family members		Supervisory board members and their direct family members		Intesa SanPaolo Group without PBZ Group		PBZ Group	
	2017	2016	2017	2016	2017	2016	2017*	2016	2017*	2016
Loans										
At beginning of the year	129	174	65	72	-	-	77,717	141,756	-	-
Loans issued during the year	181	17	-	-	-	-	1,193,012	1,989,330	80,178	-
Loan repayments during the year	(47)	(62)	(8)	(7)	-	-	(1,255,565)	(2,053,369)	(10,145)	-
At end of year	**263**	**129**	**57**	**65**	**-**	**-**	**15,164**	**77,717**	**70,033**	**-**
Impairment as at 31 December	-	-	-	-	-	-		-		-
Collateral received as at 31 December	535	487	283	269	-	-		-		-
Deposits										
At beginning of the year	893	737	2,513	2,452	127	141	116,183	79,768	-	-
Deposits received during the year	5,601	2,813	1,796	9,380	4	693	84,915	98,284		
Deposits repaid during the year	(5,069)	(2,657)	(2,971)	(9,944)	(131)	(707)	(146,091)	(61,869)		
At end of year	**1,425**	**893**	**1,338**	**2,513**	**-**	**127**	**55,007**	**116,183**	**-**	**-**
Interest expense on deposits	4	6	10	21	-	1	1,515	1,627	-	-
Interest income earned	3	4	1	1	-	-	204	222	168	-
Other revenue – fee income	1	1	1	1	-	-	555	285	19	-
Guarantees issued by the bank and commitments	-	-		-		-	5,777	1,993	527	-
Remuneration	**1,011**	**985**	**2,201**	**2,131**	**68**	**79**			**-**	**-**

** In 2017 majority shareholder became Privredna Banka Zagreb d.d..*

There were no transactions made with companies in which the Management board, Supervisory board members and their closer family members or employees with managerial contract had significant influence.

45. EVENTS AFTER THE REPORTING PERIOD

Regulatory background

The new Accounting Standard IFRS 9 issued by the IASB in July 2014 and approved by the European Commission by Regulation No. 2067/2016, replaced IAS 39 from 1 January 2018. IAS 39 regulated the classification and measurement of financial instruments until 31 December 2017.
IFRS 9 is divided into three different areas:
- Classification and measurement of financial instruments,
- Impairments and
- Hedging of risks.

With regard to the classification and measurement of financial assets, IFRS 9 provides that the classification of financial assets is derived from the characteristics of contractual cash flows and from the purpose of doing business, which is determined by the bank`s business model.
Instead of the current four categories, financial assets in accordance with IFRS 9 are classified into three categories:
- Financial assets at amortized cost,
- Financial assets at fair value, with effects in comprehensive income (for debt instruments, the reserve is transferred to the income statement if the instrument is sold); and
- Financial assets measured at fair value with effect on the income statement.

Financial assets can be measured within the first two groups at amortized cost or fair value, recognized in equity) only if it is proved that the basis for cash flows, are solely principal and interest payments (SPPI test). Equity instruments are always classified in the third category and measured at fair value through profit or loss, unless the entity invests in instruments that are not for trading purposes. In this case, changes in fair value are reflected in capital reserves that will never be transferred to the income statement, even if the financial instrument is sold. With regard to financial obligations in the new standard, there are no significant changes in their classification and valuation.

According to IFRS 9, in order to recognize losses earlier, the impairment of financial assets measured at amortized cost and fair value through equity relies on the concept of "expected loss" instead of "incurred loss",

To this end IFRS 9 requires from entitie to calculate the expected losses in the horizon of next 12 months from the initial recognition of the financial instrument (stage 1). In cases where the credit quality of the financial instrument significantly declined compared to the initial measurement (stage 2), or when the financial instrument is defined as 'In the non-performing position"(stage 3), the calculation of expected losses is based on the horizon of the total residual life of the asset.

