HYPO ALPE ADRIA
VAŠI. Z VAMI. ZA VAS.

ANNUAL REPORT 2012

Hypo Alpe-Adria-Bank d.d.
Slovenia

Content

1 Introduction

Hypo Alpe-Adria-Bank, d. d., with its headquarters at Dunajska cesta 117, Ljubljana, is a Slovenian public limited company, registered for the providing of universal banking services in the Slovenian market.

The Bank's sole owner is Hypo Alpe-Adria-Bank International AG, with its headquarters in Klagenfurt, Austria.

Current ownership of Hypo Alpe-Adria-Bank International AG:

- Republic of Austria (100 per cent holding).

1.2 Brief overview of the Bank's operations

EUR '000

Key highlights	2012	2011
Total clients	65,748	60,778
Branches	19	19
Employees	473	465
Balance sheet total	1,900,801	1,977,634
Market share*	4.12%	4.05%
Core capital	174,037	174,037
Total capital	153,062	160,112
Operating net income	45,001	45,807
Pre-tax loss	-9,663	-33,843
Interest margin	1.71%	2.03%
Return on average equity (ROAE)	-6.12%	-21.54%
Return on average assets (ROAA)	-0.49%	-1.69%
Cost income ratio (CIR)	69.56%	65.31%
Number of ordinary shares	41,706	41,706

*Source: Bank of Slovenia

1.3 Significant events in 2012

January
Mag. Marko Bošnjak was appointed member of the Bank's Management Board.

In Velenje, the Hypo Group (the Bank and Hypo Leasing) began its operations on a joint location.

February
Services of securities transactions previously provided by BPH Certius, were assumed by the Bank.

On the opening day of the refurbished offices, the Bank and Hypo Leasing donated to the University Library of Maribor 20 Hypo dictionaries of economic terms, as part of the Hypo Pro Futuro Project.

The Bank began trading »Dream 5« deposit on the Slovene market, which offers a choice of 5 deposit terms with different interest rates.

Slovenian Association of Friends of Youth organised a winter camp »Let's enjoy childhood vitality in the snow« in Kranjska gora, with the support and sponsorship of the Bank, Hypo Leasing and a chain of Qlandia shopping centres, which are owned by Hypo Leasing.

March
The function of the President of the Bank was temporarily assumed by mag. Matej Falatov, who was previously a Member of the Management Board. On the initiative of the Supervisory Board, Dr. Aleksander Picker, former Chairman of the Supervisory Board, took over the management of Hypo Alpe-Adria-Bank d.d. in Mostar, Bosnia and Herzegovina a s from 1 March 2012.

In collaboration with Hypo Leasing, the Bank organised an exhibition of works of art by Blanka Sajnkar, entitled »Rhythms«.

In Qlandia shopping centres in Kranj and Novo mesto, the Bank set up mobile banking points intended for marketing the services provided by the Bank.

April
The Bank and Hypo Leasing together participated at the agricultural fair in Komenda.

In collaboration with Hypo leasing, the Bank as a financial partner participated in »KIA Road Show« – promoting its banking services and KIA cars, which ran until October 2012.

May
Together with Hypo Leasing, the Bank participated in the rowing regatta BMW EKO.

The Bank organised special presentation for financial market clients under the title: Financial risk management focussing on interest rate risk management, including practical examples«.

June
Heribert Fernau was appointed new President of the Management Board and .Mag. Matej Falatov has assumed a new function of deputy president of the Management Board.

Together with Hypo leasing, the Bank as the official financial partner sponsored cycling event »31st Franja Marathon«.

In collaboration of Hypo Leasing and Qlandia, the Bank, as the main sponsor, participated at the Goriško festival »GOF«, which ran until September.

At the traditional banking games, the Bank employees took the overall 6th position among 21 Slovenian banks. The Bank took gold in men's and women's cross-country run and bronze in men's basketball competition.

July
By establishing a Hypo Club, the Bank again upgraded its customer loyalty programme and set up a special web site www.hypoklub.si especially for the Hypo Club members.

A special prize game »I shop with my card« was organised for the Bank's clients.

August

The Bank and Hypo Leasing sponsored Jesus Christ Superstar musical at the 61st Ljubljana Festival.

The Bank and Hypo Leasing extended their sponsorship agreement with the Football Association of Slovenia.

September

As the main sponsor of the 45th MOS International Trade Fair in Celje, the Bank and Hypo Leasing provided special offers for clients. At the roundtable »Credit crunch - fact or fiction«, organised as part of the trade fair supporting events, mag. Matej Falatov, Deputy President of the Management Board participated in discussions.

The Bank and Hypo Leasing in collaboration with the investor Tridana d.o.o., took part in presentation of the business and housing development »Situla« in the centre of Ljubljana to the wider public.

October

To celebrate the World savings day, the Bank organised a reception for its clients and a visit to the show »Slovene music from A to Z«.

In the Hypo Gallery, the Bank and Hypo Leasing opened an exhibition of statuary art »Love depicted in wood« by Peter Venet.

As part of the Bank's internal project »HypoDAY for a good cause«, employees of the Bank and Hypo Leasing helped in clearing the area around the Dolfka Boštjančič Centre for Training, Work and Care at Ig.

November

The Hypo Group (members of the Hypo Group in Austria, Slovenia, Croatia, Bosnia and Herzegovina, Serbia and Monte negro) as the main sponsor and official financial partner, signed a sponsorship contract for the largest sports event in Slovenia i.e. European basketball championship EuroBasket 2013, to be held from 4 to 22 September 2013.

For the first time, the Bank awarded »Certificates of Consultant Banker 2012« to some of the personal bankers, granting them licences after a successful internal training.

December

Funds earmarked for Christmas presents by the Bank and Hypo Leasing were donated to 15 families chosen by the Association of Friends of Youth, thus making their Christmas that little bit special.

At the initiative of the employees, the Bank and Hypo Leasing donated funds earmarked for the Christmas party to the relief fund set up to eliminate consequences of floods Slovenia experienced in November.

The Bank and Hypo leasing opened an exhibition of drawings made by children »My Dream Christmas Eve« in the Hypo Gallery.

The Bank set up a w eb stock brokerage »HypoBroker«.

In Qlandia shopping centres in Kranj, Novo mesto, Nova Gorica, Maribor and Ptuj, the Bank set up mobile banking points intended for marketing the services provided by the Bank.

The Bank and Hypo Leasing were awarded the basic certificate »Family Friendly Company«.

The Bank and Hypo leasing awarded prizes for excellence in Hypo »HippOSCAR«, in seven categories.

A Christmas party was organised for children of employees of the Bank and Hypo Leasing.

The Management Board

From left to right: mag. Marko Bošnjak, Member, dr. Heribert Fernau, President, mag. Matej Falatov, Vise – President

Dr. Heribert Fernau, President of Management Board **(CEO, CFO, COO)**
Internal Audit
Legal
Compliance & Security
Human Resources
Economic Research
Accounting & Reporting
Financial Controlling
Balance Sheet Management & Treasury
Project Management
Procurement
Operations
ORG/IT
Collection
Real Estate Management
Real Estate Asset Management

Mag. Matej Falatov, Vise – President of Management Board **(CMO)**
Marketing & Corporate Communications
Sales Planning & Controlling
Segment, Product & Channel Mgt. Retail
Corporate & Public Finance
Retail Sales Force Mgt.

Mag. Marko Bošnjak, Member of Management Board **(CRO)**
Retail Risk Management
Credit Management
Risk Controlling
Credit Rehabilitation
Task Force Rehabilitation
Credit Processing

1.4 Address by the Management Board

Dear Business Partners and Colleagues,

The 2012 financial year, which proved to be extremely demanding, brought a number of challenges and opportunities to Slovenia. For the first time since its independence, Slovenians faced real deterioration in their circumstances as they felt the impact of the recession, contraction of economic activities, delays in payments, salary reductions, rise in unemployment, social unrest, as well as other circumstances that led to general dissatisfaction. All these negative trends resulted in difficult conditions on financial markets. Since the start of the financial crisis, access to financial markets has worsened as a result of reduced creditworthiness. The 2012 financial year will be remembered by a number of austerity measures that resulted in additional reduction in investments.

We successfully fought these negative conditions and viewed them as an opportunity to focus our efforts on getting ready for times when optimism, development and stability return to Slovenia. We successfully renewed our business strategy, carried out internal restructuring and set up strong foundations for our future business operations. Strong and increasing client support as well as support of the owner show that our strategy is appropriate. Although several metrics are used to manage and measure performance, the capital adequacy ratio is one of the most significant as it reflects our power and capability to provide services to our clients. Although as a result of our net operating loss in 2012, the Bank's capital fell by 4 per cent, the Bank's capital position remains strong. Furthermore, as a result of the capital increase by our owner, the Republic of Austria, the Bank's operation is now safe and stable. Therefore, we ended the financial year under review with more stable sources of funds and stronger capital.

Despite successful internal restructuring and stability, reduced economic activity impacted the Bank's performance. At the year-end, the Bank's balance sheet of €1,901 million was 4 per cent below that recorded in 2011. Despite this minor reduction, the balance sheet total is stable and in accordance with our strategy aimed at maintaining our market share.

With a 4.12 per cent market share, Hypo Alpe Adria Bank is one of the 9 largest banks in Slovenia. The operating result of the Bank above all reflected the deteriorating economic conditions, and as a result we set aside an additional €23 million of provisions. Although the amount of impairments and provisions is more than 50 per cent below the amount recognised in the previous year, it still led to an operating loss of just under €7 million. The fact that our clientele rose by 8 per cent is an indication of the continuing public confidence in the Bank as a financial institution. The total number of clients exceeded 65,000 at the end of 2012.

Our main and foremost focus is on our clientele. Therefore, the majority of internal efforts, processes and projects that were either began or completed in 2012 were aimed at achieving our strategy of a clear business policy in dealing with retail clients, medium-size, small and micro companies. We have set up a financial services infrastructure by combining banking, leasing and insurance operations. Our clients can take advantage of a complete financial experience, giving us a competitive advantage on the Slovene market.

Through various projects at the level of the Group, which support the optimal, efficient and rapid realisation of our strategy, we justify the confidence of all our stakeholders: clients, employees as well as our owner, who is looking for a new investor for the Hypo Group on the South-Western European markets. Through hard work and perseverance we intend to show potential investors that we are a financial institution worthy of trust and investment. Major credit for this goes to our highly professional employees who follow the set strategy and build constructive and long-term relationships with clients. Our increasing number of clients confirms this.

Our activities are not only aimed at increasing profitability; our aim is to contribute to the environment in which we operate. As part of our socially responsible activities, we participated in humanitarian projects throughout the year. In addition to the established annual donation to socially disadvantaged children in 2012, we donated funds earmarked for our New Year's party to the floods relief fund set up following the November floods. We support top athletes, sports and cultural events with sponsorships and donations, and also help those in need. In 2013, our main sponsorship efforts will be devoted to the largest sports event hosted by Slovenia in 2013 - EuroBasket 2013. As an international financial partner, the Hypo Group will participate as the main sponsor and official financial partner. This will require a focused and united approach of all Hypo Group companies during the whole year.

These sponsorships bring added value to our clients, both existing and potential. During the whole of the year we will organise various activities and promotions to make them feel an active part of these events. To our business partners, this definitely represents an upgrade of our relationship, and further encouragement and motivation to our employees. The "Family Friendly Company" certificate proves that we devote special attention to our employees. In addition to being an acknowledgment of our efforts, the certificate reflects our resolution to make every effort to make it easier for our staff to balance family life and their job.

Our outlook is positive. We are confident that the realisation of our strategy will contribute to our competitive advantage and promotion of development of the economy. We shall continue to develop also in the future. Both the Bank and Hypo Leasing are aware of their mutual responsibility to contribute to economic development and the creation of new jobs.

When our work is at our best, we contribute most to our stakeholders: our clients, local community, employees and owners. We shall continue to make every effort to afford them all attention. We are confident that through our activities we constantly prove that the Hypo Group is one of the best financial organisations, best organised and most productive. We want to be SUPPORTIVE partner, work together with you in a FRIENDLY manner, and most of all FAIR. We believe that our partnership will last for many years to come.

The Management Board

Mag. Marko Bošnjak
Member

Mag. Matej Falatov
Vice - President

Dr. Heribert Fernau
President

1.5 Report by the president of the Supervisory Board

In 2012, the Supervisory Board of Hypo Alpe-Adria-Bank met at four regular sessions. It conducted its work in accordance with the Bank's Articles of Association and the Rules of Procedure of the Supervisory Board. The materials prepared in advance and explanations provided at meetings enabled the Supervisory Board to monitor and oversee business operations of the Bank responsibly and in accordance with the Slovenian and Austrian legislation. Also, the Bank of Slovenia conveyed to the Supervisory Board all the documentation based on the inspections of the Bank's operations.

The Bank's Management Board regularly informed the Supervisory Board members about the Bank's operations.

In accordance with Article 282 of the Companies Act and based on current monitoring of the Bank's operations, on periodical reports by the Internal Audit department and on the unqualified opinion issued by the auditing company Ernst & Young, the Supervisory Board analysed the Report on operations of Hypo Alpe-Adria-Bank in 2012. The Report will also be presented to the Bank's Meeting of Shareholders. The Supervisory Board approved the Management Board's proposal for partial coverage of realized losses, and proposed it for adoption at the General Meeting of Shareholders.

On the initiative of the Supervisory Board, Alexander Picker took over the management of Hypo Alpe-Adria-Bank d.d. in Mostar, Bosnia and Herzegovina, on 1 March 2012. Prior to that, he was the Bank's President of the Management Board, and as of that date, his function was assumed by Matej Falatov, previously the Member of the Management Board. On June 1 2012, dr. Heribert Fernau was appointed new President of the Bank's Management Board, with mag. Matej Falatov as the Deputy President.

Financial markets remained turbulent in 2012. In light of the poor conditions on the financial and economic market and bad business decisions taken in the past, the Bank was again forced to recognise impairments and provisions (although at a reduced level compared to the previous year), leading to a negative result at the end of the year. The Bank paid special attention to risk management, which enabled timely, responsible and appropriate actions and measures to be taken, thus delivering higher safety of operations particularly to its clients.

We believe that the managements of both Hypo Slovenia companies (Hypo Alpe-Adria-Bank d.d. and Hypo Leasing d.o.o.) and our highly motivated colleagues will help create a good and successful future, thus permanently strengthening our position on the Slovenian market and supporting the entire Group.

Johannes Leopold Proksch
President of the Supervisory Board

2 Presentation of the Bank in Slovenia

2.1 Vision

Hypo Alpe Adria is the leading provider of banking and leasing services in the Alpe-Adria region. Our services are founded on reliable relationships with clients, which is our advantage.

We are an international Group operating locally as our roots are set in individual regions and their traditions. Our services are adjusted to the needs of local clients and we assume economic and social responsibility in individual regions. Local roots and our high reliability help us build special and strong relationships with our clients that surpass the purely financial transactions. This is the key characteristic that makes us the leading provider of banking and leasing services in the region.

Mission

Our clients know that we are a reliable partner as we provide sustainable services of the highest quality, thus supporting them in achieving their business and personal goals.

We are a reliable partner, building our services on trust, safety and sustainability. Our employees follow these values and ethical principles and thus contribute to making the Group the best it can be. We believe in the highest possible standards in terms of sustainability and quality of our work and services we provide. This is our contribution to the future of the Alpe-Adria region: supporting our clients in their efforts to achieve their individual personal and business objectives.

Values

Every love begins with flirting and it is this very sensation that leads to a relationship and partnership, which has inspired our values:
F - Fair
L - Local
I - Integrity
R - Respectful and Responsible
T - Transparent

Fair
Our relationships are fair and helpful. We share information and adapt our conditions to the needs of our clients. We do not promise anything that we can't deliver. We are reliable, and approachable even in difficult circumstances.

Local
We are proud to be part of the local community. We are united through common habits and customs, tradition and history. We speak the same language and together we create future.

Integrity
Our integrity shines through the courtesy we show to each and every client. We treat our partners in dialogue as equals and communicate with them in a manner that is frank, fair and polite. Any problems that may come our way are discussed and resolved objectively and amicably.

Respectful and Responsible
We listen to the needs of others with respect, tolerance and responsibility. We value their opinions and listen carefully to them in order to identify with them. We respect agreements made and assist each other.

Transparency
Everything we do is clear and unambiguous and this is true for our internal working relations as well as for our relations with our clients. We reveal processes and facts that lead to our decisions.

Client relations

Supportive. Friendly. Fair.
These words are the essence of our relationships with our clients. They convey what we expect from ourselves and our services.

Our advice is professional and directed towards reaching solutions. We treat our clients with respect, we take time to listen in order to ensure efficient assistance. We act as partners to our clients in order to achieve set objectives. We take the initiative and are always ready and willing to assist whenever the need arises.

Our approach to our business partners is friendly. Everything we do is well considered, reliable and based on our understanding of individual issues. Our response is fast and to the point, we approach every transaction with enthusiasm. Our word is solid and sealed with a handshake; everything we do and each of our solutions are based on the code of ethics. We strongly believe in equal opportunities for all, in fairness and objectivity.

2.2 Milestones in the Bank's history

1994 – entry of Hypo Leasing d.o.o. into Slovenian market
1999 – entry of Hypo Alpe-Adria-Bank d.d. into Slovenian market
2000 – Hypo Alpe-Adria-Bank d.d., Business Unit Celje
2001 – Hypo Alpe-Adria-Bank d.d., Business Unit Maribor
2002 – Hypo Alpe-Adria-Bank d.d., Business Unit Koper and Kranj
2003 – Hypo Alpe-Adria-Bank d.d., Branch Tyrševa, Maribor
2004 – Hypo Alpe-Adria-Bank d.d., Ljubljana at "Stekleni dvor", new headquarters of the Bank
2004 – Hypo Alpe-Adria-Bank d.d., Branch Trg Osvobodilne fronte, Ljubljana and a Business Unit in Murska Sobota
2005 – Hypo Alpe-Adria-Bank d.d., Branch Domžale and a Business Unit in Novo mesto
2006 – Hypo Alpe-Adria-Bank d.d., Business Unit Nova Gorica
2007 – Hypo Alpe-Adria-Bank d.d., Branch Center, Ljubljana and a branch office in Trbovlje
2008 – Hypo Alpe-Adria-Bank d.d., Branch Šiška, Ljubljana, Branch offices in Brežice and Velenje
2008 – New appointment of members of the Management Board
2009 – Hypo Alpe-Adria-Bank d.d., Branch Jesenice
2009 – Changes in the ownership of the Hypo Alpe Adria Group in Austria
2011 – Hypo Alpe-Adria-Bank, d. d., Branch Moste
2011 – Hypo Alpe-Adria-Bank, d. d., Branch Trg Leona Štuklja (change of venue)
2011 – Reshuffle of the Management Board at the initiative of the Supervisory Board
2012 – Changes in the membership of the Management Board

2.3 Corporate and working bodies

According to the Articles of Association, Hypo Alpe-Adria-Bank has the following corporate bodies:

- Management Board,
- Supervisory Board and
- Shareholders' Meeting.

Pursuant to the Articles of Association, the **Management Board** is composed of two or more members appointed by the Supervisory Board. At 31 December 2012, the Management Board members included:

- dr. Heribert Fernau – President of the Management Board,
- mag. Matej Falatov – Member and Deputy President,
- mag. Marko Bošnjak – Member of the Management Board.

Mag. Marko Bošnjak was appointed member of the Management Board on 9 January 2012. Dr. Alexander Picker, the former president of the Management Board assumed a new function of the managing director of the Hypo Alpe-Adria-Bank, d. d., in Mostar, Bosnia and Herzegovina on 1 March 2012. The function of the president was assumed temporarily by mag. Matej Falatov. On 1 June 2012, dr. Heribert Fernau was appointed President of the Management Board, with mag. Matej Falatov as a Deputy President.

As at 31 December 2012, **the Supervisory Board** is composed of four members as follows:

- mag. Johannes Leopold Proksch – Chairman,
- mag. Wolfgang Edelmüller – Deputy Chairman,
- dr. Sebastian Firlinger – Member,
- Marko Popovič – Member.

Shareholders' Meeting

The Management Board convenes the Shareholders' Meeting in cases laid down by law or the Articles of Association or when this benefits the Bank. Three General Meetings of Shareholders were convened in 2012, namely in February, July and December.
At the Shareholders' Meeting, the shareholders exercise their rights in the matters concerning the Bank. Our Shareholders' Meeting is universal as the Bank only has one shareholder (Hypo Alpe-Adria International AG holds a 100 percent interest in the Bank).

Advisory bodies of the Management Board:

- Management Committee

Committees:

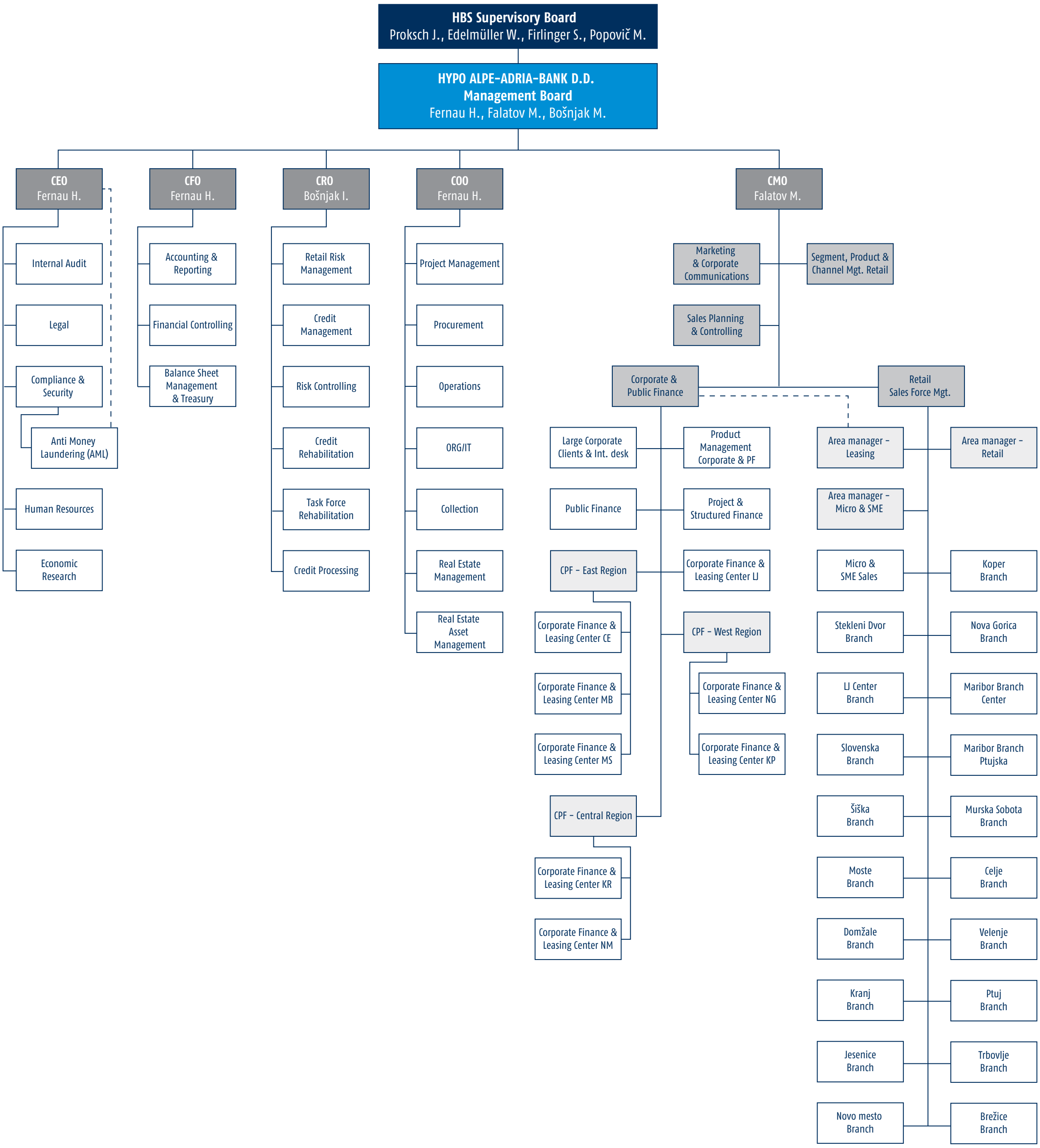
- Liquidity Committee,
- Bank's Credit Committee – PL (Performing Loans)
- Bank's Credit Committee – NPL (Non-Performing Loans),
- Bank's Credit Committee,
- Assets and Liability Committee - ALCO
- Risk Executive Committee – RECO,
- Investment Committee– INCO,
- Internal Control Committee – ICCO,
- Tax Committee – TCO,
- Portfolio Steering Committee – PSC,
- Audit Committee - AC.

The objectives, tasks, authorisations and composition of committees are laid down in the Rules on Organisation and Job Systematisation of the Bank, as well as in the Rules on the Powers, Authorisation and Signatories in the Bank, while the operation of the Bank's corporate bodies is governed by individual rules of procedure applicable in the financial year 2012:

- Rules of procedure of the Hypo Alpe-Adria-Bank Credit Committee
- Rules of procedure of the Management Board of Hypo Alpe-Adria-Bank d.d.,
- Rules of procedure of the Supervisory Board of Hypo Alpe-Adria-Bank d.d.,
- Rules of procedure and authorisations of the Risk Executive Committee of Hypo Alpe-Adria-Bank d.d.,
- Rules of procedure of the Credit Committee of Hypo Alpe-Adria-Bank d.d.,
- Rules of procedure of the Management Board's Credit Committee of the of Hypo Alpe-Adria-Bank d.d.,
- Rules of procedure of Investment Committee for monitoring of specified investments,
- Rules of procedure and authorisations of the Portfolio Steering Committee of Hypo Alpe-Adria-Bank d.d.,
- Rules of procedure of the Credit Committee for monitoring of non-performing loans and special investments,
- Rules of procedure and authorisations of the Assets and Liabilities Committee of Hypo Alpe-Adria-Bank d.d.,
- Rules of procedure of the Investment Committee for monitoring investments,
- Rules of procedure of Capital Committee for monitoring the bank's capital,
- The Group's rules of procedure for managing operational risks, internal control system and risk of loss of reputation of Hypo Alpe-Adria-Bank d.d. and Hypo Leasing d.o.o.,
- Rules of procedure of the Committee for monitoring operational risks, internal control systems and risk of loss of reputation of Hypo Alpe-Adria-Bank d.d. and Hypo Leasing d.o.o.,
- Rules of procedure of the Committee for prevention of fraud in Hypo Alpe-Adria-Bank d.d.,
- Rules of procedure of the Committee monitoring Hypo innovations.
- Rules of procedure of the Audit Committee of the Supervisory Board of Hypo-Alpe-Adria-Bank, d.d..
- The Group's rules of procedure for managing operational risks, internal control system and risk of loss of reputation of Hypo Alpe-Adria-Bank d.d. and Hypo Leasing d.o.o.,
- Rules of procedure of the Committee for monitoring operational risks, internal control systems and risk of loss of reputation of Hypo Alpe-Adria-Bank d.d. and Hypo Leasing d.o.o.,
- Rules of procedure of the Committee for prevention of fraud in Hypo Alpe-Adria-Bank d.d.,
- Rules of procedure of the Committee monitoring Hypo innovations.

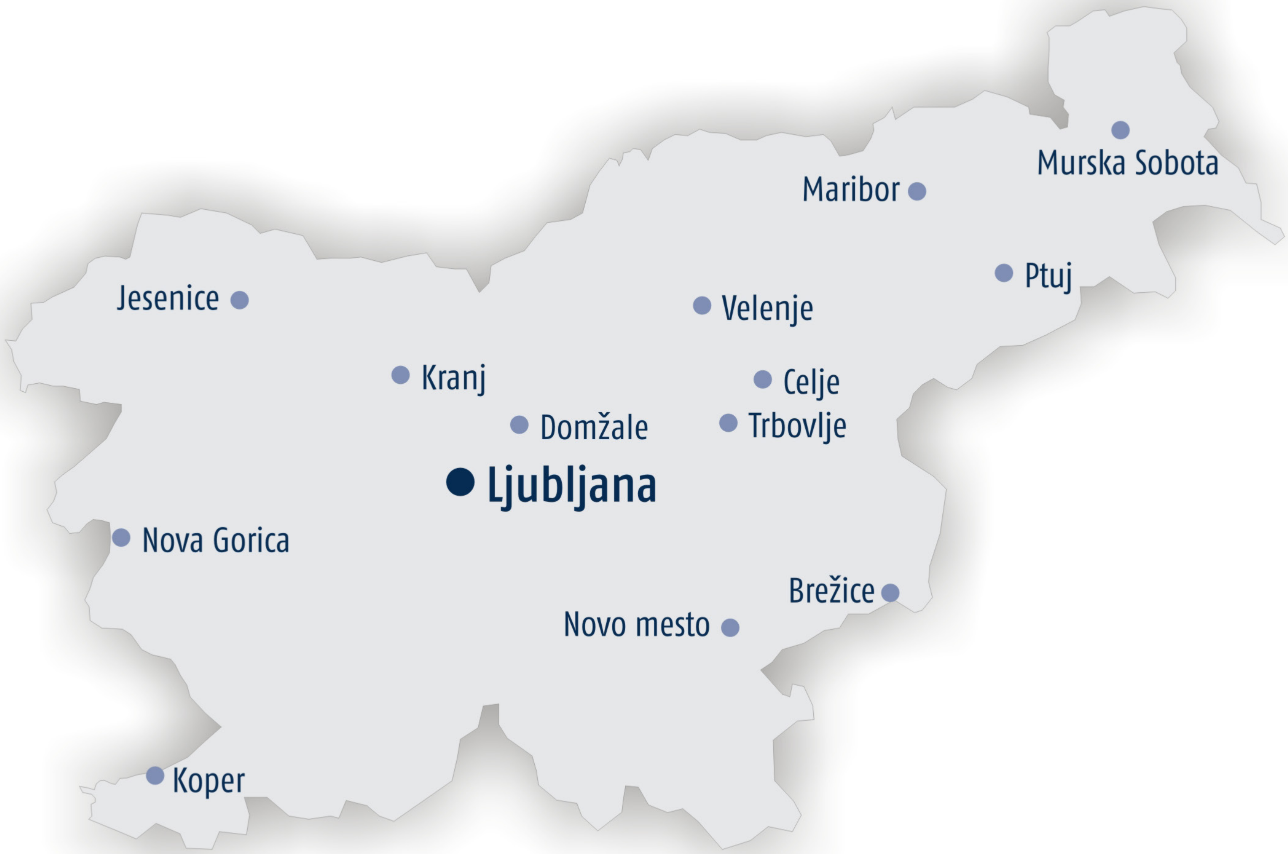
2.4 Organisational structure

As at 31 December 2012.



2.5 Business network

As at 31 December 2012.



3 Business Report

3.1 General economic conditions in 2012

Economic conditions

Europe
Along with deepening financial crisis, European economies faced further decline in 2012. Lack of confidence in economic policies of countries that are deeply in debt, primarily Greece, Spain and Italy, drove higher expectations of return also in other countries. Unstable political conditions and failure to implement the necessary reforms or to implement them at a sufficient pace, added to the market tension. We saw a slight release of this tension in the second half of the year when localised countries gained easier access to international markets.

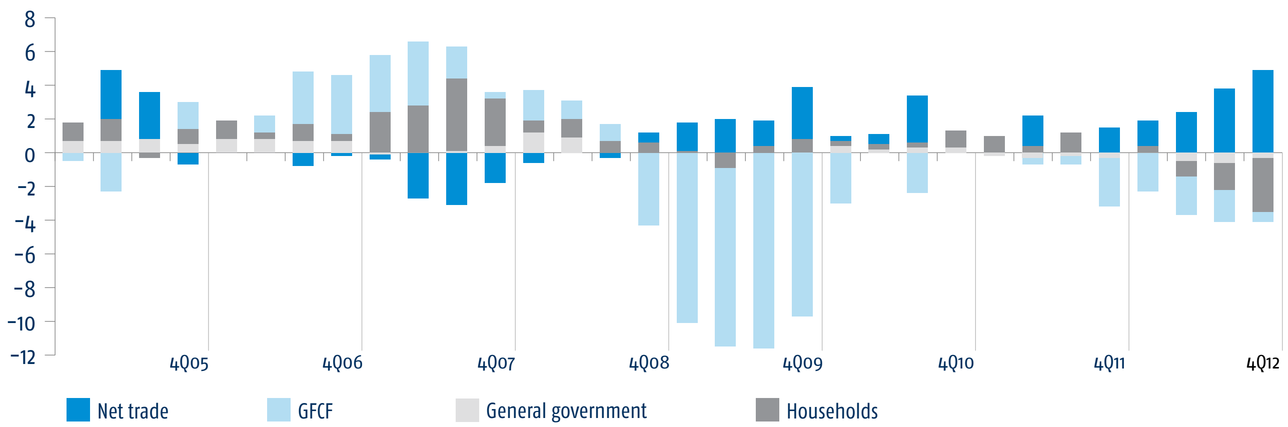
Fear of insolvency of the banking system and additional impairments resulted in formation of additional provisions and in turn, these led to additional capital requirements. In addition, European banks imposed further restrictions on lending, which affected East European markets where countries faced a decline in the inflow of fresh capital.

Slovenia
In 2012 recession again hit Slovenia and economic activity fell by 2.3% as a result of ever decreasing investments due to deleverage of industry and financial sector, decline in government spending due to fiscal consolidation and reduced household spending due to lower income levels, increased unemployment and stricter credit standards. In the year under review, only the net export had a positive impact on the growth in GDP in combination with a reduced import.

In addition **to** the impact this negative trend will have on the next financial year 2013, economy will be affected primarily by the speed by which economic problems and issues are resolved in key EU markets, continued deleverage of key sectors and delays in resolving banking issues such as non-performing loans and capital increase of the banking system. In 2013 we expect a drop in domestic consumer spending as a result of further government austerity measures and divestment of the industry and banking sectors. That there is a real cause for concern is also shown by other indicators such as a declining trend in production orders, drop in employment rate and continuing decrease in retail sales. Potential additional downgrading of the country's credit rating will have an added negative impact on the GDP growth.

Despite these difficult conditions, Slovenia succeeded in keeping a number of key stakeholders that contributed to strong growth in the past such as: young and highly qualified workforce, relatively beneficial fiscal policy, good access to Europe and global financial markets and fairly constant inflow of international investment. Recent progress in the implementation of structural reforms will further promote productivity, flexibility and industry's competitive advantage, which will ensure that Slovenia is once again one of the developed markets.

Due to deteriorating economic conditions, unemployment rose to 118 thousand as the number of employees in the public sector also began to slowly fall. At the year-end, unemployment reached 13%. Additional evidence of the crisis is a decline in actual household income resulting from higher unemployment and austerity measures. In December 2012 the average net salary of €991 was by 3.4% lower than in December 2011.



Significant macroeconomic indicators

	2007	2008	2009	2010	2011	2012n	2013n	2014n
GDP in EUR million, current prices	34.6	37.2	53.6	35.6	36.2	35.8	35.5	36.2
GDP growth in %	7.0	3.4	-7.8	1.2	0.6	-2.5	-2.2	0.6
Private consumption (%)	6.2	2.5	0.2	1.4	1.0	-2.4	-3.2	0.0
Investments (v %)	13.3	7.1	-23.2	-13.8	-8.1	-10.0	-4.4	0.3
Industrial output	7.2	2.5	-17.4	6.2	2.2	0.7	-1.0	1.6
Unemployment rate (survey) (%)	4.9	4.4	5.9	7.3	8.2	8.6	9.8	9.7
Average inflation (%)	3.6	5.7	0.9	1.8	1.8	2.6	2.5	2.5
Inflation at year-end (%)	5.6	2.1	1.8	1.9	2.0	3.1	2.1	2.5
Nominal change in salaries (%)	5.9	7.9	3.4	3.9	2.1	0.4	-1.1	0.8

Decline in consumer spending and poor labour market conditions both impact the banking operations and despite relatively low level of indebtedness of Slovene households, the volume of financing has been falling through the financial year 2012. This, and the way real estate market is developing, brings an additional level of uncertainty and prudence.

Banking environment in Slovenia

For the third year running, Slovenian banking system will record negative as the result of the first nine months is pre-tax loss of €769 million. The negative result arose on account of the government having difficulties in accessing financial markets as it was not until late in 2012 when Slovenia finally succeeded in securing funds on financial markets. The financial crisis shook banking confidence all over the world and as a result, Slovenian banks relied above all on deposits from the domestic market, which was at the beginning of the year only slightly eased by the refinancing of the Euro system. At the same time, lending activity of banks declined due to lower demand on the local market as a result of economic conditions, as well as poor liquidity and deteriorating credit portfolio, combined with austerity measures brought about in order to balance out the budget deficit. This resulted in a number of investment projects to be put aside and reduced the likelihood of any potential stimulation activity.

These negative effects are the result of deteriorating credit portfolio and slow recovery of non-performing loans, including the slow pace of establishment of a bad bank. Credit portfolio deteriorated in the first nine months of 2012 and the share of borrowers who are experiencing problems with servicing their liabilities has drastically increased; in delays over 90 days, this share rose to 14.2 per cent as a result of heightened conditions faced by households and corporates alike, and this leads the banking system in having to set aside additional provisions.

In 2012 we saw continued tightening of credit standards resulting in a more selective approval of loans and pursuing price policy based on risk. The core issue is the unresolved problem of bad portfolio which affects not only the revenue, but also capital adequacy, and the Slovenian banking system has been facing the issue of adequate and sufficient management of capital requirements since the start of the crisis. Due to capital inadequacy, a number of banks reduced their credit portfolio, withdrew from non-strategic activities and decrease investments, as they had no access to either short-term or long-term financing on international markets.

Expectations for the financial year 2013 remain negative. Deteriorating credit portfolio, combined with increased delays in repayments and increasing costs of financing due to restructuring of banking debt, will lead to reduced income effect and in 2013 we anticipate a 10 per cent reduction in net interest income. Interest income is affected by poor credit demand due to tightened credit conditions, uncertainty in terms of potential further reduction in credit rating, higher costs of refinancing, and slowdown of economic growth in Slovenia as well as the most significant export markets.

3.2 Business results in 2012

Financial highlights

EUR '000

INDICATORS	31.12.2012	31.12.2011
1. BALANCE SHEET		
Balance sheet total	1,900,801	1,977,634
Aggregate amount of deposits by non-banks	727,987	713,632
a) legal and other persons	474,921	484,691
b) retail	253,065	228,941
Aggregate amount of loans to non-banks	1,643,995	1,750,239
a) legal and other persons	1,080,884	1,172,123
b) retail	563,567	578,117
Total capital	153,062	160,112
Impairment of financial assets at amortized cost, and provisions	69,146	56,225
Off-balance-sheet items	896,716	880,539
2. INCOME STATEMENT		
Net interest	33,396	40,587
Net non-interest income	10,041	3,939
Labour costs, general and administrative expenses	28,983	27,500
Amortization/depreciation	2,318	2,417
Impairments and provisions	-23,364	-49,734
Pre-tax profit/loss from ordinary and discontinued operations	-9,663	-33,843
Income tax from ordinary and discontinued operations	-1,753	6,977
3. PERFORMANCE RATIOS		
a) Capital		
Capital adequacy	13.46%	12.81%
b) Quality of assets		
Impairment of financial assets at amortized cost and provisions for commitments/reclassified items	3.31%	2.73%
c) Profitability		
Interest margin	1.71%	2.03%
Financial intermediation margin	2.22%	2.22%
Pre-tax return on assets	-0.49%	-1.69%
Pre-tax return on equity	-6.12%	-21.54%
Return on equity after tax	-7.23%	-17.10%
d) Operating costs		
Operating costs/average assets	1.60%	1.49%
e) Liquidity		
Average liquid assets/average short-term deposits of non-banks	7.64%	13.59%
Average liquid assets/average assets	2.05%	3.26%
4. EMPLOYEES		
At year-end	473	465
5. SHARE VALUE AT YEAR-END		
Number of shareholders	1	1
Number of shares	41,706	41,706
Book value per share	3.67	3.84

Performance ratios are calculated using the Bank of Slovenia methodology.

Financial position

At 31 December 2012, **the Bank's balance sheet total** amounted to €1,901 million, representing a 4 per cent nominal decline as compared to 2011. The Bank is striving to maintain stable balance sheet total in line with its strategy of maintaining its market share.

The **structure of assets** is similar to the one recorded in 2011. The share of loans to non-banks accounts for 87 per cent of assets, whereas structural changes of other assets were only minor.

During the year the **structure of liabilities and equity** was changing, with the share of primary sources (used by the Bank to improve diversification of its sources of financing) rising to 38 per cent, whereas bank deposits and loans dropped from 51 to 49 per cent. Structural changes of other liabilities were only minor.

Loans to banks increased by 93 per cent in 2012 to €39 million at the year-end. Almost total amount represents sight deposits.

Loans to non-banks fell in 2012 by €104 million or 6 per cent, primarily due to the reduction in loans to corporate and other entities and the Bank's policy aimed at securing a more balanced credit portfolio. As at 31 December 2012, loans to non-banks amounted to €1,646 million.

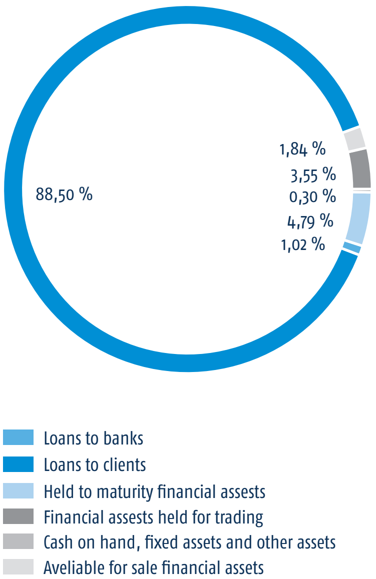
Financial assets held for trading decreased by 76 per cent in 2012 as a result of revaluation and disposal of certain financial assets. At the end of the year, financial assets held for trading amounted to €6 million.

Available-for-sale financial assets decreased as a result of restructuring of the bonds portfolio held to maturity and

Structure of assets

2011

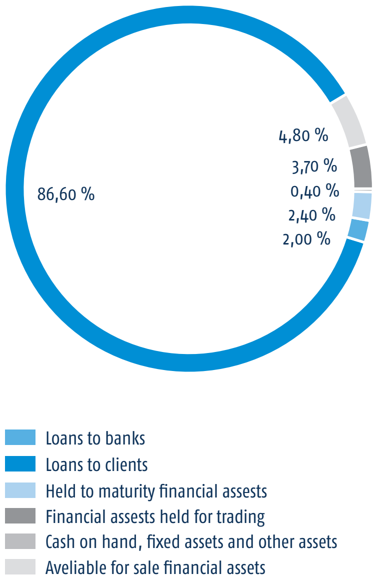
(%)



Structure of assets

2012

(%)



exchange of the Banka Celje bonds after the new issue. The portfolio balance at the end of 2012 amounted to €46 million, accounting for 2 per cent in the structure of total assets.

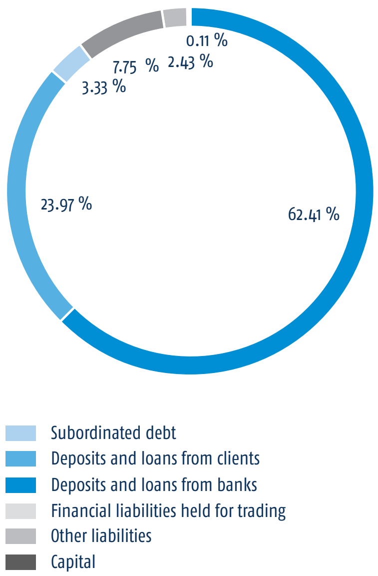
Financial assets held to maturity increased by 148 per cent in 2012 to €91 million at the end of the year; they account for 5 per cent of the total assets.

Financial liabilities to banks represent the largest share in the total structure of liabilities and capital with 52 per cent, and have, compared to the previous year, decreased by €77 million. At the end of 2012 they amounted to €997 million, of which €73 million is subordinated debt and the remaining amount represents deposits and loans from banks. With regards to the structure, liabilities to other banks are on the increase, whereas liabilities to the parent bank are decreasing although they still account for the major share of the sources of funds received from banks.

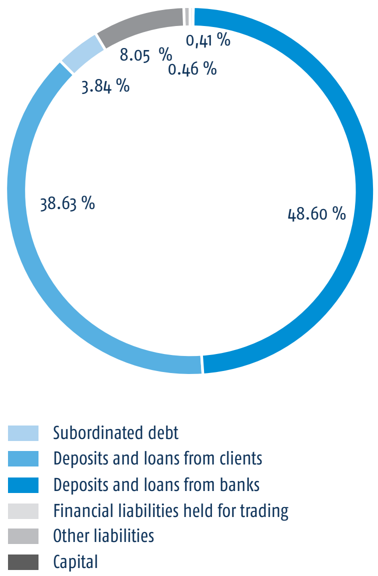
Financial liabilities to non-banks increased by €21 million or 3 per cent to €734 million at the end of 2012. This increase is the result of our intense efforts to strengthen the primary sources and is in line with the Bank's strategy of restructuring the liabilities towards primary sources of funds.