FTA impact of IFRS 9 on equity as at 1.1.2018

Distribution of the profit of the year	Before tax	After tax
Impairment of performing loan & off balance exposures	(3,830)	(3,102)
Impairment of debt securities	(2)	(2)
Impairment of non-performing loan and off balance exposures	(631)	(511)
Changes due to reclassfication and measurement of financial assets	(1,035)	(838)
Total	**(5,498)**	**(4,453)**

Credit risk impairments under IFRS9

For the purpose of credit impairments calculation in accordance with IFRS9, the following activities have been completed:

- Rules necessary to track the evolution of quality of single financial instrument measured at amortized cost or measured at fair value through other comprehensive income.
- Definition of parameters that have the function of classifying performing financial instruments into Stage 1 or Stage 2 due to a significant increase of credit risk
- Models for measuring the expected credit loss (ECL parameter) for performing financial instruments, which are for Stage 1 measuring the expected credit loss over one year period, whereas for Stage 2 are measuring the lifetime expected loss. The ECL models are including also the forward looking component. The estimation of the expected loss is based on obligor's internal rating for customer segments with internal rating system in place. Currently the Bank has been assigning internal ratings to Corporate and SME segments.

The significant increase of credit exposure is tracked in a uniform way for all credit exposures at a level of single financial instrument since its initial recognition. The purpose of credit quality tracking is a timely detection and classification of financial instruments in Stage 2, subsequent to credit risk deterioration. The credit quality tracking is necessary also to render possible a return of the financial instruments in Stage 1, whenever the causes leading to credit risk increase cease to exist. The criteria triggering changes of stage classification are the following:

- Significant internal rating downgrade between origination (or initial recognition) and reporting date or cumulative PD increase over lifetime period, above the threshold representing a significant change of risk.
- Amounts in arrears more than 30 days for financial instruments that exceed the materiality threshold of 5%.
- Forborne status for performing exposures
- Credit exposures with deteriorated credit quality that have been identified and subsequently received an active status in the Early Warning System.

With the rising of all listed situations it is assumed that financial instruments have been exposed to significant increase of credit risk and therefore are fulfilling conditions for the classification in Stage 2.

Bonds, measured at fair value through other comprehensive income that have an investment grade rating, will be subject to the application of exemption rule permitted by IFRS9. The exemption rule allows that bonds with investment grade rating are considered as low credit risk exposure and therefore will be classified under Stage 1 for first time adoption purposes.

An important element for measuring the expected credit loss is the forward looking component, which contain prospective macroeconomic scenarios. The Bank has adopted the approach of Most likely scenario increased for Add-on. The most likely scenario approach is considering the most likely expected credit loss, increased for add-on, conditioned on macroeconomic projections and different scenarios. The macroeconomic parameters taken into account are EBA parameters published for stress-test exercise purposes and comprise the best scenario, baseline scenario and adverse scenario.

GALLERIE D'ITALIA.
THREE MUSEUM VENUES: AN ITALIAN CULTURAL NETWORK.

Through the Gallerie d'Italia project, Intesa Sanpaolo intends to share its artistic and architectural heritage with the public at large: 1,000 works of art displayed in historic palazzi in three cities creating a unique museum network.
Set in an architectural context of great value, ***Gallerie d'Italia - Piazza Scala in Milan*** displays a selection of two hundred nineteenth-century works of the Lombard school of painting, along with a collection representative of twentieth-century Italian art. ***Gallerie d'Italia - Palazzo Leoni Montanari in Vicenza*** holds the most important western collection of Russian icons, examples of eighteenth-century Veneto art, and a collection of Attic and Magna Graecia pottery.
Gallerie d'Italia - Palazzo Zevallos Stigliano in Naples houses The Martyrdom of Saint Ursula, Caravaggio's last documented painting, as well as a collection of over one hundred and twenty artworks representative of Neapolitan artistic output from the early seventeenth century to the beginning of the twentieth century.

Napoli, Via Toledo: impressione di pioggia / Naples, Via Toledo: Rain Impression by Carlo Brancaccio depicts an outdoor daily-life scene with a lively narrative style. The artist is particularly renowned for his radiant depictions of the most famous streets and sites in Naples, as well as for his seascapes and landscapes.
This picture is part of the permanent collection on display at Gallerie d'Italia - Palazzo Zevallos Stigliano, Intesa Sanpaolo's museum venue in Via Toledo, Naples. This collection of nineteenth-century paintings offers a remarkable overview of landscape painting, a genre that experienced an incredible season in Naples, on a par with the most advanced figurations developed in the rest of Europe.

Cover photo:

CARLO BRANCACCIO
(Naples 1861–1920)
Napoli, Via Toledo: impressione di pioggia /
Naples, Via Toledo: Rain Impression *c. 1888-1889*
oil on canvas, 40 x 80 cm
Intesa Sanpaolo Collection
Gallerie d'Italia - Palazzo Zevallos Stigliano, Naples

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