The equity of the Bank decreased in 2012 by 4 per cent as a result of the operating loss. However, in spite of this, capital adequacy of the Bank was never jeopardized.

Structure of liabilities and equity
2011
(%)



Structure of liabilities and equity
2012
(%)



Financial result

- **General**

At the end of 2012, the result of the Bank's financial and operating activities was a loss of €11,416 thousand and represents a slight improvement compared to the loss of €26,886 thousand reported in 2011. This improvement is primarily due to decrease in impairments of non-performing loans, which in turn was a result of transfer of a portion of loans to non-banks to a group company at the end of 2011. The effect of this transfer was reflected in the Bank's result in 2012 when compared to the previous year, loan impairments fell by 54 per cent.

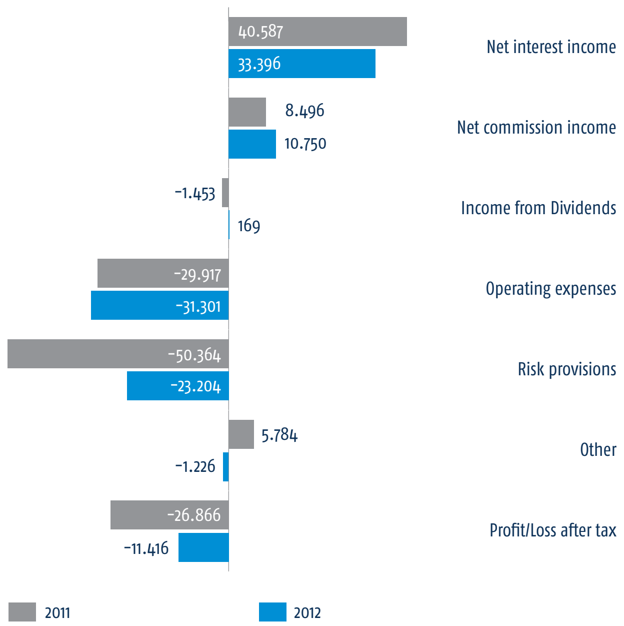
The Bank recorded net financial and operating income of total €45,001 thousand, a drop of 2 per cent compared to the year-end 2011. Administrative costs, labour costs and depreciation expenses amounted to €31,301 thousand, a 5 per cent increase over the 2011 financial year. Impairment of financial assets not measured at fair value through profit or loss and provisions for off balance sheet liabilities amounted to €62,316 thousand at the end of 2012.

- **Interest and fee and commission**

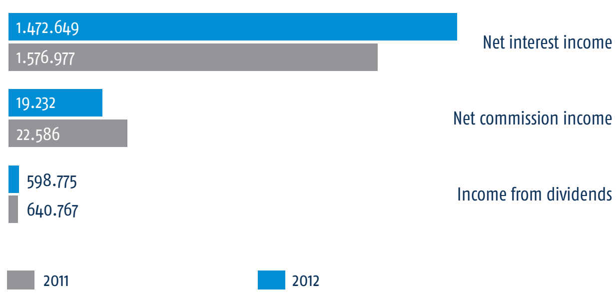
Net interest income amounted to €33,396 thousand at the end of 2012 and represents an 18 per cent decrease over the previous year. Net interest income represented, with 75 per cent, the majority of total net income. In the net income structure, the share of net interest dropped by 18 percentage points along with a decrease in the net result from financial assets available for sale, whereas the share of net fees and commissions rose by 27 percentage points. Decline in the net result from financial assets held for trading is a consequence of circumstances on capital markets and economic environment in 2012, and a more conservative policy pursued by the Bank.

Drop in the net interest income resulted in lower interest margin which decreased from 2.03 per cent in 2011, to 1.71 per cent in 2012.

In 2012, the Bank recorded €840 thousand of dividend income, a drop of 11 per cent compared to the previous year. This decline is a result of reduction in dividends from shares of Mercator and Petrol, which are classified as available-for-sale financial assets.



Income from dividends, net commission and interest income



Net fee and commission income amounted to €10,750 thousand at the year-end and accounted for 24 per cent of the Bank's net income. Compared to 2011, they rose by 27 per cent. In nominal and real terms, the increase was a consequence of increased volume of fees and commission from credit and guaranty transactions, as well as a result of the increase in other fee and commission income. Despite a reduction in the gross amount of lending to non-banks, the amount of the related fee and commission rose on account of fee and commission income from transactions with the Slovene Enterprise Fund. Increase in the other fee and commission income arose on transfer of a portion of credits to non-banks to a group company and which is subject to fee and commission charged for portfolio management. The achieved net fees and commissions covered 37 per cent of the Bank's administrative costs, which represents an increase of 6 per cent compared to the previous year. If only labour costs are considered, the coverage amounts to 71 per cent.

- **Financial assets**

Realised loss from financial assets and liabilities not measured at fair value through profit or loss amounted to €1,155 thousand at the end of 2012 and reflects a decrease in income from the sale of shares from the bank book. This relates to the sale of shares of Mercator and Sava, which in the financial year under review lost more than 20 per cent of their average price.

Net gains from financial assets and liabilities held for trading amounted to €484 thousand, which is a major improvement compared to the previous year (121 per cent more than the year before). In 2011, we incurred loss in the amount of €2,308 thousand primarily from futures. The volume of transactions in futures decreased drastically in 2012 and in the financial year under review, major contribution to the gains from financial assets and liabilities held for trading comes from the positive result from trading in interest swaps.

The Bank realised €110 thousand of net loss from foreign exchange differences. Compared to the previous year, in 2012 there was a decline in the amount of exchange rate differences as a result of a decreased volume of transactions in foreign currencies and improved stability of the exchange rates.

- **Costs and provisions**

In 2012, administrative costs amounted to €28,983 thousand, representing approximately 5 per cent increase against 2011. A major portion of administrative costs is attributable to labour costs which accounted for 53 per cent or €15,225 thousand. General and administrative expenses accounted for the remaining 47 per cent or €13,578 thousand.

The depreciation costs amounted to €2,319 thousand in 2012, which represents a decrease of 4 per cent compared to the previous year.

In 2012 the Bank set aside another €160 thousand of net provisions, which represents a decrease of 75 per cent compared to the financial year 2011. Despite a €685 thousand increase of provisions for termination benefits resulting from the restructuring process, the net decrease in total amount of provisions set aside is due to the reduced amount of provisions for off-balance-sheet liabilities.

3.3 Bank's operations by segments

Corporate banking

Strategy and Results of Operations in the Corporate Banking Sector

Economic recovery, so eagerly awaited and expected in 2012, did not materialise and Slovene economy continued its downturn. While certain sectors such as export-oriented companies and hi-tech companies recorded certain levels of growth, business was much slower for companies in the construction sector, real estate and financial sector. Continued crisis had a significant effect on trading companies as both wholesale and retail trade declined. On the other hand, in 2012 the banks were subjected to more expensive sources of financing than in the years prior to the economic crisis. In the beginning of the year the Bank of Slovenia intervened, however not all banks complied with its recommendations and as a result there was no positive effect on decrease of prices of financing.

As a consequence, banks pursued a more prudent and conservative investment approval policy, which in turn resulted in a decline in credit activity in the segment of corporate banking. At the end of 2012, Slovene banks registered a 7.69 per cent drop in loans approved to corporates and other clients compared to the previous year.

The volume of loans approved to clients in the Corporate Banking sector by Hypo Alpe-Adria-Bank in 2012 fell against the volume reported in 2011, as is true for corporate banking sector of all banks. In 2013, our primary focus will be devoted to regular servicing of existing liabilities by borrowers and the funds collected will be re-invested in the Slovene economy in full compliance with the credit policy of the Hypo Group and prevailing market conditions in the Slovene economy.

Significant progress was made in 2012 in terms of repricing. We continually monitored contractual terms agreed on existing transactions and clients' compliance. The average margin was increased for the whole portfolio by approximately 4 base points and this had a significant positive impact on the Bank's performance.

Increasing the share of fee and commission income in total income of the sector remains one of the key objectives. In 2012, fee and commission income from the Corporate Banking sector amounted to €5,259 thousand, which accounts for 10.8 per cent increase compared to the previous year. An increase is also planned for 2012, will be achieved mostly by cross-selling of the remaining products (payment transactions, investment banking, derivatives, documentary businesses, and leasing services) thus increasing the variety of services provided to individual clients, as well as by strengthening the existing and introducing new products and services. Before approving any investments, we check the client's performance and identify its needs so we can offer additional banking services that are most suited to the individual client.

In the Corporate Banking sector, client deposits represent an important element of managing the Bank's liquidity and collection of available financial assets will continue to be one of the Bank's priorities. Through increasing the number of clients, we will continue to reduce dependency on individual large clients. In line with this policy, reduction in the average amount of individual deposits is along with the increase of the total amount of deposits, one of our main priorities.

The project of introducing a single strategy of the Corporate Banking sector to the entire Hypo Group characterised a large portion of 2011 and 2012 and established a solid foundation for further operations. In 2012 we established joint sales and marketing teams composed of the Bank's staff as well as staff from our sister company Hypo Leasing. The strategy behind this approach to the market is to take full advantage of client potential, namely clients that are currently only clients of either the Bank or Hypo Leasing. In 2012 we have already felt some positive results in increased number of active clients, growth in services, improved transparency of operations as well as in other areas.

The strategy of client relations management is one of the key factors of success and further successful operations of the Bank in the Corporate Banking sector. The key element of this strategy is precise task definition for managers of individual clients and groups of related companies (so called, global client trustee). The objective we pursue is deepening of our relations with clients and developing long-term partnership cooperation with them. Each individual manager should have an excellent knowledge of his clients to be able to identify their individual needs and requirements. We are sure that in the forthcoming year, which is expected to be another challenging one and one where no recovery in the Slovene economic position is expected in the first half of the year, partnership cooperation between the Bank and individual clients will be of utmost importance.

Distribution channels

One of our significant competitive advantages remains cross-selling of various banking services within the Bank and within the Hypo Group Alpe Adria in Slovenia, which consists of our Bank and Hypo Leasing.

Business cooperation with our sister banks within the Hypo Group Alpe Adria, which runs through the so called Hypo Group Network, is the added value which we can offer to our clients. The Hypo Group Network was established as a joint project of banks and leasing companies in the Hypo Group Alpe Adria with the purpose of assisting the clients of the Hypo Group Alpe Adria to establish business partnerships in the Alpe-Adria region.

In addition to the Bank's competitive advantages already mentioned, in cooperation with CRM we will develop quality lists of target clients for each individual region separately and identify potential clients who, in terms of their activities and financial indicators, comply with the Bank's lending policy. This will provide clear objectives and criteria for the managers to assist them when acquiring new clients and this will bring additional added value to the Bank and increase the volume of operations primarily on account of non-interest income.

We see major potential in empoloyees of the companies that are our clients. Partnership concept, where Corporate and Retail client trustees give presentation of advantages the Bank offers, will be one of our most important tasks in the forthcoming year and we anticipate major increase in the number of retail accounts.

The development of information technology also had an effect on banking, in that the traditional model of banking operations, carried out through branch offices, is increasingly being replaced by modern banking channels which use electronic communications between a bank and its clients. Marketing of banking services through direct contact between a bank's adviser and the client will continue to play an important role in deepening and developing of long-term partnership cooperation with our clients. On the other hand, development of modern banking channels will enable the Bank to attract also those clients who prefer more sophisticated type of operations.

Objectives for 2013

We will continue our successful operations of the Corporate Banking sector of the past years also in 2013. We build our competitive advantages on solid foundations, which we established with a clear strategy, directed to:

- Acquiring new clients in the sector of small and medium--size companies,
- Offering structured services (cross-selling of combined banking services suitable for our business partners),
- Increasing the number of services per client; increasing the number of transaction accounts, increasing the volume of payment transactions with existing clients, increasing the market share in the area of letters of credit and deposits,
- Taking full advantage of the Hypo Leasing clients' potential,
- Focussing on employees of corporates who are our clients in order to increase the number of retail transaction accounts,
- Contributing to the overall result of the Bank through cross-selling of various banking services,
- Increasing overall income of the Corporate Banking Sector, primarily on account of non-interest bearing income. Main focus will be on Trade finance and Guaranties as these transactions do not require high (expensive) liquid assets, while providing commission (non-interest bearing) income,
- Trustees will continue to regularly monitor servicing of contractual commitments by clients of the Bank and Hypo Leasing, while strictly complying with the Bank's pricing policy,
- Developing highly experienced and professional employees and optimisation and modification of business processes.

Retail banking

The 2012 financial year was marked by deteriorating economic conditions, which was reflected in lower demand for goods and services, as well as banking services. For this reason, in retail banking sector, which is divided into a larger »sales force« comprising of a complete sales and business network of 19 branch offices, servicing retail clients, small companies and sole proprietors, and product management comprising of business support and new product development, all our efforts were directed towards innovative approach, profitability and high quality of our services and products that may be of interest to our clients.

The year 2012 was very interesting with the introduction of new projects, implementation of the business rationalisation process, cost efficiency and changes to working processes. Throughout 2012, we carried out activities to finally merge the retail banking and the leasing sector into a single unit of the Bank and Hypo Leasing through a business centralisation project.

Business strategy

In the area of retail banking and transactions with sole proprietors and limited liability companies, the Bank continued with its modified strategy of deepening the relationships with individual segments of clients and of ensuring even better attention to the personal approach, which it started already in 2010 with the fundamental aim of increasing the number of clients and the number of sold products per client.

In the first half of the year, the Bank continued with the implementation of a new management concept, i.e. SFE II – Sales Force Effectiveness in order to increase the sale of services per client particularly with a different work organisation and an increase in the productivity especially in the sector of individual clients. The project, which began in 2011, was continued through the 2012 financial year with specific focus on SME clients. The project was implemented at the Group level and introduces completely new roles and approaches to the SME department and is aimed at increasing sales:

- Sales organisation: extension of the opening times
- Sales tools: we additionally equipped our sales staff with sales tools that have increased sales performance.
- Sales monitoring: we inspired our sales staff with motivational tools to ensure better sales performance and to increase the transparency of operations.

In July, the SFE project was successfully introduced in all 19 branch offices of the Bank in Slovenia. The results of the sale of bank services and attracting new clients show that the SFE project had a positive impact on the improved efficiency of the sales network.

In September we began introduction of a new project: »Card strategy« aimed at increasing income from card transactions. Huge amount of efforts is devoted to the sale of insurance products of three insurance companies we cooperate with and market their products.

While our focus was on these projects, we complied with the new credit policy, faced the challenges of worsening market conditions and strived to maintain liquidity.

We continued with implementation of a new concept of advising to affluent clients. It represents an expansion of a special relationship with more demanding clients. By supporting tailored services for individual segments and taking care of a comprehensive solution of client needs and wishes, we pursued the goals of positive operations of the Bank, in particular:

- To strengthen client loyalty,
- To keep and stabilise the existing asset portfolio of the Bank's clients,
- To increase the cross-sale indicator with a special client approach,
- To attract new clients.

One of the most significant projects of the Hypo Group, »Service Quality« project, has been introduced in all the Group companies in all of the Hypo countries. The project, which began in April was completed at the end of the year. The project aims to set up new standards in client relations thus raising quality of our services and increasing the Bank's income.

The project was carried out in the following three stages:

a) Setting up standards for customer complaints: a new concept has been introduced, which is supported by a new software tool and will be used throughout the Bank.
b) Setting up standards for client services, employee standards and branch office standards. All employees working in the retail services sector attended training where they became familiar with the standards applicable to servicing retail clients.
   The Bank will carry out regular checks of customer satisfaction, the results of which will also provide information on work practices of individual branch offices.
c) Simplification of services and processes. At this stage, certain services and processes will be simplified and shortened to allow for improved work in the commercial sector and increased client satisfaction.

This is another way in which we are improving the Bank's high standing and recognition.

Later in the year, there was a major change in the organisation of the Bank. Through unification of supporting services and centralisation process, a part of the sales support was moved out of the branches in order to move mass transactions out of branch offices so that banking consultants can devote their attention to more demanding sales efforts.

Integration of the leasing network into two networks (corporates and retail sector), is proving to be a major project. In retail clients sector, there are three sales segments to be led by three segment managers: public, micro and leasing.

Transactions in 2012

The results of the modified strategy of these segments are evident in the number of sold services per client, per employee as well as per branch office. In 2012, the Bank increased the number of retail clients by 5.4 per cent.

Retail banking – Commission income resulting from a higher number of services per client and more frequent use of individual services grew by more than 18 per cent in 2012 as compared to the year before. The highest growth was recorded in the commission income from transaction accounts (45%), ATM (37%), e-banking (135%) and card transactions (10%).

Micro-enterprises – Commission income resulting from a higher number of services per client and more frequent use of individual services grew by over 23% in 2012 as compared to the year before. The highest growth was recorded in the commission income from loan approval (65%), transaction accounts (13%), card transactions (131%), e-banking (41%) and payment transactions (5%).

Operational support, product management and sales channels

In terms of banking products for retail clients, we successfully upgraded our existing products and introduced two new products: »Sowing Package« for farmers and »Car Package« for marketing through car dealers. In addition, three new packages of services were introduced for use by micro companies.

In 2012 we began active approach to process management and more effective sales support. We upgraded software tool Neoarc used for processing credit requests and this will be continued in 2013 with introduction of proposals for credit limits, packages and credit cards.

The business strategy of new sales channels was based on searching for new possibilities to improve sales performance and on an increased diversification of the loan portfolio through intensive sales of consumer loans by including new loan agents and special offers for promotional activities on special occasions or agreed dates.

The cooperation between the retail banking and leasing sector further strengthened as a result of integration of the product and sales channels at Hypo Leasing with the banking into one department, which allows for even more harmonious operations and consequently better and more coordinated services and activities.

In 2012 we also completed negotiations and included Hypo Leasing in the Hypo Club loyalty programme; as part of this, we issued a printed version of the catalogue.

Our objectives for 2013

We will continue to specialise on individual segments of clients, following the principle and the projects started in 2012. We are continuing work on the loan policy renewal for retail banking to enable electronic granting of loans, merging various applications that are an integral part of the loan process, and shortening the approval process, which will be reflected in lower operating costs and a much more transparent risk management as we are devoting much attention to the quality of our portfolio and this remains one of our priorities.

Results of surveys show that clients are satisfied with our services. This is primarily due to our employees who, despite difficult business conditions, are able to present to individual clients advantages of doing business with the Bank and thus promote the sale of our services.

The latest independent analysis (Project customer satisfaction and market research-GFK) showed high satisfaction level of our clients, which proves that we have made the right decisions.

Our card transaction services and sale of insurance products will be upgraded in 2013 as we begin marketing more extensive and renewed services to achieve key objectives of fundamental modernisation of the retail client services.

The main focus in the forthcoming year will be on continued implementation of our Service Quality and Complaint management projects, which will result in improved quality of our services. This will be achieved with further training of employees, improved work processes, a comprehensive offer of services by the Bank and Hypo Leasing, efficient risk management, profitability of sales and cost reduction.

Financial markets

Treasury Sales

After a highly successful year 2011, the success continued in 2012 as a result of high quality client advisory services, enlargement of the solution package and our focus on target clients. We focused our activities on long-term cooperation with clients at all levels and additionally strengthened already fully established principle of cross-selling of services. As expected, the general situation on financial markets in 2012 deteriorated further and required additional efforts devoted to monitoring of financial risks related to our clients. The result of this additional monitoring and risk adjusted strategy in 2012 our treasury sales department performed very successfully and achieved the objectives set in the beginning of the financial year. Projects implemented in the retail client sector are currently in progress and thus we have realised all our goals.

The forthcoming financial year 2013 will be a turning point. Challenges will be even bigger as there is an increasing gap between the European and Slovene market. Thanks to our new services, we are able to offer to our clients solid solutions, tailored to their individual needs in addition to existing ones, thus increasing our range of services. In 2012 we put higher emphasis on education and training of the Bank's employees, and we will pursue this policy also in the future. We intend to meet with our clients at every possible opportunity: at business meetings, seminars and other events. In addition, in 2013 our aim is to penetrate the commodity market with a range of our services

ALM

In 2012, the assets and liabilities management department ensured the Bank's liquidity balance in accordance with the adopted policy of the Group and within set limits. The Bank experienced no problems with liquidity, also due to the provision of suitable amount of liquidity reserves. Besides liquidity management, the department also manages the banking and trading book and the Bank's assets and liabilities in terms of the currency and interest rate risk. With the aim of improving financial risk management, we introduced new derivatives and certificates of deposit. As the first Bank in Slovenia, in 2012 we began the securitisation project aimed at the existing portfolio of SME credits. This will become one of the alternative means of refinancing the Bank in the future and we expect the project to be completed by the summer 2013.

Capital Markets

On capital markets, the Bank recorded an increase in revenue compared to the previous year. Despite distinctive deterioration of conditions on capital markets due to poor macro data from Euro zone, USA and China, weak market liquidity, lack of interest of domestic investors on financial markets and high lending interest rates, the capital markets department achieved its planned level of commission income. In February the transfer of clients and portfolio from the Certius stockbrokers to the Bank was completed and this was reflected in increased turnover on local and foreign markets. In June we introduced custody services on the Slovene market, aimed above all at foreign institutional clients. Most of our efforts were devoted to the asset management and active processing of stockbrokerage clients. Marketing activities and further development of both services to a high professional level were at the forefront of our endeavours. In December we introduced web application HypoBroker, which allows for real-time trading at the Ljubljana stock exchange, live monitoring of stock prices and access to the securities portfolio at the Bank.

In the forthcoming year, our focus will be firmly on increasing income from stockbrokerage on foreign markets (optimisation of Slovene and Balkan portfolios), attracting new active clients on the local market through HypoBroker application, attracting institutional investors with our trustee services (for large local and foreign investors), promoting sales through direct marketing, attempting to takeover other stockbrokerage firms and, above all, on increasing the number of clients and volume of assets under management.

Operations

At the end of 2011 we established an Operations department and in 2012 we implemented the process of centralised loan approval process for individuals and leasing of movable property. Added value provided by this centralised approach is a clear segregation of supporting functions from the sales in order for the sales department to focus only on sales, optimisation of processes, major reduction in credit and operational risks, and improve efficiency by 30 per cent. The process will continue in 2013 and is aimed primarily at optimisation of the application support, which will allow for additional improvement in efficiency. In 2012, the process of archiving both banking and leasing documentation was also centralised and this will provide for better transparency and easier access to documentation. The process will continue throughout the forthcoming financial year.

Our aim for 2012 was to optimise work processes and software in all banking areas within the Operations department. The result of this was provision of faster and improved services to our clients.

Payment services

The incorporation of Slovenia into the European payment systems brought numerous changes and activities in the sector of payment operations for the Bank and 2012 proved to be another dynamic year in this particular sector.

After successful migration of loan repayments, standing orders and mass payments to the SEPA scheme, in 2012 our efforts were directed towards migration of direct debits for recipients of payments under B2B and CORE schemes. In accordance with the plan harmonised at the level of the Bank Association of Slovenia, we completed migration of existing mandates to creditors under the SEPA DD scheme.

Furthermore, in 2012 we completed migration of pensions to the SEPA payments in accordance with the plan adopted by the Bank Association of Slovenia.

As regards the domestic payment transactions, we recorded a 23 per cent increase in the number of transactions on the outflow side compared to the year before, and a 39 per cent increase on the inflow part. On the other hand, the volume of payments decreased by 23 per cent. The increase in the number of transactions was expected since following the discontinuation of the Bankart centre, all the transactions which were processed through the file system in the past, were transferred to the SEPA payment system.

The volume of cross-border SEPA payments in Target2 system increased by 13 per cent. There was also a noted increase in the SEPA payments by 25 per cent as new participants continue to adopt the SEPA scheme.

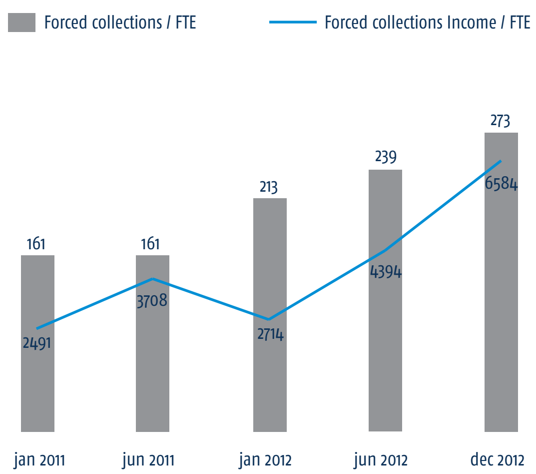
Payment transactions which were processed through a correspondence network increased by 7 per cent compared to the financial year 2011. However, we have noted a slight decrease in the volume of payments in cross-border as well as other payment transactions.

Card transactions

We participated in the introduction of a black card for clients of consulting banking.

Transaction accounts

As part of the optimisation process, we implemented a project of scanning resolutions on forced collection of various issuers (courts, tax administration and customs administration) and their importing into internal application which allows for a faster and more efficient processing of forced collection resolutions as illustrated in the chart below.



In 2012, the National Assembly passed a new Act on prevention of late payments, which, among other provisions, introduces a new instrument - an enforcement draft, which has already been established as an instrument used by creditors and debtors alike, Furthermore, the new instrument can be cashed at banks where debtor has his/her transaction account. To process the enforcement drafts, the Bank has provided the relevant software to ensure legal, timely and efficient processing of enforcement drafts.

In addition, in 2012 we participated in the transfer of the e-account to the processing centre.

Treasury support and IB

We actively participated in the implementation of projects that were in progress on financial markets as follows: transfer of stockbrokerage services from BPH Certius to the Bank, assuming custody over securities, and implementation of derivatives (FRA, BASIC SWAP,SWAPTION).

Documentation Centre

At the beginning of 2012 a new Documentation Centre began to operate, which will integrate the employees of the Bank and Hypo Leasing.

The centre is responsible for efficient recoding of received mail, dispatch of mail, processing of documentation in a hard copy, and getting documentation ready for scanning.

The majority of documentation is scanned at the end of the daily process. Digitising process is partly performed by ourselves and partly by an external contractor who digitises documentation at the end of a daily process.

However, as documentation scanning at the end of the daily process is not the best solution, we have included the scanning process in the existing work process so that some documentation can be (and already is) scanned at the beginning of its processing. This allows for improved access and transparency of documentation. On the other hand, by doing this we relieved the sales department of this particular task. This optimisation process will continue throughout 2013.

Support to loan transactions

Activities of this department are closely tied to the RBACKO project whose aim is centralisation of back office support services of the Bank and Hypo Leasing, their integration and process optimisation.

In the beginning of 2012, 19 members of staff worked in back office support services of the Hypo Leasing business units. By 15 September 2012, the function was completely centralised in the Ljubljana area and employees were reallocated to the Operations or Business support departments. As from 1 October 2012, a new credit approval policy was adopted for leasing transactions and as from November, all lease arrangements with retail clients have been centralised in accordance with the newly adopted policy. This resulted in rationalisation of processes and implementation of a standard process for the whole of Slovenia, which significantly reduced operational and credit risks. Furthermore, the new department assumed all activities related to inflows and outflows for the complete business operations of Hypo Leasing.

In terms of banking, all active banking transactions from the back office services provided by 19 business units were centralised. A new credit approval policy was adopted and successfully implemented for all retail clients. Business processes were standardised and certain documentation was either discontinued or upgraded. All active banking services other than limits, packages, card transactions and housing loans, were centralised. The remaining services will be centralised in the first quarter of 2013.

In the financial year 2013 we intend to actively continue with the optimisation of the loan approval process, contract drafting and payments, so that both, the Bank and Hypo Leasing are able to provide client services in a timely and cost-efficient manner.

3.4 Internal development of the Bank

Informatics

The segment of Informatics, which is in charge of the maintenance, development and availability of the information system at the Bank, focused its work on supporting the improved cost efficiency of processes, upgrading the reporting process, and providing support to the new products in 2012.

We provided support to all legislative and other regulatory developments and requirements. In terms of business operations, we successfully implemented the following:

- Upgrading of the collection system,
- Re-assessment of tariffs,
- Renewed applications supporting key clients (partners),
- Introduction of certificates of deposits,
- Introduction of e-accounts,
- Support to e-social,
- Comprehensive support to SEPA payment instruments,
- Support to money laundering prevention,
- Introduction of a software solution to support legal office,
- e-portal for capital market orders,
- comprehensive upgrading of the reporting system relating to retail client risk management.

In the area of systems and communication management, we doubled key elements of air conditioning systems and significantly reduced risks of failure due to malfunctioning.

Furthermore, we updated central disc system capacities and improved IT network safety.

In terms of safety and risk management, we successfully implemented the Security Information and Event Management system (SIEM).

Several drills of the system shutdown and recovery were carried out successfully.

3.5 Expectations for the future

In the forthcoming financial year we anticipate further resolution of structural challenges in Slovenia. Despite some positive signs, there is still high level of uncertainty particularly due to pessimistic mood prevailing in businesses, unresolved political issues and restrictive regulatory environment. For these reasons the banking environment is expecting additional impairments driven by uncertain developments in the real estate market.

The financial year 2012 was challenging for the Hypo Group however, despite deteriorating economic conditions, we demonstrated that the Hypo Group's strategy is solid and the increasing and strengthened support of our clients and owners proves that we are on the right track. At the year-end our capital position was stronger, with more stable sources of financing and above all clear business policy aimed at the sector of retail clients and corporates. Furthermore, with optimisation of key processes we consolidated our competitive position and this provides basis for more solid and flexible approach to challenges posed by the economic environment in 2013. The most important objective is setting up a comprehensive financial services infrastructure by integration of the banking and leasing operations into a single financial experience for clients. In doing this, the Hypo Group is becoming one of the largest and most important financial institutions in Slovenia. Profitability improvement will be at the forefront of our efforts although, due to ever more heightened conditions, this will not be an easy task particularly since we expect revenue to fall compared to the financial year 2012 as a result of further reduction in assets, declining demand for basic financial services, high costs of financing and anticipated reduction in interest rates.

Our key driving force will be the strategy of a universal bank with a stable business growth in all business areas, which is based on a safe and reliable partnership with all stakeholders and risk balanced business operations. The quality of credit risk depends to a large extent on the economic climate and due to high level of uncertainties, this risk will remain high. In 2013 we expect further increase in impairments. However, in spite of this our aim is to maintain high level of credits and alongside business growth maintain controlled and high quality of portfolio and business sustainability. To this aim we will continue to pursue the policy of stabilising sources of financing by increase in the share of the primary resources through higher amounts of clients' assets.

Our general universal business model as well as capital strength and solid liquid and financial position, ensure balanced operations as well as flexibility when facing future challenges. We are convinced that by focussing on our clients, we support the wider economic development in the country, whilst at the same time realise our objective of strengthening the Group's standing and profitability in the Slovenian market where we aim to become one of the five largest banks.

We strive for professionalism in all areas of our business and by doing this we support the economy and realise expectations of all our stakeholders: clients, local communities, employees and shareholders and we are determined not to disappoint them. Pursuing the set strategy is the key to realisation of our key objective as we look for opportunity to prove to our strategic investor that the Hypo Group continues to be the best organised, well managed and profitable financial institution in Slovenia and will ensure the expected return.

3.6 Social responsibility of the Bank

At the Bank, we are aware of the fact that responsibility for our activities, with which we influence our internal and external environment, is of crucial importance. Thus, we feel our responsibility and care for employees, owners, clients, wider community and supervisors.

Responsibility for employees

In 2012, the Bank was voted a "Family Friendly Bank". This award is acknowledgement of our long-standing efforts to ensure good working conditions for all our employees and our appreciation of difficulties in balancing family obligations and demands of work.

Care for our employees is one of the Bank's core values, which has become even more meaningful in the time of the difficult economic situation. We are aware that our employees are the foundation for our future development and success.

At the end of 2012, the Bank had 473 employees. Movement of employees during the years is shown in the table below:

		Number of employees
Year	at 31 December	according to working hours*
2011	465	446
2012	473	438

* Number of employees based on working hours reflects the actual employment in the Company. Following the completion of restructuring process and integration of the leasing activity, there is a number of staff who, due to the nature of work and responsibility, has agreed employment contracts with Hypo Leasing and the Bank under the 50% : 50% principle, and accordingly, they registered as employed by both.

Educational structure

Educational structure of our staff is at a very high level and just less than 66 per cent of employees have either higher education or university degree.

	Employees by educational structure in	
Educational level	2012	2011
4	3	3
5	159	167
6	42	39
7/1	106	105
7/2	143	131
8	20	20
Balance at 31 December	473	465

Staffing structure

In 2012, the Hypo Bank continued its efforts towards a revised and unified staffing structure. As part of integration of the banking and leasing activities, job positions were reconciled and standardised, forming a basis for the future structure of the Hypo Group.

The main objective of these activities is to develop a standard staffing structure that will apply to all employees of Hypo. This staffing structure gives a clear description of each job position in Hypo within its new organisational structure, with four levels of staff career development for each job position. In close cooperation with his/her seniors, an individual will in future be able to develop his/her career in Hypo through annual performance interviews.

Recruitment

The recruitment and selection of new employees are supported by clearly defined requirements and targets of an individual organisational unit. Priority is given to the internal labour market, and the desires and ambitions of employees are taken into account. This allows our employees' career development as they move from one job position to another. The selection of employees is systematised in several circles of structured interviews carried out with the job applicants. Where certain more demanding job positions are concerned, the candidates have to undergo testing by a professional external partner. The final decision is made on the basis of the analysis of their expertise and personal competences needed for successful performance on a specific post.

Education and training

We believe that only highly qualified staff can follow the development and needs of the Slovene financial market. For this reason, the Bank provides constant and comprehensive expert training of all employees. This constant need for new expertise, as well as for knowledge from the field of personal development, are present all year round and each year more employees participate in educational training, as compared to the previous year. To achieve business objectives, we have set key educational domains for the development of banking business which arise from strategic requirements.

Each year, we organise various internal trainings in accordance with our needs. In 2012, we focused primarily on training of sales staff and key managerial staff and organised the following courses

- Training in sales,
- Training to obtain licences for insurance brokerage,
- Certification of personal bankers (Certificate of consultancy banking),
- Web based training on prevention of money laundering for all employees and
- Training for efficient management.

All these courses were very versatile providing participants with a wide spectrum of applicable knowledge and skills required for successful performance of their jobs. We also organised a number of language courses of which the English language course was attended by the highest number of employees.

All new recruits attend HYPO 1 training courses where they become familiar with individual sectors within the Bank; at the end of the training, the new recruits take an exam to check their knowledge.

Certain internal trainings are also organised at the level of the Hypo Group, namely from the areas of managerial staff training, as well as for specific work fields, such as project management. In collaboration with IEDC Bled, at the beginning of 2012 we organised an international training "Business learning excellence for development". This and similar training courses are especially useful because they allow exchange of experience and flow of knowledge within the Hypo Group and promote the new development strategy of the Group.

Besides internal trainings, employees often participate in seminars, conferences or debates, organised by the Bank Association of Slovenia or other relevant institutions. Each year selected employees take the exam or obtain the licence for insurance intermediaries and for the sale of investment coupons or shares of investment funds. In addition, the Bank often co-finances the part-time studies or educational courses attended by employees to obtain various licences in the financial field.

The employees transfer the knowledge, obtained through education or self-education, to their colleagues through their activities in certain sectors or departments.

In spite of our dedication to cost optimisation, education of our employees is high on the list of priorities and for this reason we make sure funds are available for implementation of a variety of courses and trainings.

Annual interviews and management by objectives

The aim of annual interviews is to ensure, on a long-term basis, successful operations of the Bank. Yearly interviews enable us to systematically set new targets, to review the implementation of the agreed targets in the previous year, and to provide for systematic professional and personal development of the managerial staff and associates. The yearly interview is first held by heads of individual departments with their superiors or the Management Board, and is followed by an interview of the head with his/her subordinated staff. After the conclusion of the interviews, the department head and the individual are responsible for the implementation of the agreed targets, while the human resources department provides for the organisation of agreed trainings and implementation of the development plans in line with the Bank's strategy. Target interviews are being held twice a year and development interviews once a year.

Bonus system

The variable component of remuneration is divided into group, individual, and project remuneration. Individual remuneration is closely linked to management by objectives. By applying individual and project remuneration, we want to incite the development of an individual employee, while the group remuneration aims at better motivation for team work and achievement of targets. The amount of bonuses and criteria depend on economic conditions and business results, whereas despite difficult economic conditions, the bonus system has been maintained as it has positive impact on employees and successful operations of the Company and its further growth and development.

Having future in mind, we include our employees in the collective voluntary pension insurance.

Reward policy

Our reward policy complies with provisions of the labour legislation, CEBS guidelines, the Bank of Slovenia decisions and EU directives pertaining to capital requirements III. In accordance with the policy adopted by the parent bank in Austria, our local policy that regulates payments to employees in Slovenia, is drafted and adopted for each individual year. This policy clearly sets criteria and conditions for payment of bonuses to the managerial staff and employees. When a member of management or staff qualifies for bonus, the payment is made only after prior approval of the Supervisory Board. Members of staff with special powers, who are able to significantly affect the risk profile of the Bank, include members of the Management Board and directors of individual sectors including risk management and internal audit function. The amount of bonuses and criteria depend on economic conditions – in accordance with the Group Bonus policy for 2012 no bonuses were paid to employees.

Measuring of organisational climate and satisfaction

In 2012 we again included all employees in the measurement of organisational climate and employee satisfaction. In the Bank, we are aware that employees cannot be motivated only externally, but also by means of increasing the working climate and conditions for the satisfaction of employees. Recently, we have noticed a downward trend in the satisfaction of employees and we are searching for ways of improving and turning this trend around. The reasons can be found in the overall uncertainty of the environment we work in, and partially they are a consequence of the past some major organisational changes at the Bank.

We will continue to measure organisational climate and employee satisfaction also in the future, as the results show clear picture of the climate within the Hypo, our competitive advantages and our staff's development potential.

Informal socialising also contributes to the well-being of employees; therefore the Bank organises numerous events where staff can meet socially. Through donations, the Bank actively contributes to the development of Hypo Sports and Culture Society, which enables its members to actively spend their free time by offering them very affordable sports and cultural activities of their own choice. This way we strengthen the relationship and socialising of employees also outside the working hours and environment.

HR projects

In 2012 we organised a number of HR projects which the employees greeted with enthusiasm. In the beginning of the fall we organised a corporate voluntary work day »HypoDAY – for a good cause« where employees devoted one working day to those who are in need of assistance. They spent the day was at Ig, visiting the Dolfka Boštjančič Centre. The employees tended the garden and spent time with recipients of the centre's care.

Another important event was organised in December with HippOSCAR award ceremony. The HippOSCAR is an award for excellence in Hypo and is awarded at the level of the Group. In Slovenia, these awards were presented to our employees in seven categories for the first time in 2012.

Towards the end of the year our first web based e-newsletter was enthusiastically greeted by the employees and will provide a source of in-depth information presented in a lighter way.

Plans for the future

In 2013, we will further endeavour to make sure all our HR activities deliver long-term benefit to our employees, who represent a stable foundation of our existence and development in the future. In line with approved plan, we shall make every effort to be awarded the full certification as a Family Friendly Bank, however our focus will be primarily on open and regular communication with employees as well as provision of various projects for employees to get involved in.

Responsibility to owners

Responsibility to the owner is expressed by daily communication with him, regular monthly reports, publishing of annual report and cooperation with the Supervisory Board. The Bank has a single owner, to whom it used to pay the total profit after taxes decreased by statutory reserves totalling five percent of the profit until 2009. However, in 2009, the Bank transferred the total realised profit to reserves and did not pay out dividends. In 2011 and 2012, the Bank failed to achieve profit.

EUR '000

	2012	2011
Dividend payout in EUR 000'	0	0
Dividend payout per share in EUR	0	0

Responsibility to clients

The Bank demonstrates responsibility to its clients through a wide range of its products and services. The relations between the Bank and its clients are based on trust and understanding of the client's needs. The Bank adapts to clients' needs by improving the existing and developing new banking services through modern business channels and approaches. In operations, the protection of the client's personal data and client's rights presents one of the most important principles of the Bank. Of course, along with that, the soft factors of cooperation, aimed at keeping the clients or further improving the professional relationship with them, are of key importance. One of such approaches is the organisation of various events for clients (of cultural, sports or business nature), by which we demonstrate our appreciation for their trust and loyalty.

In accordance with the banking legislation, the Bank guaranteed for the payout of the banking deposits in the sum of €22,000 until 11 November 2008. After that date, the banks, savings banks and the Republic of Slovenia guaranteed for unlimited net deposits of investors until 31 December 2010. As of 1 January 2011, such guarantee applies for the payout of the banking deposits totalling up to EUR 100,000.

EUR '000

	2012	2011
Advertising expenses	688	587

Responsibility to wider community

The resources that the Bank dedicated to sponsorship and donations in 2011 and 2012 are presented in the following table.

EUR '000

	2012	2011
Sponsorships	219	222
Donations	60	14

Through a wide network of its branches, the Bank covers the whole territory of Slovenia and we have good relations with local and wider community. Our involvement in social activities is supported by our sponsorships and donations as well as our active involvement in humanitarian, sports and cultural events.

As part of the "Hypo Pro Futuro" project at the level of the entire Hypo Alpe Adria Group, we are engaged in humanitarian events aiming at providing help to underprivileged children. We are aware that there are large numbers of children, who never experience the sunny side of life and our aim is to bring smiles to their faces. In December, the Bank and Hypo Leasing donated a total of €45,000 to children in need as part of the Group's responsibility to social community. Some of the funds, earmarked for Christmas gifts to business partners were donated to underprivileged children with the assistance of the Association of Youth Moste Polje, whereas the remaining funds were donated with the assistance of the Slovenian Association of Friends of Youth to the project "Together higher than the sky" for children and families from the areas affected by floods. After the flooding in November 2012, a number of ideas were proposed to the Management as a means of helping people in the affected areas. One of them was to do away with the Christmas party and instead donate the funds to families from the flood affected areas. By doing this, our employees showed real compassion and proved that we can all join our efforts to assist when help is needed.

Another show of our employees' compassion was our internal project »HypoDAY – for a good cause«, where our employees joined their forces to help people in need. Employees spent the day at Ig in the Dolfka Boštjančič Centre where they enjoyed a day of gardening together with the recipients of the centre's care.

The Bank dedicated 37 per cent of its total donation funds for ensuring better living conditions to socially deprived families. We made these donations through the Association of Friends of Youth of Slovenia, our regular partner in the organisation of humanitarian fund raising events.

We perceive supporting sports and sports activities as our contribution to a healthier and better quality of life. Therefore, we ensure sponsorship funds to become involved in the lives of those who represent our country in the European area and worldwide. By doing this we express our support to athletes, their endurance, discipline, competitiveness and the desire to create great results. Furthermore, we sponsored the Slovenian football team, the fastest Slovenian runner Matic Osovnikar, and local sports events and other male and female athletes.

The main event in terms of sports sponsorship was sponsorship agreement with the European Basketball Championship EuroBasket 2013, which will take place in September 2013 in 4 Slovene cities. All the Hypo countries are involved in the project (Austria, Slovenia, Croatia, Bosnia and Herzegovina, Serbia and Montenegro), and will appear under a single trademark as the main sponsor and official financial partner of EuroBasket 2013. This will require a focused and united approach over the whole of the year of all the Hypo Group members. These sponsorships bring added value to our clients, both existing and potential. As over the whole of the year, we will organise various activities and promotions to make them feel an active part of these events. The peak of these activities will be during the actual championship (September 4 through to 22, 2013).

With its donation and sponsorship contributions, the Bank is actively involved also in the cultural happening in the Slovenian area. Help and support of cultural events, festivals and performances are becoming a part of our activities. By donating, we express our support to cultural activity as one of the most important spheres of social life. In these cultural events, we also include our clients, thus adding value to our relationship with them. In 2012, nearly 3 per cent of our donation funds were allocated to cultural activities or organisations.

In collaboration with Hypo Leasing, the Bank sponsored the issue of a book "A politician writes history" by Alois Mock.

We also support all activities that accelerate the economic development. For a number of years, we have regularly cooperated with the Celje Trade Fair and sponsored the International Trade Fair. In 2012, we dedicated 10% of all sponsorship funds to this event.

The amounts of tax paid in the financial years 2012 and 2011 by the Bank are presented below.

EUR '000

	2012	2011
Taxes	6,276	7,966

Responsibility to supervisors

In accordance with the Banking Act, the supervision of banking operations is carried out by the Bank of Slovenia within the framework of reviews at the supervised bank's headquarters and through reports that the Bank sends regularly each month. This way, permanent supervision over banks and savings banks is assured, which enables the safety and stability of the financial system in Slovenia.

Within the framework of cooperation with the financial system supervisory institutions and external auditors, the Bank obtains appropriate assurances that its operations are within the framework of the legislation of the Republic of Slovenia and within the framework of general norms, in effect for well-regulated and stable members of financial system. The Bank builds the cooperation with institutions on an open and fair relationship, which leads to cooperative search for solutions. This, according to independent supervisors and consultants, assures long-term stability of the Bank's operations. In case of substantial changes in the systems of the Bank's operations, the Bank attempts to obtain in advance positive opinions on the planned solutions, which it intends to implement in its operating environment, with the purpose of obtaining reassurance, that these are in accordance with the legislation, and that they do not present significant threat to the Bank's development. In the framework of cooperation, the Bank strives to obtain independent opinions for all key risks from at least one independent body. The costs of auditing and consulting services, which the Bank hired in 2011 and 2012, are presented in the following table.

EUR '000

	2012	2011
Cost of auditing and consultations	2,814	2,936

Of total costs of auditing and consultations, in 2012 audit fees paid to the Ernst & Young auditors amounted to €76 thousand (2011: €118 thousand). Please see disclosure of the income statement items, Note 8. A.

The biggest share of the above costs represents the costs of legal services and services of notaries (€762 thousand), valuations and expert opinions (€528 thousand), and consultation services (€569 thousand).

Internal control system

Internal control system of the Hypo Group is composed of internal controls that include the risk management function, business compliance function and internal audit function. The Bank endeavours for coherent operation in accordance with applicable legislation, regulations, rules, codes, standards, best practices and any other rules with regular and effective execution of the function of ensuring business compliance. By taking preventive measures, the Bank avoids potential violations, which could occur when performing various banking services and could lead to the loss of reputation, various actions imposed by supervisory authorities or other potential consequences. Here, it is important to point out:

- Consulting services, both in the development of new products and services, as with existing products and services, which the Bank constantly complements and improves due to the requirements and changes in the market;
- Education in the sense of ensuring adequate and appropriate understanding of the meaning and purpose behind an individual regulation;
- Control, both in the sense of regular inspections of the mechanisms of internal control, as well as operation, relating to the performance of investment services;
- Compliance monitoring in the sense of regular monitoring compliance with information safety and security policy;
- Compliance of internal rules and regulations with current regulations.

The compliance monitoring is coordinated and run by the Business compliance services with the support of all the Bank's organisational units and employees. The business compliance services function is an independent and in terms of location separate organisational unit responsible directly to the Bank's Management Board. Some of its most important tasks are as follows:

- Ensuring safety, which is guaranteed by regular monitoring of physical and technical safety;
- Information and personal data protection;
- Business conformity with legislation and standards of good practice (Banking Act, Payment Services and Systems Act, Financial Instruments Market Act, Consumer Credit Act with all subordinate regulations and other laws, which influence the operation of a bank, family standards, ISO 2700x);
- Business conformity with the Act on prevention of money laundering and terrorist financing including the rules »Know Your Client«
- Implementation and upgrading of the system for prevention of fraud including the rules »Know Your Employee«;
- Fight against corruption and ensuring high level of integrity;
- Cooperation with government bodies
- Informing employees of the changes in the relevant legislation and;
- Cooperation when resolving customer complaints.

The Hypo Group has given undertaking to comply with high legal, social and ethical standards. Our motto is **»zero-tolerance«** to activities that result in economic damage to the company as well as loss of its high standing and thus the loss of confidence and trust in our company.

Based on these standards, we have implemented efficient fraud prevention policies with the aim of safeguarding our Group against potentially damaging activities. To this aim we have implemented a **System of anonymous reporting of irregularities in the Hypo Group**.

The Business compliance services of the Bank closely cooperate with its counterpart of the parent Bank, which at regular meetings sets the guidelines for concerted action and reporting.

Internal audit

The Internal Audit department, in accordance with the Banking Act, reports to the Supervisory Board about the realisation of annual plan, adequacy and efficiency of risk management, adequacy and efficiency of internal controls system operations, and about important findings and their realisation. The Internal Audit department's annual report is submitted to the Bank's Meeting of Shareholders.

In line with the Banking Act, the Bank also established the Audit Committee in 2009, which met four times in 2012. In accordance with the Companies Act, the Audit Committee also monitors the efficiency of internal audit.

The Internal Audit department also cooperates with the internal audit department of the parent bank, which at regular meetings sets directives for harmonised operations and reporting. The Internal Audit department employs 5 internal auditors; 1 of them has obtained the title of a certified internal auditor, whereas 1 is currently in the final stage of the training course to obtain the title.

In 2012, the Internal Audit department of the parent bank carried out external assessment of all internal audit departments in the Group. The report issued confirmed compliance with standards in all its more important parts. Based on the findings, the department will carry on implementing activities to improve the quality of operations.

At least once in a five year period the Bank is required to have an internal audit quality review performed by an external institution to review its compliance with International standards for the professional practice of internal auditing. In 2012, internal audit function quality review was performed by VERUM d.o.o., which issued a report on 19 October 2012. According to the report, the internal audit department complied with International standards for the professional practice of internal auditing and Code of Ethics of Internal Auditors..

4 Financial statements

4.1 Statement of management's responsibilities

The Management Board has approved the financial statements for the year ended 31 December 2012, the accounting policies and assessments used, and notes to the financial statements.

The Management Board is responsible for the preparation of the financial statements that give a true and fair presentation of the financial position of the Bank and of its financial performance for the year ended 31 December 2012. The Management Board is also responsible for the appropriate accounting system and adoption of measures to secure the assets, and to prevent and detect fraud and other irregularities and/or illegal acts.

The Management Board confirms that the appropriate accounting policies were consistently applied, and that the accounting estimates were made under the principle of prudence and the diligence of a good manager. The Management Board also confirms that the financial statements and notes thereof have been compiled under the assumption of the Bank's continued operation, and in accordance with the current legislation and International Financial Reporting Standards, effective in the EU.

In the following 5 years, the authorities may at any time review the company's operation from the day of the calculation of income tax for financial year-end on, delay penalties and penalties from tax income or other taxes. Management of the Bank is not familiar with any circumstances which could cause potential liabilities from income tax.

The most recent review of income tax compliance was performed by the tax authorities in 2011 when they reviewed the Bank's income tax declarations for the financial years 2008, 2009 and 2010.

The Management Board

4.2 Independent Auditor's Report

ERNST & YOUNG

This is a translation of the original report in Slovene language

INDEPENDENT AUDITOR'S REPORT

To the shareholder of Hypo Alpe-Adria-Bank d.d., Ljubljana

Report on the Financial Statements

We have audited the accompanying financial statements of Hypo Alpe-Adria-Bank d.d., which comprise the statement of financial position as at December 31, 2012, and the statement of income, statement of comprehensive income, statement of changes in shareholders' equity and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards as adopted by the European Union and with the requirements of the Slovenian Companies Act related to the preparation of the financial statements, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of Hypo Alpe-Adria-Bank d.d., as of December 31, 2012, and its financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union and with the requirements of the Slovenian Companies Act related to the preparation of the financial statements.

Report on Other Legal and Regulatory Requirements

Management is also responsible for preparing the business report in accordance with the Slovenian Companies Act. Our responsibility is to assess whether the business report is consistent with the audited financial statements. Our work regarding the business report is performed in accordance with ISA 720, and restricted to assessing whether the business report is consistent with the financial statements and does not include reviewing other information originated from non-audited financial records.

The business report is consistent with the audited financial statements.

Ljubljana, March 29, 2013

Janez Uranič
Director
Ernst & Young d.o.o.
Dunajska 111, Ljubljana

ERNST & YOUNG
Revizija, poslovno svetovanje d.o.o., Ljubljana 1

Primož Kovačič
Certified Auditor

4.3 Financial statements

Income statement

EUR '000

	Notes	2012	2011
Interest and similar income	1	75,706	85,813
Interest and similar expense	1	(42,310)	(45,226)
Net interest income		**33,396**	**40,587**
Dividend income	2	840	946
Fee and commission income		13,558	11,031
Fee and commission expense		(2,808)	(2,535)
Net fee and commission income	**3**	**10,750**	**8,496**
Realised gains (losses) on financial assets and liabilities not measured at fair value through profit or loss	4	(1,155)	(91)
Net gains (losses) on financial assets and liabilities held for trading	5	484	(2,308)
Net gains (losses) on currency translation differences	6	(110)	725
Net gains / (losses) on derecognition of assets excluding non-current assets held for trading		0	53
Other net operating income / (losses)	7	796	(2,600)
Administrative costs	8	(28,982)	(27,500)
Amortisation and depreciation	9	(2,318)	(2,417)
Provisions	10	(160)	630
Impairment	11	(23,204)	(50,364)
LOSS FROM ORDINARY ACTIVITY		**(9,663)**	**(33,843)**
Income tax	12	(1,753)	6,977
NET LOSS FOR THE YEAR		**(11,416)**	**(26,866)**

The accompanying notes on pages 48 to 93 form an integral part of the financial statements and should be read in conjunction with them.

Statement of comprehensive income

EUR '000

	Notes	2012	2011
NET LOSS FOR THE YEAR	**32**	**(11,416)**	**(26,866)**
OTHER COMPREHENSIVE INCOME AFTER TAX		**4,367**	**(4,641)**
Net losses on revaluation of available-for-sale financial assets		**5,356**	**(5,801)**
Gains / (losses) recognised as revaluation reserve		8,628	5,162
Transfer of gains / (losses) from revaluation reserve to profit and loss		(3,272)	(10,963)
Income tax relating to components of other comprehensive income	**30**	**(989)**	**1,160**
TOTAL NET COMPREHENSIVE INCOME FOR THE YEAR		**(7,049)**	**(31,507)**

The accompanying notes on pages 48 to 93 form an integral part of the financial statements and should be read in conjunction with them.

Statement of financial position

EUR '000

	Notes	31.12.2012	31.12.2011
Cash and balances with Central Bank	13	47,638	39,753
Financial assets held for trading	14	8,494	5,898
Available-for-sale financial assets	15	46,155	94,638
Loans		1,684,973	1,774,325
– Loans to banks	16	38,843	20,107
– Loans to clients	17	1,643,995	1,750,239
– Other financial assets	18	2,135	3,979
Held-to-maturity financial assets	20	90,501	36,462
Property, plant and equipment	21	5,131	5,605
Intangible assets	22	4,060	4,122
Income tax credits		11,772	13,951
– Deferred tax assets	30	11,772	13,951
Other assets	23	2,077	2,880
TOTAL ASSETS		**1,900,801**	**1,977,634**
Financial liabilities to Central Bank	24	131,299	120,147
Financial liabilities held for trading	25	7,846	4,721
Financial liabilities at amortised cost	26	1,599,870	1,684,421
– Deposits from banks	26a	674,852	720,837
– Deposits from clients	26a	727,987	713,632
– Borrowings from banks	26b	117,711	159,615
– Subordinated liabilities	27	73,003	73,012
– Other financial liabilities	28	6,317	20,817
Provisions	29	6,829	6,676
Income tax liabilities		566	44
– Income tax payable		0	41
– Deferred tax liabilities	30	566	3
Other liabilities	31	1,328	1,513
TOTAL LIABILITIES		1,747,738	1,817,522
Share capital	32a	174,037	174,037
Capital surplus	32b	2,696	27,696
Revaluation reserve	32c	1,386	(2,981)
Revenue reserves	32d	(13,640)	(11,774)
Retained earnings (accumulated loss) including net profit/(loss) for the year	32e	(11,416)	(26,866)
TOTAL EQUITY		153,063	160,112
TOTAL LIABILITIES AND EQUITY		**1,900,801**	**1,977,634**

The accompanying notes on pages 48 to 93 form an integral part of the financial statements and should be read in conjunction with them.

The Management Board of Hypo Alpe-Adria-Bank, d. d., hereby approves the financial statements and notes thereto.

The Management Board

Mag. Marko Bošnjak	**Mag. Matej Falatov**	**Dr. Heribert Fernau**
Member	Vice - President	President

Ljubljana, 29 March 2013

Statement of changes in equity

EUR '000

	Notes	Share capital	Capital surplus	Revaluation reserve	Revenue reserves	Retained earnings (accumulated loss) including net profit/ (loss) for the year	Total equity
Balance at 1 January 2011	**32**	**174,037**	**2,696**	**1,660**	**1,862**	**(13,637)**	**166,619**
Subscription (payment) of new capital		-	25,000	-	-	-	25,000
Total comprehensive income for the year		-	-	(4,641)		(26,866)	(31,507)
Balance at 31 December 2011	32	174,037	27,696	(2,981)	1,862	(40,502)	160,112
Settlement of losses b/f		-	(25,000)	-	-	25,000	0
Total net comprehensive income for the year		**-**	**-**	**4,367**	**-**	**(11,416)**	**(7,049)**
Balance at 31 December 2012	**32**	**174,037**	**2,696**	**1,386**	**1,862**	**(26,918)**	**153,063**

The accompanying notes on pages 48 to 93 form an integral part of the financial statements and should be read in conjunction with them.

Cash flow statement

EUR '000

	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES		
Profit or loss before tax	(9,663)	(33,843)
Amortisation and depreciation	2,319	2,417
Net gains / (losses) from currency translation	110	(725)
Net gains / (losses) on financial assets held to maturity	30	0
Net (gains) / losses on sale of property, plant and equipment, and investment property	0	(53)
Other (profit) / loss from investing	(55,612)	4,387
Other (profit) /loss from financing	1,784	(22,927)
Net unrealised profit in equity from revaluation of available-for-sale financial assets (excluding the deferred tax effect)	(4,366)	5,801
Other adjustments of profit before tax	2,947	12,641
Operating cash flows before changes of operating assets and liabilities	**(62,451)**	**(32,302)**
(Increase) / decrease of operating assets (excluding cash equivalents)	**134,146**	**193,177**
Net (increase) / decrease of assets with Central Bank	(27,086)	(2,480)
Net (increase) / decrease of financial assets held for trading	(2,112)	15,885
Net (increase) / decrease of available-for-sale financial assets	49,577	(20,121)
Net (increase) / decrease of loans	113,022	203,646
Net (increase) / decrease of other assets	745	(3,753)
Increase / (decrease) of operating liabilities	**(68,300)**	**(193,754)**
Net increase / (decrease) of financial liabilities to Central Bank	11,152	80,137
Net increase / (decrease) of financial liabilities held for trading	3,125	2,270
Net increase / (decrease) of deposits and borrowings measured at amortised cost	(82,383)	(289,456)
Net increase / (decrease) of other liabilities	(194)	13,295
Net cash flows from operating activities	**3,395**	**(32,879)**
Corporate income tax (payment) / credits	**(41)**	**350**
Cash flows from operating activities	**3,354**	**(32,529)**
CASH FLOWS FROM INVESTING ACTIVITIES		
Cash receipts from investing activities	**1,863**	**2,292**
Proceeds from sale of property, plant and equipment and investment property	290	826
Other proceeds from investing activities	1,573	1,466
Cash disbursements from investing activities	**(2,073)**	**(2,684)**
(Disbursements for acquisition of property, plant and equipment, and investment property)	(935)	(1,733)
(Disbursements for acquisition of intangible assets)	(1,138)	(951)
Cash flows from investing activities	**(210)**	**(392)**
CASH FLOWS FROM FINANCING ACTIVITIES		
Cash receipts from financing activities	**0**	**25,000**
Other proceeds from financing activities	0	25,000
Cash disbursements from investing activities	**(1,793)**	**(2,067)**
(Repayments of subordinated debt)	(1,793)	(2,067)
Cash flows from financing activities	**(1,793)**	**22,933**
Effects of exchange-rate changes on cash and cash equivalents	2,184	(2,331)
Net increase of cash and cash equivalents	**1,351**	**(9,988)**
Cash and cash equivalents at the beginning of period	**42,712**	**55,031**
Cash and cash equivalents at the end of period	**46,247**	**42,712**

The accompanying notes on pages 48 to 93 form an integral part of the financial statements and should be read in conjunction with them.

EUR '000

	Notes	2012	2011
Cash and cash equivalents comprise:			
Cash and balances with Central Bank	13	7,404	26,605
Loans to banks with maturity up to three months	16	38,843	16,107
TOTAL		46,247	42,712

Cash equivalents comprise of cash (excluding obligatory reserves with the Central Bank) and loans to banks with maturity of up to 90 days.

Interest and dividends

EUR '000

	Notes	2012	2011
Interest paid		29,228	33,855
Interest received		43,936	68,904
Dividends received		840	946

4.4 Notes to the financial statements

Basic information

Hypo Alpe-Adria-Bank, d. d., is a Slovenian public limited company registered for providing universal banking services on the Slovenian market.

Full address of the Bank is: Hypo Alpe-Adria-Bank, d. d., Dunajska cesta 117, Ljubljana, Slovenia.

The Bank's sole owner is Hypo Alpe-Adria-Bank International AG, Klagenfurt, Austria, member of the Hypo Alpe-Adria Group. Until 29 December 2009, the ultimate parent of the Bank was Bayern LB, Germany. On 30 December 2009, the ultimate parent of the Company became the Republic of Austria, with 100 per cent ownership of Hypo Alpe-Adria-Bank International AG.

The consolidated financial statements can be obtained at the following addresses or web addresses:

Hypo Alpe-Adria-Bank d.d.
Dunajska cesta 117
1000 Ljubljana
Slovenia
www.hypo-alpe-adria.si

Hypo Alpe-Adria-Bank International AG
Alpen-Adria-Platz 1
9020 Klagenfurt
Austria
www.hypo-alpe-adria.si

All the amounts in the financial statements and the accompanying notes are stated in thousands euros unless stated otherwise.

Significant accounting policies

The following significant accounting policies have been applied in the preparation of the financial statements.

1. Basis for preparation

The financial statements were prepared in accordance with the International Financial Reporting Standards (hereinafter: IFRS) as adopted by the European Union.

The Bank prepares its financial statements (with the exception of cash flow information) on the accrual basis of accounting.

The financial statements of the Bank have been prepared under the historical cost convention and modified by the revaluation of available-for-sale financial assets, financial assets and financial liabilities measured at fair value through profit or loss, and all derivatives.

The Bank's Annual report includes information and notes as prescribed by the Companies Act, IFRS as adopted by the EU, and the Decision on books of account and annual reports of banks and savings banks.

The preparation of financial statements under IFRS requires the use of estimates and fundamental accounting assumptions such as going concern and accrual basis of accounting. Under these assumptions, the effects of transactions and other business events are recognised on accrual and not when they are paid, and are recorded and reported for periods to which they refer.

The significant accounting estimates and assumptions are presented in Section 21.

The estimates and assumptions are continuously reviewed and are based on the latest information or latest developments or, past experience.

The financial statements have been prepared on the going concern basis, which assumes continuity of normal business activities and the realisation of assets and the settlement of liabilities in the ordinary course of business.

1.a) Going concern assumption

The financial statements have been prepared on the going concern basis, which assumes continuity of normal business activities and the realisation of assets and the settlement of liabilities in the ordinary course of business.

The ability of the Bank to continue as a going concern is dependent upon the continued funding and support from its shareholder Hypo Alpe-Adria-Bank International AG, Klagenfurt, Austria (the Parent) under the currently agreed financial terms. To this extent, the Parent has provided funding to the Bank to support its operations. This support includes agreeing not to seek repayment, other than originally contracted, of intercompany loans made by them to the Group for a period of at least 12 months from the date of these financial statements.

The acquisition of full interest in the Hypo Alpe-Adria-Bank International AG by the Republic of Austria was made on 30 December 2009,and subsequently Hypo Alpe-Adria-Bank International AG including subsidiaries (including Hypo Alpe Adria or HAA), is at the balance sheet date undergoing a restructuring process.

HAAs previous owner made contributions towards the restructuring as part of its disinvestment. Additionally, Republic of Austria announced another injection of capital effected in June 2010, through issue of shares in total amount of 450 million Euro.

Following in year 2012 Hypo Alpe-Adria-Bank International AG agreed with the parent on the additional capitalization of 1.5 bn Euro (500 million Euro by the Republic of Austria and 1 bn Euroby subordinated bond issue), which was approved by the European Commission. Through this, Financial Market Authority removed its measure on 12,04% total equity ratio and on the gap between the expected bad debt losses and the total risk provisions. FMAs April 2012 review detected a shortfall in the amount of 622 million Euro to reach total equity ratio of 12.04% by 31 December 2013.

HAA is planning to reach a certain amount of capital using its own measures. In the case that the planned risk reduction and further improvement of risk profile is not sufficient for the full realization of the anticipated amount of capital, there could be a risk for business continuation.

The European Commission provisionally approved the measures put forward by the Republic of Austria on 23 December 2009 for a period of up to six months and instructed the Republic of Austria to present in depth restructuring plan for HAA in

the first half of 2010, to enable it to judge whether the aid measures are consistent with EU laws on state aid.
The European Commission will check:

- whether the measures planned can return HAA to long-term profitability,
- whether support from the state is kept to the required minimum,
- whether the own contribution made will be appropriate and,
- whether sufficient measures have been undertaken, to limit the distortion to competition caused by the financial assistance given.

In addition to the above that it will examine whether the previous owner has contributed sufficiently to the restructuring costs.

As part of the restructuring plan (prepared by the Parent for the European Union), a significant number of HAA member companies will stop operating.

HAA will be restructured on the basis of this restructuring plan and this will also lead to a significant number of the HAA member companies being relinquished. In this context, the restructuring and exit from the market costs are anticipated by the current business plan for the period until 2015, and these costs – depending on the timing of the exit and the then existing market environment – may have a corresponding negative impact on the future periods.

On 22 June 2010, the provisional approval of capital measures was prolonged „until making the final decision about the restructuring plan regarding Hypo Alpe Adria‘. However, the Commission reserved its right to give its final approval after examining the restructuring plan submitted to the Commission by the Republic of Austria in mid-April 2010.

In its decision dated 4 August 2010, the EU approved the acquisition of Hypo Alpe Adria by the Republic of Austria in respect of merger control laws.

In November 2012 a meeting took place in Brussels at which occasion updating of the restructuring plan was discussed. As agreed, the updated restructuring plan was sent to the owner at the beginning of 2013 in order to be forwarded to the European Commission.

The midterm goal is reprivatisation of Hypo Alpe-Adria-Bank International AG through the sale of its operative units in the South-East European network. Already in 2011 (the transfer in Croatia, Austria and Italy was done in 2012) in Slovenia, Bosnia and Hercegovina and Montenegro portfolios of non-performing loans were transferred to the special purpose entities with the aim of cleaning the portfolio of bad loans and to achieve a better market position of operative units for reprivatisation.

Hypo Alpe-Adria-Bank International AG, taking into account the sovereign debt crisis in the Eurozone and its impact on the European financial sector, as well as gloomy economic prospects in Europe and especially in the South-East Europe as core Hypo region, responded by sharpening its strategy. Planning was adapted to the deteriorated prospectives for the national economy and among others it was decided that as of 2012 subsidiaries should switch to self-financing arrangements by using local deposits. Moreover, in December 2012 a subordinated bond guaranteed by the Federal Government was issued in the amount of 1 bn Euro as a measure of providing additional capital and the capital increase in the amount of 500 million Eurp took place.

After prior consultation with the Commission and as further measures for the year 2012, HAA repurchased various hybrid and supplementary capital instruments of Hypo Alpe-Adria-Bank International AG and the Austrian subsidiary Hypo Bank Austria considerably under their nominal value i.e. it terminated them without payment thus taking further significant steps to strengthening of its capital resources and sharing the burden with the providers of hybrid and supplementary capital.

Subsequent to the above listed capital measures, the European Commission imposed conditions by means of a provisional approval on 5 December 2012 referred to as »Behavioural Measures« which came into effect on 1 January 2013. They primarily refer to the management of new business representing a catalogue of criteria which should ensure the value of the newly granted loans. Among others, these conditions stipulate:

- the specific credit standing,
- collateralisation ratios and maturities,
- they regulate granting of FX-loans and
- increase the level of self-financing by the improvement of the Loan-to-Deposit Ratio within a respective time period.

The negotiations with the European Commission on the state aid proceedings are presently in their closing stage. The current focus is directed to a possible adaptation of feasible dates and reprivatisation proceeds from the three tendered bank segments in Austria, Italy and the SEE-network The European Commission foresees the completion of the state aid procedure already in 2013. Guarantee expires on June 30, 2013. Generally speaking, the Brussels authorities are satisfied with the strategic alignment of the HAA after the restructuring process. Possible scenarios and their impacts have been submitted to the European Commission in form of a concept and they are being discussed.

Per 31.12.2012, it cannot be estimated with any degree of certainty when the EU state-aid proceedings will be concluded and whether the European Commission will accept the restructuring plan for Hypo Alpe Adria. Hypo Alpe-Adria-Bank International AG has declared its willingness to cooperate fully with the European Commission.

The Company's management is confident that the restructuring activities of the parent bank and its owner will not have negative impact on the Company's operations in the Republic of Slovenia.

2. Segment reporting

In accordance with IFRS 8, the Bank is not required to report per individual business segments as it has not issued either debt or equity instruments that are traded publicly (on domestic or foreign stock exchange or outside the stock market inclusive of local or regional markets) and has not submitted or is not in the process of submitting its financial statements to the Securities and Exchange Commission or another administrative organisation with intention to issue any group of instruments on a public market.

3. Foreign currency translation

Functional and presentation currency

The financial statement items of the Bank are measured using the currency of the primary economic environment in which the Bank operates. The Bank measures the financial statement items in euros, which is functional and presentation currency of the Bank.

Translation of foreign currency transactions

Foreign currency transactions are translated into the functional currency on the trade day using the reference exchange rate of ECB published by the Bank of Slovenia on its web page. The rate published after 2 p.m. is used from midnight of the next day.

Translation gains and losses resulting from the settlement of foreign currency transactions and from the translation of monetary items recorded in a foreign currency are recognised in the profit or loss.

Translation gains and losses resulting from the change of the amortised cost of monetary securities nominated in foreign currency that are classified as available-for-sale financial assets, are recognised in the profit or loss. Translation gains and losses resulting from non-monetary securities, such as equities, classified as available-for-sale financial assets, are recognised in the revaluation reserves together with the fair value measurement effect.

Gains and losses resulting from purchase and sale of foreign currencies are recognised in the profit or loss as net profit from financial assets and liabilities held for trading.

The exchange rate used in the translation to the functional currency as at 31 December 2012 was 1 EUR=1.3183 USD (2011:1 EUR=1.2939 USD); 1 EUR=1.2080 CHF (2011:1 EUR=1.21561 CHF); 1 EUR =0.81695 GBP (2011: 1 EUR=0.8353 GBP).

4. Interest income and expense
Interest income from debt securities is recognised in the profit or loss using the effective interest method.

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 period. The effective interest rate is the rate that exactly discounts estimated future cash payments.

Interest income and expenses for other interest bearing financial instruments are recognised in the profit or loss in the charged amounts on the basis of the amounts, deadlines and methods prescribed by the Bank's interest rates price list.

Once a financial asset or a group of similar financial assets has been written down as a result of impairment, interest income is recognised using the rate of interest applied in discounted future cash flows. Interest income derived using the method described is unwinding and is recognised separately from the ordinary interest income.

Interest income includes regular, default and deferred interest for interest bearing financial instruments and prepaid fees for approved loans and is transferred to income using a classic linear method of deferral, which represents a deviation from the IFRS requirements. However, the Management believe that the difference does not represent a significant deviance for a fair presentation of financial statements.

Interest on liabilities for deposits and borrowings are recognised as interest expenses.

5. Fee and commission income and expense
Fees and commissions are generally recognised on an accrual basis when the service has been provided. Fees and commissions for services that are performed continuously in a certain period of time are recognised proportionally over the period in which the service is performed.

Fees and commissions include primarily fees for payment transactions, commissions on loan transactions (loan management fees, costs of reminders), commission on brokerage transactions and warranty fees.

Fees resulting from approval of loans are recognised as interest income and expenses.

6. Dividend income
Dividends are recognised in the income statement when they are declared.

7. Financial assets

a) Classification
On initial recognition, the Bank classifies the financial assets to the following groups according to the purpose of acquisition, duration of possession and type of financial instrument: held-to-maturity investments, available-for-sale financial assets, financial assets at fair value through profit or loss, or investments in loans and receivables.

Held-to-maturity financial assets
Held-to-maturity financial asset are non-derivative financial assets with fixed or determinable payments that an entity intends and is able to hold to maturity and that do not meet the definition of loans and receivables and are not designated on initial recognition as assets at fair value through profit or loss or as available for sale. Held-to-maturity financial assets are measured at amortised cost. If the Bank sells other than insignificant amounts of held-to-maturity financial assets, or as a consequence of a non-recurring, isolated event beyond its control that could not be reasonably anticipated, all of its other held-to-maturity financial assets must be reclassified as available-for-sale in the current and next two financial years.

Available-for-sale financial assets
Available-for-sale financial assets are non-derivative financial assets, which the Bank intends to hold for indefinite period of time and which may be sold in response to liquidity requirements, changes of interest rates, currency exchange rates or prices of financial instruments.

The Bank can exceptionally be allowed to use valuation model for measurement of the fair value of defined financial instruments, if it is able to prove, that the existing market for these financial assets is not active. To define if a market is active or inactive, the bank must define the key parameters, which indicate market activity. It is also important to follow up the trends in those parameters. The parameters should be used consistently according to the content and in time, so that as much of subjective judgement in interpretation of the given results can be eliminated as possible. The bank should take into the account in the conditions of inactive market all risk parameters, which would be, under the condition of the active market, required by the participants on the market, especially the issuer credit risk and the premium for liquidity.

In 2012, the Bank did not apply valuation method for measurement of available-for-sale financial assets.

Financial Assets at Fair Value through Profit or Loss

Financial assets measured at fair value through profit or loss are further classified as financial assets held for trading and financial assets which are, on initial recognition, designated as measured at fair value through profit or loss.

Financial Assets Held for Trading

A financial asset is classified as held-for-trading if it is acquired principally for sale in the near term, or forms part of a portfolio of financial instruments that are managed together and for which there is evidence of short-term profit taking. Derivative financial assets are also classified as held for trading unless they are designated as hedging instruments.

In the statement of financial position, derivative financial instruments are initially recognised at cost which is equal to the fair value of consideration received or granted. They are measured at fair value which is determined on a daily basis using generally accepted financial methodology, whereby quotations/prices of entry values (e.g. zero coupon yield curve, FRA, interest rate differentials of currencies, etc.) are obtained from information systems (Reuters, Bloomberg).

Fair values of derivatives are recognised either within assets or liabilities when their fair value is negative. All derivative financial instruments of the Bank are classified as financial assets held for trading and are not used in hedge accounting.

Financial assets are designated **at fair value through profit or loss** only if the designation eliminates or significantly reduces the inconsistent treatment that would otherwise arise from measuring the assets and liabilities or recognising gains or losses on them on a different basis. Financial assets designated at fair value through profit or loss include some instruments such as equity instruments which are managed and their performance evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and which are reported to the key management on this basis. Financial assets and liabilities containing one or several embedded derivatives that could significantly impact cash flows of the host instrument, are also recognised at fair value through profit or loss.

The Bank did not classify financial instruments to a subgroup of financial assets which are on initial recognition designated at fair value through profit or loss.

Loans and Receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not traded on an active market.

b) Initial recognition and measurement

All financial assets are recognised on the date of trading at fair value (usually at cost), increased (instruments that are not recognised at fair value through profit or loss) by costs that are directly attributable to the transaction, whereas for financial assets at fair value through profit or loss, costs of the transaction are reported in the profit or loss. Subsequent measurement of a financial asset reflects its initial designation.

Financial assets held for trading and available-for-sale financial assets are recognised at fair value. Gains or losses on financial assets at fair value and held for trading are recognised in the profit or loss of the period in which they accrued.

Gains or losses on available-for-sale financial assets designated at fair value are recognised in the comprehensive income until the asset is derecognised or impaired, in which case gains and losses are transferred to profit or loss. Interest accrued on the basis of effective interest rate method and exchange-rate differences from cash items classified as available-for-sale financial assets are recognised directly in profit or loss.

Loans and receivables, and financial assets held to maturity are carried at amortised cost.

»Day one profit«

When the value of a transaction in an inactive market for the same financial instrument significantly differs from its fair value at another comparable market or, if the value of transaction significantly deviates from the valuation model that considers assumptions from an active market, the Bank immediately recognises the difference between the transaction value and fair value in profit or loss as net gains or losses on trading as »day one profit«. When the market value is irrelevant, the difference between the value of transaction and the valuation model is recognised in profit and loss only when the market becomes significant or on disposal of a financial instrument.

c) Reclassification of financial assets

Financial instruments may only be reclassified from held-for-trading group in exceptional circumstances such as the balancing of the maturity of assets and liabilities or hedging against market risk. The fair value at the reclassification date becomes financial instrument's new amortised cost. Reclassification of an asset from the group of financial assets held to maturity is not allowed.

d) Derecognition

Derecognition of financial assets is carried out when contractual rights to cash flows expire, or when they are transferred to another party and where such transfer fulfils the criteria for derecognition (an entity has transferred all risks and benefits of the asset).

e) Principles applied in fair value measurement

The calculation of the fair value of financial assets traded on an active market is based on the published market value on day of the statement of financial position, namely the price that represents the highest demand value excluding the transaction costs. The fair value assessment of financial instruments not traded in an active market is based on values obtained from an external expert. The Bank verifies the external expert's valuation and in case the verification is positive the valuation is taken into consideration. In case there is no external expert's valuation an internal valuation is prepared. Internal valuations are prepared using standard valuation methods such as discounted future cash flow model, peer-to-peer analysis (direct comparison with companies that are publicly traded) and liquidation value. Final valuation of the financial asset takes into account all approaches, but using different weights, depending on industry, financial stability of the company and other factors that can affect fair value of financial instruments.

f) Temporary purchases of securities (reverse repo)

Temporary purchases of securities (reverse repo) are recognised in the statement of financial position as approved loans. The difference between the sale price and the repurchase price is recognised in the financial statements as interest income and is accrued over the duration of the contract.

8. Impairment of financial assets

a) Financial assets at amortised cost

General:

The Bank makes an assessment of its financial assets portfolio at amortised cost and off-balance exposure on a monthly basis using its own methodology:

- The necessary impairment is recognised for financial assets at amortised cost, and
- The required provisions are set aside for off-balance-sheet exposures.

The method used to create the necessary impairment of financial assets at amortised cost depends primarily on the exposure (the Bank distinguishes between individually relevant exposures and individually irrelevant exposures) and on formal status of financial assets. The Bank distinguishes between the financial assets that are subjected to breaches of material factors defined by the Bank as objective factors indicating an impairment of the financial asset, and the financial assets where no such factors are detected.

In accordance with the methodology of the HAA Group, the Bank treats each client, whose total exposure exceeds €150,000, as individually relevant exposure.

Distinguishing Between Different Methods of Impairment of Financial Assets at Amortised Cost

Financial assets at amortised costs are classified into one of the following segments for the purpose of impairment:

1. Individually relevant exposures, in relation to which a breach of at least one objective factor indicating the impairment of the financial asset at amortised cost is detected;
2. Individually irrelevant exposures, in relation to which a breach of at least one objective factor indicating the impairment of the financial asset at amortised cost is detected;
3. All exposures where no breach of any of the objective factors indicating the impairment of the financial asset at amortised cost is detected and where an individual impairment is not required.

In its internal policies, the Bank specified the following objective factors indicating the impairment of the financial asset at amortised cost:

- Materially important delay in settlement of contractual obligations lasting over 90 days;
- Bankruptcy or compulsory settlement of the client;
- Existence of proof of client's serious financial problems, including also:
  - Reprogramming due to client's economic, legal or other problems,
  - Irregular settlement of liabilities within the group of related entities;
  - Poor client's internal rating; or
  - Significant economic problems in the client's industry.

Detailed Presentation of Individual Methods of Impairment of Financial Assets at Amortised Cost

Individual impairment

Individually relevant exposures are addressed individually; in the event of a breach of at least one of previously determined factors that objectively indicate the impairment of an individual financial asset at amortised cost, such exposures are impaired individually. The Bank individually assesses expected cash flows for repayment (it evaluates expected cash flows from regular loan repayment as well as expected cash flows from realisation of collateral); in the event of negative difference between the discounted value of all expected cash flows and the book value of receivable the Bank creates individual impairment. Realisation of collateral is recognised as potential future cash flow in cases where the collateral fulfils the required formal criteria with regards to the degree of legal certainty and realisation. Impairment of such exposures is referred to individual impairment (also known as Specific Risk Provisions – SRP).

Based on the available information, the Bank makes individual assessment in terms of the time and amount of expected repayment, whereas current value of expected cash flows is calculated with the use of discounted effective interest rate.

Collective impairment

Individually irrelevant exposures that also fulfil at least one of the previously determined factors are grouped into groups with similar characteristics, and collectively impaired using the formula that reflects the fact that at least one factor, which objectively indicates the impairment of individual financial asset, was breached. The amount of impairments created depends primarily on the scope of relevant collateral (it is the exposed part of the investment that is subject to collective impairment) and on the segment into which the exposure is allocated. The loans and other financial assets at amortised cost granted to the following borrowers are designated by the Bank as groups of loans with similar attributes:

- Group of financial assets granted to enterprises for their regular operations;
- Group of financial assets granted to sole proprietors;
- Group of financial assets granted to public sector entities and budget users;
- Group of financial assets granted to individuals.

The impairments for the above exposures are called Collective Impairments - CI).

Group Impairments (Latent losses)

Group impairments (Latent losses) are recognised for exposures that as of the balance sheet date do not breach any of the objective factors indicating the impairment of the financial asset and for individually treated exposures where no individual impairment is required. For collective impairment, the Bank applies the formula that reflects the fact that none of the factors, which objectively indicate the impairment of individual financial asset, were breached. The mathematical formula derives from the Basel II methodology, adjusted for the assessment of the scope of realised but not yet identified losses in the Bank's portfolio. The adjustment is made in respect of collateral and determination of the time period in which the Bank is capable of detecting the occurrence of the loss.

Relevant value of Collateral:

The relevant value of collateral used by the Bank is the market value of collateral decreased by:

- Expected costs of realisation of such collateral,
- Expected decrease of the collateral's value due to the realisation process,
- Considering the time component of the realisation of collateral (discounting).

The cumulative effect of all three factors, which cause the current value of expected cash flows from realisation of collateral to be normally lower than its current market value, is reported by the Bank in its calculations through use of special coefficients, in accordance with the policy of the HAA Group.

In order for collateral to be considered as relevant, it should fulfil at least three minimum criteria with regards the degree of legal certainty and realisation. Furthermore, the Bank has to obtain an authentic assessment of the market value of collateral.

Probability of default

The Bank assesses the probability of default on the basis of internal rating tools. According to the Hypo Group policy, different rating tools are used for individual segments of clients. Regardless of the tool applied, the final results are transferred to a single 25-level scale that determines the probability of default for each client separately.

Loss given default

The expected scope of loss in the event of default (loss given default) is shown using a LGD coefficient, which indicates what part of unsecured exposure the Bank can expect to lose in the event of default. The coefficients are compliant with the HAA Group policies and follow the conservative assessment of expected losses in the IRB approach to the new Capital Directive CAD III.

Segment	LGD (Basel II Standard)
Banks	0.50
Regional government and local authorities	0.45
Central government and central banks	0.45
Individuals	0.90
Legal entities	0.70
Public sector entities	0.50
Project financing	0.75

Period in which the Bank identifies the realisation of portfolio loss

The Bank has defined the period, in which it recognises the realisation of loss in its portfolio (Loss identification period), as a period during which the Bank can detect that the client breaches one of the objective indicators of impairment of the financial asset. The Bank has implemented a monitoring system by means of which it believes that it is capable of detecting the negative events for most of its clients in relatively short time. The Bank uses the LIP factor of 1.0 for financial assets where regardless of the sufficient frequency in monitoring of the portfolio, the Bank is unable with sufficient probability to assess potential loss since the regularity of repayments of liabilities does not reflect the ability of clients to repay loans when they mature. Such transactions include above all overdraft facilities on transaction accounts, credit lines, guarantees, and loans with a single repayment or loans with a moratorium. For all other exposure the Bank uses the LIP factor 0.5.

b) Available-for-sale financial assets

The Bank assesses on a monthly basis whether there are any indications of impairment of available-for-sale financial assets. If there is objective evidence that an impairment loss on financial assets available for sale has been incurred, the cumulative impairment loss is transferred from equity to profit or loss.

Impairment losses included in profit or loss as equity instruments are not derecognised through profit or loss. If the value of a debt instrument classified as available-for-sale increases and the increase can be related objectively to an event occurring after the impairment loss was recognised, the previously recognised impairment loss is reversed through profit or loss.

The Bank applies the following criteria to determine whether available-for-sale financial assets have been impaired:

For debt instruments: fair value is lower than 90% of the purchase value (which represents the value of 100%),

For equity instruments: significant decrease of the fair value lasting more than 9 months, and the fair value falls more than 20% below the purchase value.

c) Restructured loans

The Bank assesses the restructured loans individually at the time of approval of restructured loan in order to determine the need for impairment.

When a loan is restructured due to client's economic, legal or other problems that significantly affect the client's future ability to repay its obligations, the Bank accordingly reclassifies such client to lower rating grade and individually assesses on a monthly basis the need for individual impairment. If the Bank does not detect the need for individual impairment, the client is considered within a group using the same methodology as for other investments of the Bank.

9. Offset

In the statement of financial position, the financial assets are offset with liabilities when there exists a legal right and upon the intent of a net offset or on the basis of simultaneous realisation of assets and settlement of liabilities.

10. Property, plant and equipment, and intangible assets

Property, plant and equipment and intangible assets are stated at cost in the financial statements less accumulated depreciation and impairment losses.

On initial recognition, the cost of an asset includes all expenditures that are directly attributed to the acquisition and are necessary to make the asset ready for its intended use. Subsequent expenditure incurred on an item of property, plant and equipment is added to the cost of the assets and recognised only if it is probable that the future economic benefits embodied in the item of property, plant and equipment will flow to the entity and if these costs can be reliably measured. All other expenditure such as additional investment, maintenance and repairs, are recognised in profit or loss as an expense when incurred.

Depreciation and amortisation expense is accounted for individually on a straight-line basis by allocation of the costs of the assets to the residual value over the useful lives of the assets.

The depreciation (amortisation) rates applied are as follows:

	2012	2011
Buildings	2.5%	2.5%
Computer hardware	20 to 33.3%	20 to 33.3%
Furniture and other equipment	5 to 50%	5 to 50%
Cars	20%	20%
Investments in leasehold improvements	5 to 50%	5 to 50%
Intangible assets	10 to 20%	10 to 20%

The residual values of assets and their useful lives are reviewed as of the day of the statement of financial position and are adjusted accordingly, if expectations differ from the previous assessments.

The land is recognised separately from the buildings. As it normally has unlimited useful life the Bank does not depreciate it. The assets are derecognised upon their disposal or when no additional future economic benefits can be expected from their use. Gains and losses resulting from disposal of assets represent the difference between the net gain on disposal and the carrying amount of the asset.

Depreciation of an asset begins on the first day of the following month after the asset is made ready for its use.

The Bank assesses on the day of the statement of financial position, whether there is any impartial evidence that an assets might be impaired. If there is objective evidence that an asset has been impaired, the assessment of the recoverable amount is made. The recoverable amount is the higher of the value in use or net sale value of the asset. If the recoverable value is higher than the carrying amount, the impairment of assets is not required, whereas if the contrary is true, a loss is recognised in profit and loss in the amount of the difference between the recoverable and carrying amount of the assets.

In 2012 there was no objective evidence of impairment.

11. Leases

A lease is a contractual relationship in terms of which the lessor transfers the right to the asset for an agreed period of time to the lessee, in exchange for a payment or a line of payments. The key factor for classifying a lease is the scope in which the risks and rewards of ownership are transferred from the lessor to the lessee.

The Bank as a Lessee

The Bank mostly enters into lease contracts where the lessor bears majority of the risks and awards relating to the ownership of the asset (operating lease). Payments made in respect of the operating lease are included in profit or loss proportionately over the duration of the contract. If operating lease is terminated prematurely all payments, requested by the lessor, are recognised as costs in the period of termination of the contract.

12. Cash and cash equivalents

In the statement of cash flows, cash and cash equivalents comprise of cash on hand and balances with the Central Bank (excluding the obligatory reserves), and loans to banks with initial maturity of up to 90 days.
Cash and cash equivalents are measured at amortised costs.

13. Provisions

A provision is recognised when the Bank has a present legal or constructive obligation as a result of a past event that may be reliably measured, and it is probable that an outflow of economic benefits will be required to settle the obligation.
Where there are a number of similar obligations, the likelihood that an outflow will be required for the settlement is determined by considering the class of obligations as a whole. A provision is recognised even if the likelihood of an outflow with respect to any one item included in the same class of obligations may be small.
The Bank recognises the provisions in respect of potential credit-related obligations (financial and service guarantees, provisions for undrawn part of the loan) and employees' benefits (jubilee awards, termination benefits upon retirement).

14. Taxes

The corporate income tax is accounted for at the tax rate applicable on the date of the statement of financial position. Tax is levied on the tax basis determined in accordance with the Corporate Income Tax Act. The tax rate applicable in 2012 is 18%.

Deferred tax is provided using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes; deferred tax is recognised using tax rates enacted at the date when temporary differences are expected to be eliminated. A deferred tax asset is recognised only to the extent that it is probable that future taxable profit will be available against which the deductible temporary differences can be utilised.

The Bank recognised the deferred taxes in respect of the differences resulting from different depreciation rates of assets used for operating and tax purposes, revaluations and impairment of available-for-sale securities, provisions for employees' benefits and in respect of the amount of tax losses and tax allowances which the Bank was unable to utilise in the current tax return due to the loss incurred.

The deferred tax, associated with the measurement of available-for-sale financial instruments, is recognised directly in the equity.

15. Employee benefits

In accordance with the law, the Bank provides to its employees jubilee awards and termination benefits upon retirement, which are legally prescribed benefits. An independent actuary calculates the provisions on the date of the statement of financial position. The significant assumptions applied in the calculation are as follows:

- Discount factor: 3.6% annually;
- Number of employees entitled to receive the payment: 427
- Increase in the average salary in the Republic of Slovenia: 3% annually
- Assessment of staff turnover.

The calculation of the termination benefits upon retirement is tied to the pension qualifying period of each individual employee. Employees are entitled to receive the jubilee award for every ten years of service with the same employer.

The Bank pays social security contributions at the rate of 8.85% in accordance with the Slovenian legislation. These payments are recognised in the financial statements as labour costs in the period they refer to.

16. Financial liabilities

The financial liabilities are recognised at fair value (normally at cost) on the trade date. The costs of transaction are recognised in the profit or loss. After initial measurement they are recognised at amortised cost. A financial liability is derecognised only when the contractual obligation is fulfilled, cancelled or expired.

17. Share capital and reserves

The share capital is recognised in the nominal amount and was subscribed or paid by its owners.
Dividends on shares decrease the equity in the period in which they are approved by the owners of the Bank.

18. Financial Guarantee Contracts

Financial guarantee contracts require the issuer to make specified payments to reimburse the holder for a loss it incurs if a specified debtor fails to make payment when due under the original or modified terms of a debt instrument. Such guarantees are issued to banks, financial institutions, and other entities as means of securing loans, overdrafts and other banking facilities. Financial guarantee contracts are initially recognised at fair value which is equal to the fee received under the »Other liabilities«. Fees received are transferred to profit or loss using the straight-line method.

19. Fiduciary accounts

The Bank also offers its clients securities brokerage services and asset management services. Operations are conducted through a separate account and the client assumes the operational risk. A commission charged for these services to clients is recorded in the Note number 3a. These assets are not included in the statement of financial position but are recorded in the off-balance-sheet items as authorised operations.
Assets and liabilities of clients from the brokerage services as well as fee and commission income and expense related to the brokerage operations are recorded in the Note number 34 in accordance with the local legislation.

20. Amendments to standards and interpretations

The accounting policies used are consistent with those applied in the previous years, except for the adoption of new and amended standards and interpretations effective as from 1 January 2012 and which are noted below.

Newly adopted standards and interpretations

IFRS 1 – First-time Adoption of International Financial Reporting Standards: Severe Hyperinflation and Removal of Fixed Dates for First-time Adopters

The amendment provides guidance on how an entity can resume presenting IFRS financial statements when its functional currency ceases to be subject to severe hyperinflation.
A further amendment is the removal of the legacy of fixed dates in IFRS 1 relating to derecognition and day one gain or loss transactions have also been removed. The amendments are effective in the EU for periods beginning on or after 1 January 2013. The amendment has no impact on the Bank's financial statements.

IFRS 7 – Financial Instruments: Disclosures – Transfer of Financial Assets

The amendments are effective for periods beginning on or after 1 July 2011 and were issued to improve the disclosure requirements relating to the transfer of financial assets. Amendments require disclosures for transfers of financial assets that are derecognised in their entirety, as well as those that are not, to enable the user of the financial statements to understand the relationship with those assets that have not been derecognised and their associated liabilities. The amendment requires retrospective application. The amendment affects disclosures only and has no impact on the Bank's financial position statements.

Standards and interpretations issued but not yet effective and not early adopted

The Bank has not early adopted any standard or interpretation issued but not yet effective. The Bank intends to adopt these standards, if applicable, when they become effective.
The following new and amended standards will be applied in future periods as required by IFRSs and the European Union:

IFRS 7 – Financial Instruments: Disclosures – Offsetting Financial Assets and Financial Liabilities (amended)

The amendment is effective for annual periods beginning on or after 1 January 2013. The amendment introduces common disclosure requirements. These disclosures would provide users with information that is useful in evaluating the effect or potential effect of netting arrangements on an entity's financial position. The amendments to IFRS 7 are to be applied retrospectively.

IFRS 10 – Consolidated Financial Statements

This standard replaces the part of IAS 27 Consolidated and Separate Financial Statements which refers to consolidated financial statements. It also addresses the issues raised in SIC-12 Consolidation – Special Purpose Entities. The standard is applicable in the EU for periods beginning on or after 1 January 2014. IFRS 10 establishes a single control model that applies to all entities. This will require management to exercise significant judgment to determine which entities are controlled, and therefore are required to be consolidated by a parent. The standard also changes the definition of control.

IFRS 11 – Joint Arrangements

This standard replaces IAS 31 Interest in Joint Ventures and SIC 13 Jointly-controlled entities – non-monetary contributions by venturers. The new standard addresses only two forms of joint arrangements (joint operations and joint ventures), where there is joint control. IFRS 11 uses the principle of control in IFRS 10. In addition, IFRS 11 removes the option to account for jointly-controlled entities using proportionate consolidation, leaving only the option to use the equity method. The standard is effective in the EU for periods beginning on or after 1 January 2014.

IFRS 12 – Disclosure of Interests in Other Entities
This standard is effective in the EU for periods beginning on or after 1 January 2014 and includes disclosure requirements that were previously in IAS 27 Consolidated and Separate Financial Statements related to consolidated financial statements, as well as all of the disclosures that were previously included in IAS 28 Investments in Associates and IAS 31 Interest in Joint Ventures. A number of new disclosures are also required, especially regarding judgments made to determine whether an entity controls another entity.

IFRS 13 – Fair Value Measurement
The new standard is applicable for periods beginning on or after 1 January 2013. IFRS 13 does not change when an entity is required to use fair value, but rather provides guidance on how to measure the fair value of financial and non-financial assets and liabilities when required or permitted by IFRSs.

IAS 1 – Presentation of Financial Statements: Presentation of Items in Other Comprehensive Income
The amendments to IAS 1 change the grouping of items presented in other comprehensive income. Items that could be reclassified to profit or loss at a future point in time would be presented separately from items which will never be reclassified. The amendments are effective for periods beginning on or after 1 July 2012.

IAS 12 – Deferred Tax (amended)
The amendment is effective in the EU for annual periods beginning on or after 1 January 2013. This amendment concerns the determination of deferred tax on investment property measured at fair value and also incorporates SIC-21 Income Taxes – Recovery of Revalued Non-Depreciable Assets into IAS 12 for non-depreciable assets measured using the revaluation model in IAS 16. The aim of this amendment is to include a) a rebuttable presumption that deferred tax on investment property measured using the fair value model in IAS 40 should be determined on the basis that its carrying amount will be recovered through sale and b) a requirement that deferred tax on non-depreciable assets, measured using the revaluation model in IAS 16, should always be measured on a sale basis.

IAS 19 – Employee Benefits (amended)
In June 2011, the International Accounting Standards Board (the “the IASB”) issued numerous amendments to IAS 19. The key amendment refers to the removal of the corridor mechanism for recognising changes in the value of defined benefit plans. This means all changes in the value of defined benefit plans will be recognised as they occur depending on the type of change either in profit or loss or in other comprehensive income. The amendments are effective for periods beginning on or after 1 January 2013.

IAS 27 – Separate Financial Statements (revised)
This revised standard was issued in May 2011 as a result of the new standards IFRS 10, IFRS 11 and IFRS 12. IAS 27 contains accounting and disclosure requirements for investments in subsidiaries, joint ventures and associates when an entity prepares separate financial statements. The standard is effective in the EU for periods beginning on or after 1 January 2014.

IAS 28 – Investments in Associates and Joint Ventures (revised)
This revised standard was issued in May 2011 as a result of the new standards IFRS 10, IFRS 11 and IFRS 12. IAS 28 prescribes the accounting for investments in associates and sets out the requirements for the application of the equity method when accounting for investments in associates and joint ventures. This revised standard is effective in the EU for periods beginning on or after 1 January 2014.

IAS 32 – Financial Instruments: Presentation (amended) – Offsetting Financial Assets and Financial Liabilities
The amendment is effective for annual periods beginning on or after 1 January 2014. This amendment clarifies the meaning of 'currently has a legally enforceable right to set-off' and also clarifies the application of the IAS 32 offsetting criteria to settlement systems (such as central clearing house systems) which apply gross settlement mechanisms that are not simultaneous. The amendments to IAS 32 are to be retrospectively applied. Earlier application is permitted. However, if an entity chooses to early adopt, it must disclose that fact and also make the disclosures required by the IFRS 7 – Offsetting Financial Assets and Financial Liabilities amendments.

IFRIC 20 – Stripping Costs in the Production Phase of a Surface Mine
The interpretation applies to waste removal (stripping) costs incurred in surface mining activities, during the production phase of the mine. It represents a change from the current life of mine average strip ratio approach used by many mining and metals entities reporting under IFRS. The Interpretation is effective for annual periods beginning on or after 1 January 2013.

In compliance with the requirements of IFRSs and subject to the endorsement by the European Union, the Bank will have to apply in future periods the following amended and revised standards and interpretations:

IFRS 1 – First-time Adoption of International Financial Reporting Standards: Government loans (Amendment)
The amendment is effective for annual periods beginning on or after 1 January 2013. This amendment sets out how a first-time adopter would account for a government loan with a below-market rate of interest when they transition to IFRSs. This amendment provides the same relief to first-time adopters as is granted to existing preparers of IFRS financial statements when applying IAS 20 Accounting for Government Grants and Disclosure of Government Assistance.

IFRS 9 – Financial Instruments
The Standard replaces IAS 39. IFRS 9 Financial Instruments was published in November 2009 and contained requirements for financial assets. Requirements for financial liabilities were added to IFRS 9 in October 2010. Most of the requirements for financial liabilities were carried forward unchanged from IAS 39. However, some changes were made to the fair value option for financial liabilities. In December 2011, the IASB amended IFRS 9 to require application for annual periods beginning on or after 1 January 2015 and to not require the restatement of comparative-period financial statements upon initial application. Phase II of IFRS 9, relating to impairment, has been in the process of re-deliberations from January 2011.

In September 2012, the IASB issued a review draft on general hedge accounting requirements (Phase III of IFRS 9) which will be added to IFRS 9 Financial Instruments.

IFRS 10 – Consolidated Financial Statements: Investment Entities (amendment)
In October 2012, IASB issued an amendment to IFRS 10 Consolidated Financial Statements to provide an exception to the consolidation requirements for entities that meet the definition of an investment entity. The exception to consolidation requires investment entities to account for subsidiaries at fair value through profit or loss in accordance with IFRS 9 Financial Instruments. An entity must meet all three elements of the definition and consider whether it has four typical characteristics, in order to qualify as an investment entity. There is one exception to this requirement not to consolidated subsidiaries for investment entities. If an investment entity has a subsidiary that provides investment-related services (e.g. investment management services) to the entity or third parties, then the investment entity must consolidated its subsidiary. The amendment applies for annual periods beginning on or after 1 January 2014.

IFRS 12 – Disclosure of Interests in Other Entities: Investment Entities (amendment)
In addition to the amendments to IFRS 10 Consolidated Financial Statements, IFRS 12 Disclosure of Interests in Other Entities has also been amended to require additional disclosures for investment entities. The amendment applies for annual periods beginning on or after 1 January 2014.

IAS 27 – Separate Financial Statements: Investment Entities (amendment)
In addition to the amendments to IFRS 10 Consolidated Financial Statements, IAS 27 Separate Financial Statements has also been amended to define the accounting for and disclosure of subsidiaries of investment entities in the separate financial statements of an investment entity. The amendment applies for annual periods beginning on or after 1 January 2014.

Transition Guidance (Amendments to IFRS 10, IFRS 11 and IFRS 12)
The guidance is effective for annual periods beginning on or after 1 January 2013. The IASB issued amendments to IFRS 10 Consolidated Financial Statements, IFRS 11 Joint Arrangements and IFRS 12 Disclosure of Interests in Other Entities. The amendments change the transition guidance to provide further relief from full retrospective application. The date of initial application in IFRS 10 is defined as 'the beginning of the annual reporting period in which IFRS 10 is applied for the first time'. The assessment of whether control exists is made at 'the date of initial application' rather than at the beginning of the comparative period. If the control assessment is different between IFRS 10 and IAS 27/SIC-12, retrospective adjustments should be determined. However, if the control assessment is the same, no retrospective application is required. If more than one comparative period is presented, additional relief is given to require only one period to be restated. For the same reasons IASB has also amended IFRS 11 Joint Arrangements and IFRS 12 Disclosure of Interests in Other Entities to provide transition relief.

The Bank is reviewing the impact of standards and interpretations which are not yet mandatory and have not yet been endorsed by the EU and, for the time being, has not assessed the impact of new pronouncements on its financial statements. The Bank will apply new standards and interpretations in accordance with their requirements, if endorsed by the EU.

Improvements to IFRS

In May 2012, the IASB issued its annual improvements to IFRSs which included improvements of some of the existing standards. The effective date for the amendments is for annual periods beginning on or after 1 January 2013, but the amendments have not been endorsed yet by the EU.

IFRS 1 – First-time Adoption of International Financial Reporting Standards: Repeated application of IFRS 1
This amendment clarifies that an entity that stopped applying IFRS in the past and chooses, or is required, to apply IFRS again, has the option to re-apply IFRS 1. If IFRS 1 is not re-applied, an entity must retrospectively restate its financial statements as if it had never stopped applying IFRS (according to IAS 8).

IFRS 1 – First-time Adoption of International Financial Reporting Standards: Borrowing costs
Upon transition to IFRS, an entity will be allowed to retain its previously capitalised borrowing costs, without adjustment. After transition, borrowing costs are recognised in accordance with IAS 23 Borrowing costs.

IAS 1 – Presentation of Financial Statements: Clarification of the requirements for comparative information
The amendment clarifies the difference between voluntary additional comparative information and the minimum required comparative information (this is generally the previous period information). If an entity chooses to voluntarily provide comparative information beyond the minimum required comparative period, it must include comparative information also in the related notes to the financial statements.

Also, the amendment requires entities to present a third balance sheet (the opening balance sheet) (a) when an entity changes its accounting policies; or (b) makes retrospective restatements or makes reclassifications which have a material effect on the balance sheet. In such cases the entity is not required to provide supporting notes for the opening balance sheet.

IAS 16 – Property, plant and equipment: Classification of servicing equipment
The amendment clarifies that major spare parts and servicing equipment that meet the definition of property, plant and equipment are not inventory.
IAS 32 – Financial instruments: Presentation: Tax effect of distributions to holders of equity instruments
The amendment removes existing income tax requirements from IAS 32 and requires entities to apply the requirements in IAS 12 Income taxes to any income tax arising from distributions to equity holders.

IAS 34 – Interim financial reporting: Interim financial reporting and segment information for total assets and liabilities
This amendment aligns the disclosure requirements for total segment assets with total segment liabilities in interim financial statements. It also ensures that interim disclosures are aligned with annual disclosures in IFRS 8 Operating segments.

The Bank is reviewing the impact of the improvements to IFRS which are not yet mandatory and have not yet been endorsed y the EU and, for the time being, has not assessed the impact of new pronouncements on its financial statements. The Bank will apply the improvements to IFRS in accordance with their requirements, if endorsed by the EU.

21. Significant accounting policies and assessments

a) Impairment of Loans and Receivables

The Bank assesses its portfolio of financial assets valued at amortised cost and off-balance-sheet exposure on a monthly basis. In consideration of the objective factors indicating the impairment of the financial asset valued at amortised cost, the Bank assesses the need for its impairment. The objective factors are above all: irregular settlement of liabilities and material delay over 90 days; deterioration of economic conditions in the operating industry; reprogramming due to a client's economic, legal or other problems. If any client fulfils any of the objective criteria the Bank individually assesses the anticipated cash flows for repayment (it evaluates both the expected cash flows from regular loan repayments as well as potential cash flows resulting from realisation of collateral). In the case of negative difference between the discounted value of all expected cash flows and the carrying amount of the receivable, the Bank makes individual impairments. The Bank makes an assessment of the other clients collectively using its own methodology and parameters, which are reviewed on a regular basis to decrease the differences between estimated and actual losses.

Quality of the credit portfolio and appropriateness of related bad debt provisions are notably influenced by macroeconomic developments. Unexpected development of economic conditions, especially related to real estate market, cannot be excluded and could have significant impact on market value of the loan portfolio.

Key assumptions affecting the need for additional impairment in 2012 are the following:

1. Probability of Default (PD): in case of further portfolio deterioration as a result of worsening of economic conditions, the Bank could expect higher default rates than anticipated, which would require additional impairment.
   For this reason, the Bank is considering the possibility to increase PD by 40 %. This would lead to an estimated 8.9 million EUR higher impairments. Increase of PD by 50 % or 60 % would lead to an estimated 11.2 million EUR or 13.4 million EUR higher impairments.
2. Collaterals: in case of declining market value of collaterals the Bank could expect reduced cash-flows from sold collaterals and therefore additional impairment would be required. Collaterals are on the other hand seen as potential risk mitigator and the Bank has put huge efforts on improving the current portfolio collateralisation rate. For this reason, the Bank is considering the possibility to increase the portfolio collateralisation by 20%. This would lead to an estimated €6.8 million of lower impairments. Applying sensitivity of portfolio collateralisation increased by 30% or 40% would lead to an estimated €10.2 million or €13.6 million lower impairments.

b) Impairment of available-for-sale financial assets

Available-for-sale financial assets are impaired if there is a material or prolonged decrease of their fair value below their cost. Duration and the amount of decrease of their fair value are taken into consideration. The need for impairment may also be indicated by evidence of the deterioration in the financial position of the financial instrument's issuer and the industry sector in which the issuer operates. Criteria applied in recognition of impairment are described in detail in Note 21 Significant accounting policies – Available-for-sale financial assets

Key assumptions affecting the need for additional impairment in 2012:

1. Instruments tied to equity securities;
   The worsening of issuer's credit quality as a consequence of further deterioration in certain industries (construction, financial holdings) and their slow recovery.
2. Instruments tied to debt securities:
   The worsening of issuer's credit quality and unfavourable movement of market parameters, especially interest rates, as a consequence of inflation pressure in the euro zone.

22. Subsequent events

No significant circumstances or events occurred after the date of the statement of financial position that would require adjustments of the financial statements, additional notes thereto or explanatory notes to the shareholders.

The Supervisory Board approved this Annual report on 3 April 2013.

Notes to the income statement

1. Interest income and expense

EUR '000

	2012	2011
Interest income and similar income		
Deposits with Central Bank	80	208
Financial assets held for trading	2,542	1,442
Available-for-sale financial assets	2,324	2,716
Bank loans and deposits	77	290
Loans and deposits to clients	67,769	79,604
Financial assets held to maturity	2,841	1,455
Other financial assets	73	98
Total interest income and similar income	**75,706**	**85,813**
Interest and similar expense		
Bank sight deposits	144	299
Bank deposits	11,580	19,755
Deposits from clients	19,725	15,604
Deposits from Central Bank	1,295	856
Bank borrowings	5,434	5,302
Interest on financial liabilities held for trading	2,346	1,328
Subordinated debt	1,784	2,073
Interest on other financial liabilities	2	9
Total interest and similar expense	**42,310**	**45,226**
NET INTEREST	**33,396**	**40,587**

In 2012, the amount of income due from impaired financial assets was €6,100 million (2011: €4,615 million).

2. Dividend income

EUR '000

	2012	2011
Dividends from available-for-sale financial assets	840	946
Total dividend income	**840**	**946**

3. Fee and commission income and expense

EUR '000

	2012	2011
Total fee and commission income	13,558	11,031
Total fee and commission expense	2,808	2,535
Net fee and commission (a+b)	**10,750**	**8,496**

a) Fee and commission income and expense from trading for Bank's own account

EUR '000

	2012	2011
Fee and commission income		
Payment transactions	5,594	5,206
Loan transactions	2,548	1,851
Granted warranties	1,250	991
Other transactions	3,820	2,786
Total fee and commission income	**13,212**	**10,834**
Fee and commission expense		
Payment transactions	1,119	699
Loan transactions	3	3
Other transactions	1,598	1,739
Total fee and commission expense	**2,720**	**2,441**
NET FEE AND COMMISSION FROM TRANSACTIONS FOR BANK'S ACCOUNT	**10,492**	**8,393**

b) Fee and commission income from investing services and operations for clients' account

EUR '000

	2012	2011
Fee and commission income from investing and auxiliary investing services and operations for clients' account		
Receiving, brokerage and processing of orders	176	96
Financial instruments' management	31	30
Book-entry securities account management for clients	130	69
Consultation services to corporates on capital structure, business strategy and similar requests and M&A consultancy services	9	2
Total fee and commission from investing and auxiliary investing services and operations for clients' account	**346**	**197**
Fee and commission expense from investing and auxiliary investing services and operations for clients' account		
Fee and commission paid to KDD and similar organisations	50	48
Fee and commission paid to the stock exchange and similar organisations	38	46
Total fee and commission expense from investing and auxiliary investing services and operations for clients' account	**88**	**94**
NET FEE AND COMMISSION FROM INVESTING AND AUXILIARY INVESTING SERVICES AND OPERATIONS FOR CLIENTS' ACCOUNT	**258**	**103**

4. Realised Gains (Losses) from Financial Assets and Liabilities not Measured at Fair Value Through Profit or Loss

EUR '000

	2012	2011
Available-for-sale financial assets	(949)	(28)
Held-to-maturity financial assets	(137)	-
Loans	(3)	-
Other financial assets and liabilities	(66)	(63)
TOTAL	**(1,155)**	**(91)**

Gains and losses from available-for-sale financial assets comprise realised gains and losses on derecognition, whereas gains and losses resulting from changes of fair value of available-for-sale financial assets are recognised directly in the Statement of Comprehensive Income.

5. Net Gains (Losses) from Financial Assets and Liabilities Held for Trading

EUR '000

	2012	2011
Equity securities	(12)	4,588
Foreign currency purchase and sale	312	(104)
Derivatives	184	(6,792)
TOTAL	**484**	**(2,308)**

6. Net Gains (Losses) from Currency Translation

EUR '000

	2012	2011
Items in foreign currency	(2,138)	(8,623)
Items in foreign exchange	2,028	9,348
TOTAL	**(110)**	**725**

The currency translation differences in the table above refer to financial assets and liabilities measured at amortised cost. The currency translation differences resulting from financial assets measured at fair value are recognised as part of net gains or net losses from financial assets and liabilities classified as held for trading.

7. Other net operating income (expense)

EUR '000

	2012	2011
Other operating income		
Non-banking services	1,506	137
Other	181	649
Total other operating income	**1,687**	**786**
Other operating expense		
Membership fees	(65)	(76)
Taxes and other duties	(601)	(3,035)
Other	(225)	(275)
Total other operating expense	**(891)**	**(3,386)**
NET OTHER OPERATING INCOME (EXPENSE)	**796**	**(2,600)**

The item »Other« in other operating income comprises income from legal proceedings, insurance proceeds and other operating income. The most significant item under other operating expenses relates to the assets earmarked as donations.

The most significant item under »Other operating income from non-banking services« relates to services rendered to group companies (Hypo Leasing d.o.o.), during the integration process of individual sectors.

The most significant item under »Taxes and other duties« is withholding tax paid on interest on loans syndication in the amount of €270 thousand (2011: 2,129 thousand), and tax paid on total assets of banks in the amount of €219 thousand (2011: €0). Tax on the assets of banks is paid pursuant to the Tax Act on banks balance sheet assets effective from 26 July 2011 (O G RS, 59/2011). The tax is paid at the rate of 0.1% of the annual average of total balance sheet assets and may be reduced by 0.167 of the annual average balance of loans extended to non-financial organisations and sole proprietors.

8. Administrative expenses

EUR '000

	2012	2011
Employee costs	**15,224**	**15,146**
Gross wages and salaries	11,937	10,604
Social security contributions	789	705
Pension insurance contributions	1,064	951
Other contributions levied on gross wages and salaries	83	74
Other labour costs	1,351	2,812
General and administrative expenses	**13,758**	**12,354**
Costs of materials	896	1,190
Costs of rentals	1,631	1,536
Services provided by third persons	4,278	2,603
Costs of business trips	114	94
Costs of maintenance	1,974	1,809
Costs of advertising	823	1,207
Costs of hospitality	107	168
Costs of consultations, audit and legal fees	2,853	2,936
Education fees	297	224
Insurance premiums	593	411
Other administrative costs	192	176
Total administrative expenses	**28,982**	**27,500**

As at 31 December 2012, the Bank employed 473 staff (31 December 2011: 465)

Rental expenses of €1,631 thousand (2011: €1,536 thousand) relate to real estate. The Bank has no non-cancellable lease contracts. Agreements have been concluded for an indefinite period; rentals are adjusted to 3-monthly Euribor.

The most significant item of "Costs of services provided by third persons" is the cost of integration which was invoiced by related parties (Hypo leasing d.o.o.).These costs resulted from the provision of services by related parties in the integration process of individual segments.

c) Audit fees

EUR '000

	Ernst & Young		Other auditing firms	
	2012	2011	2012	2011
Audit of the annual report	76	106	-	-
Other auditing services	-	12	4	-
Other non-audit services	-	-	-	-
Total audit fees	**76**	**118**	**4**	**-**

9. Depreciation and amortisation expense

EUR '000

	Notes	2012	2011
Property, plant and equipment	21	1,118	1,371
Intangible assets	22	1,200	1,046
Total depreciation and amortisation expense		**2,318**	**2,417**

10. Provisions

EUR '000

	Notes	2012	2011
Provisions for off-balance-sheet liabilities	29	737	419
Provisions for employee benefits	29	(15)	211
Other provisions	29	(882)	-
Total provisions		**(160)**	**630**

11. Impairment

EUR '000

	Notes	2012	2011
Available-for-sale financial assets	15	(3,272)	(10,963)
Financial assets at amortised cost		(19,932)	(39,401)
- Government		(208)	10
- General public		(781)	(1,319)
- Other clients		(18,943)	(38,092)
Total impairment		**(23,204)**	**(50,364)**

12. Income tax

EUR '000

	Notes	2012	2011
Corporate income tax		–	–
Deferred tax	30	1,753	(6,977)
Total corporate income tax		**1,753**	**(6,977)**
Difference between the income tax and tax determined using the basic tax rate:			
Profit/loss before tax		(9,663)	(33,843)
Tax calculated using the applicable tax rate of 15% (2011: 20%)		(1,449)	(6,769)
Tax on income not recognised for tax purposes		(127)	(2,885)
Tax on expenses not recognised for tax purposes		3,323	2,667
Tax on income that increases the tax basis		6	10
Tax on tax relief utilised		–	–
Total corporate income tax		**1,753**	**(6,977)**

The majority of income not recognised for tax purposes relates to exemption of received dividends and exclusion of income that was included in the tax basis in previous years.

The bulk of expenses not recognised for tax purposes relates to exemption of financial assets revaluation, bonuses and other payments relating to employment, the amount of provisions not recognised as tax expenditure and similar.

In accordance with provisions of the Act Amending the Corporate Income Tax Act (O G RS No. 30/2012), the corporate income tax rates applicable to individual financial years are as follows: 2012: 18%; 2013: 17%; 2014: 16% and 2015: 15%. Accordingly, the Bank restated the amount of deferred tax recognised in previous years by using the current tax rates. The effect of this restatement amounted to €3.3million.

The effective tax rate for 2012 is 18.13% (2011: 20.61%).

Notes to the statement of financial position

13. Cash and Balances with Central Bank

EUR '000

	31.12.2012	31.12.2011
Cash	7,263	6,525
Balances with Central Bank excluding obligatory reserves	141	20,080
Cash and cash equivalents	**7,404**	**26,605**
Other short-term deposits with Central Bank – guarantee scheme	1,701	879
Obligatory reserves with Central Bank	38,533	12,269
Total cash and balances with Central Bank	**47,638**	**39,753**

Slovenian banks are required to maintain obligatory reserves with the Bank of Slovenia; the amount of obligatory reserve depends on the scope and structure of received deposits. Currently, the Bank of Slovenia requires banks to calculate obligatory reserve in the amount of 1% of all deposits with maturity of up to 2 years.

Fair values of cash and balances with the central bank are disclosed in more detail in Note “Fair values of assets and liabilities” on page 112.

14. Financial assets held for trading

EUR '000

	31.12.2012	31.12.2011
Derivatives		
Forward contracts	22	486
– foreign exchange	22	258
– equities	–	228
Interest options	575	237
Interest swaps	7,879	4,808
Total derivatives	**8,476**	**5,531**
Securities		
Shares	–	348
Other securities	18	19
Total securities	**18**	**367**
Of that quoted securities	–	348
Total financial assets held for trading	**8,494**	**5,898**

As at 31 December 2012 and 2011, no securities designated as held for trading were pledged by the Bank as collateral.

a) Contractual and fair values of derivatives

EUR '000

	Contractual value		Fair value 31.12. 2012		Fair value 31.12. 2011	
	31.12. 2012	31.12. 2011	Receivables	Liabilities	Receivables	Liabilities
Forward contracts	1,591	22,253			486	255
– foreign exchange	1,591	14,949	22	25	258	255
– equities	–	7,304	–	–	228	–
Options (interest)	14,306	14,592	575	636	237	237
Swaps (interest)	352,735	317,317	7,879	7,185	4,808	4,229
TOTAL	**368,632**	**354,162**	**8,476**	**7,846**	**5,531**	**4,721**

The contractual value represents derivative financial instruments reported in the off balance sheet records. However, these amounts do not reflect either the future cash flow or the Bank's current exposure to either the currency or interest rate risk.

Fair value is the carrying amount of the instrument reported in the Bank's Statement of financial position as follows: assets are reported under financial assets held for trading and represent positive valuation of derivatives; whereas liabilities are reported under financial liabilities held for trading and represent negative valuation of derivative financial instruments.

15. Available-for-sale financial assets

EUR '000

	31.12.2012	31.12.2011
Bonds	**25,269**	**70,147**
– Republic of Slovenia	19,550	49,678
– banks	1,026	7,851
– other issuers	4,693	12,618
Shares (gross no impairments)	**24,158**	**30,727**
– banks	235	160
– other issuers	23,923	30,567
Treasury shares	**-**	**4,727**
– Republic of Slovenia	-	4,727
Impairment through profit or loss	**3,272**	**10,963**
TOTAL NET	**46,155**	**94,638**

Of the total amount of available-for-sale securities, €44,618 thousand was quoted on the stock exchange as at 31 December 2012 (31 December 2011: €93,034 thousand).

Fair values of available-for-sale financial assets are disclosed in more detail in Note "fair values of assets and liabilities" on page 112.

a) Movement of available-for-sale financial assets

EUR '000

	Notes	2012	2011
Balance at 1 January		**94,638**	**91,280**
Purchases		18,840	43,247
Sales		(4,362)	(2,538)
Maturity		(14,590)	(21,674)
Reclassified to held-to-maturity	20a	(49,220)	-
Amortization + Interest		(1,097))	1,087
Fair value changes		5,218	(5,801)
Impairment		(3,272)	(10,963)
Balance at 31 December		**46,155**	**94,638**

16. Loans and deposits to banks

EUR '000

	31.12.2012	31.12.2011
Sight deposits	38,843	9,522
Term deposits	-	6,585
Loans	-	4,000
TOTAL NET LOANS	**38,843**	**20,107**
Loans to banks – maturing within 12 months of the reporting date	38,843	16,107
Loans to banks – maturing in a period of more than 12 months of the reporting date	**-**	**4,000**

17. Loans to clients

EUR '000

	Notes	31.12.2012	31.12.2011
Loans		1,675,208	1,775,745
Credit lines		22,228	17,911
Credit cards receivables		4,096	3,386
Receivables for collateral granted		2,076	837
Other		2,703	1,910
Impairment	19	(62,316)	(49,550)
TOTAL NET LOANS		**1,643,995**	**1,750,239**
Loans to clients – maturing within 12 months of the reporting date		550,634	622,488
Loans to clients – maturing in a period of more than 12 months of the reporting date		**1,093,361**	**1,127,751**

Interest receivable is recognised as part of the basic financial instrument.

All loans were impaired to their replaceable value.

As at 31 December 2012, the Bank had pledged loans for long-term refinancing operations and settlements in relation to STEP2. The total value of pledged loans amounted to €74,507 thousand (31 December 2011: €56,228 thousand).

Other disclosures pertaining to loans are included in Note “Financial risk management” – credit risk.

18. Other financial assets

EUR '000

	31.12.2012	31.12.2011
Commission receivable	980	300
Trade receivables	692	80
Other receivables	464	3,599
TOTAL NET OTHER FINANCIAL ASSETS	**2,135**	**3,979**
Other financial assets maturing within 12 months of the reporting date	2,135	3,979
Other financial assets maturing in a period of more than 12 months of the reporting date	–	–

19. Movement of Impairment of Loans to Clients

EUR '000

				2012				2011
	Government	General population	Other	Total	Government	General population	Other	Total
Balance at 1 January	**17**	**3,431**	**46,102**	**49,550**	**27**	**8,843**	**106,914**	**115,784**
Formation	245	2,696	45,120	47,953	1	3,337	73,093	76,431
Release	37	937	27,047	28,021	11	2,018	35,001	37,030
Net	208	1,651	18,073	19,932	(10)	1,319	38,092	39,401
Write-offi+unwinding	–	219	6,947	7,166	–	6,731	98,904	105,635
Balance at 31 December	**225**	**4,863**	**57,228**	**62,316**	**17**	**3,431**	**46,102**	**49,550**

Utilisation relates to the write-off of loans under the net principle.

Pursuant to Article 25a of the Decision on estimating credit risk losses of banks and savings banks (O G RS, no. 29/2012), the Bank wrote-off a total of €700 thousand of loans. Until the legal basis needed for the completion of the recovery process becomes available, these are reported in the off balance sheet records.

Unwinding relates to technical interest.

20. Financial assets held to maturity

EUR '000

	31.12.2012	31.12.2011
Republic of Slovenia bonds	76,601	36,462
Other issuers	6,683	–
Treasury bills	4,960	–
Bonds issued by banks	2,257	–
TOTAL	**90,501**	**36,462**
Financial assets held to maturity quoted on stock market	88,244	36,462
Financial assets held to maturity – maturing within 12 months of the reporting date	8,028	–
Financial assets held to maturity – maturing in a period of more than 12 months of the reporting date	80,216	36,462

a) Movement of HTM financial assets

EUR '000

	31.12.2012	31.12.2011
Balance at 1 January	**36,462**	**42,315**
Purchases	2,641	
Sales	0	
Matured	0	(6,020)
Reclassified from AFS financial assets	49,220	0
Amortization + Interest	2,178	167
Balance at 31 December	**90,501**	**36,462**

As at 31 December 2012, the Bank pledged securities classified as held to maturity for long-term refinancing operations and settlements in relation to STEP2. The total value of the pledged financial assets held to maturity was €74,032 thousand (2011:€36,462 thousand).

Fair values of assets classified as held to maturity are disclosed in Note "Fair values of assets and liabilities" on page 112.

b) Reclassification

For the purpose of balancing maturities of assets and liabilities and financial risk management, as at 2 July 2012, the Bank reclassified financial assets available for sale to the held-to-maturity category.

EUR '000

	31.12.2012	31.12.2011
Classification from AFS category to HTM		**-**
Carrying amount at 31 December 2012	49,563	-
Fair value at 31 December 2012	50,313	-
Fair value of gains recognised additionally if there was no reclassification	1,093	-
Losses recognised in the profit or loss after reclassification (release of revaluation reserve)	-137	

€137 thousand relates to revaluation reserve recognised in the profit or loss after reclassification of AFS to HTM category. At 31 December 2012, the remaining amount of the revaluation reserve was €1,537 thousand. The amount is recognised in the other comprehensive income.

21. Property, plant and equipment

2012

EUR '000

	Notes	Land	Buildings	Computer equipment	Furniture and other equipment	Motor vehicles	Leasehold assets	FA under constru-ction	Total
									2012
Cost									
Balance at 1 January 2012		**367**	**2,242**	**3,664**	**6,511**	**246**	**451**	**101**	**13,582**
Additions to assets under construction		–	–	–	–	–	–	645	645
Transfer to assets		–	2	568	55	–	17	(642)	–
Disposals		–	–	(181)	(108)	–	–	–	(289)
Balance at 31 December 2012		**367**	**2,244**	**4,051**	**6,458**	**246**	**468**	**104**	**13,938**
Accumulated depreciation									
Balance at 1 January 2012		**-**	**(294)**	**(2,831)**	**(4,608)**	**(184)**	**(60)**	**-**	**(7,977)**
Depreciation	9	–	(56)	(440)	(522)	(43)	(57)	–	(1,371)
Disposals			–	181	107	–	–	–	767
Balance at 31 December 2012		**-**	**(350)**	**(3,090)**	**(5,023)**	**(227)**	**(117)**	**-**	**(8,807)**
Carrying amount									
Balance at 1 January 2012		**367**	**1,948**	**833**	**1,903**	**62**	**391**	**101**	**5,605**
Balance at 31 December 2012		**367**	**1.894**	**961**	**1.435**	**19**	**351**	**104**	**5.131**

2011

EUR '000

	Notes	Land	Buildings	Computer hardware	Furniture and other equipment	Motor vehicles	Leasehold improve-ments	Fixed assets under con-struction	Total
									2011
Cost									
Balance at 1 January 2011		**367**	**2,242**	**3,733**	**6,134**	**525**	**251**	**137**	**13,389**
Additions to assets under construction		–	–	–	–	–	–	1,019	1,019
Transfer to assets		–	–	458	397	–	200	(1,055)	–
Disposals		–	–	(527)	(20)	(279)	–	–	(826)
Balance at 31 December 2011		**367**	**2,242**	**3,664**	**6,511**	**246**	**451**	**101**	**13,582**
Accumulated depreciation									
Balance at 1 January 2011		**–**	**(238)**	**(2,805)**	**(3,982)**	**(329)**	**(19)**	**–**	**(7,373)**
Depreciation	9	–	(56)	(553)	(646)	(75)	(41)	–	(1,371)
Disposals			–	527	20	220	–	–	767
Balance at 31 December 2011		**–**	**(294)**	**(2,831)**	**(4,608)**	**(184)**	**(60)**	**–**	**(7,977)**
Carrying amount									
Balance at 1 January 2011		**367**	**2,004**	**928**	**2,152**	**196**	**232**	**137**	**6,016**
Balance at 31 December 2011		**367**	**1,948**	**833**	**1,903**	**62**	**391**	**101**	**5,605**

In 2012, the Bank wrote-off property, plant and equipment with no present value in the amount of €277 thousand. The cost of property, plant and equipment that are fully depreciated but continue to be used by the Bank amounts to €5,949 thousand (2011: €3,831 thousand).

The Bank did not pledge any assets as collateral in the period under review.

22. Intangible assets

2012

EUR '000

	Notes	Software	Long-term deferred development costs	Other intangible assets	Assets being developed	Total
Cost						
Balance at 1 January 2012		**8,181**	**32**	**42**	**2**	**8,257**
Additions		1,141	-	-	-	1,141
Disposals		-	-	-	(2)	(2)
Balance at 31 December 2012		**9,322**	**32**	**42**	**-**	**9,396**
Accumulated amortisation						
Balance at 1 January 2012		**(4,061)**	**(32)**	**(42)**	**-**	**(4,135)**
Amortisation	9	(1,201)	-	-	-	(1,201)
Disposals		-	-	-	-	-
Balance at 31 December 2012		**(5,262)**	**(32)**	**(42)**	**-**	**(5,336)**
Carrying amount						
Balance at 1 January 2012		**4,120**	**-**	**-**	**2**	**4,122**
Balance at 31 December 2012		**4,060**	**-**	**-**	**-**	**4,060**

2011

EUR '000

	Notes	Software	Long-term deferred development costs	Other intangible assets	Assets being developed	Total
Cost						
Balance at 1 January 2011		**7,228**	**32**	**42**	**4**	**7,306**
Additions		953	-	-	(2)	951
Disposals		-	-	-	-	-
Balance at 31 December 2011		**8,181**	**32**	**42**	**2**	**8,257**
Accumulated amortisation						
Balance at 1 January 2011		**(3,016)**	**(32)**	**(42)**	**-**	**(3,090)**
Amortisation	9	(1,045)	-	-	-	(1,045)
Disposals		-	-	-	-	-
Balance at 31 December 2011		**(4,061)**	**(32)**	**(42)**	**-**	**(4,135)**
Carrying amount						
Balance at 1 January 2011		**4,212**	**-**	**-**	**4**	**4,216**
Balance at 31 December 2011		**4,120**	**-**	**-**	**2**	**4,122**

The cost of fully amortised intangible assets which continue to be used by the Bank amounts to €856 thousand (2011: €735 thousand).

In the year under review, no items of fixed assets were pledges as collateral.

23. Other assets

EUR '000

	31.12.2012	31.12.2011
Advances	11	2
Tax credits	11	4
Deferred costs	2,055	2,874
TOTAL	**2,077**	**2,880**

In 2012 the Bank of Slovenia amended its Decision on books of account and annual reports of banks and savings banks (O G RS No. 17/2012. Accordingly, the items and balances should be classified as defined in the Guidelines for the implementation of the Decision on reporting of monetary financial institutions. In line with the amendments, other financial assets, which were recognised under other assets, are now reclassified to loans. As a consequence, the Bank also reclassified the comparable data for the financial year 2011 (€3,979 thousand). Please see Note 18.

24. Financial liabilities to the Central Bank

EUR '000

	31.12.2012	31.12.2011
Short-term loans	131,299	120,147
Total	**131,299**	**120,147**
Financial liabilities to the Central bank maturing within 12 months of the reporting date	-	20,119
Financial liabilities to the Central bank maturing in a period of more than 12 months of the reporting date	**131,299**	**100,028**

a) ECB collateral

EUR '000

	2012	2011
Assets suitable for ECB collateral	**159,743**	**142,813**
Assets pledged into ECB Pool	132,000	122,000
AFS financial assets	24,243	55,746
HTM financial assets	74,032	36,462
Loans	61,468	50,605
Non-pledged assets (pledge-free assets)	27,743	20,813
Value of ECB Pool	**159,743**	**142,813**

In Notes 15,17 and 20, the amount of ECB collateral is inclusive of the related interest.

25. Financial liabilities held for trading

EUR '000

	31.12.2012	31.12.2011
Forward contracts – foreign exchange	25	255
Options – interest	636	237
Swaps - interest	7,185	4,229
Total derivatives	**7,846**	**4,721**

The contractual values of the derivatives are presented in the Note 19a.

26. Deposits and borrowings

a) Deposits of banks and clients

EUR '000

	31.12.2012	31.12.2011
Sight deposits by	**128,240**	**108,799**
- banks	631	248
- clients	127,609	108,551
Term deposits received from	**1,274,599**	**1,325,670**
- banks	674,221	720,589
- clients	600,378	605,081
TOTAL	**1,402,839**	**1,434,469**
Deposits of banks and clients maturing within 12 months of the reporting date	936,077	571,871
Deposits of banks and clients maturing in a period of more than 12 months of the reporting date	466,762	862,598

b) Borrowings from banks and clients

EUR '000

	31.12.2012	31.12.2011
Borrowings from banks	117,711	159,615
Borrowings from clients	-	-
TOTAL	**117,711**	**159,615**
Borrowings from banks maturing within 12 months of the reporting date	22,370	15,440
Borrowings from banks maturing in a period of more than 12 months of the reporting date	95,341	144,175

27. Subordinated liabilities

EUR '000

	Currency	Maturity	APR	31.12.2012		31.12.2011	
				Principal	Interest	Principal	Interest
Subordinated borrowings	EUR	25.06.2016	3mEUR+0.80%	20,000	0	20,000	2
	EUR	21.02.2017	6mEUR+0.65%	38,000	1	38,000	6
	EUR	30.10.2018	3mEUR+4.00%	15,000	2	15,000	4
TOTAL				**73,000**	**3**	**73,000**	**12**
TOTAL AMORTISED COST					**73,003**		**73,012**
Subordinated borrowings maturing within 12 months of the reporting date					3		12
Subordinated borrowings maturing in a period of more than 12 months of the reporting date					73,000		73,000

In the financial years 2006, 2007 and 2008, the Bank signed 3 contracts for subordinated borrowings which meet conditions to classify as an innovative instrument as specified in Article 25 of the Decision on capital calculation of banks and saving banks (O G RS, no. 100/2012). In accordance with the Decision, subordinated non-current borrowings are included the Bank's Tier 2 capital.

The issued contracts do not include any provisions on the conversion to capital or any other obligation, such as a withdrawal clause.

Fair value is disclosed in Note “Fair values of assets and liabilities” on page 112.

28. Other financial liabilities

EUR '000

	31.12.2012	31.12.2011
Fees and commission payable	62	83
Payables to suppliers	1,706	1,493
Wages and salaries payable	681	619
Contributions payable	404	380
Accrued costs	1,130	1,944
Deferred income	15	-
Other liabilities from business relations	2,319	16,298
TOTAL	**6,317**	**20,817**

29. Provisions

EUR '000

	Provisions for off-balance-sheet liabilities		Provisions for employee benefits			Provisions for legal disputes	Provisions for restructuring	Total
	Provisions for guarantees	Provisions for undrawn borrowings	Termination benefits upon retirement	Jubilee awards	Management severance payments			
Balance at 1 January 2011	**3,486**	**3,255**	**373**	**88**	**155**	**-**	**-**	**7,357**
Set aside	3,911	18,005	0	12	-	-	-	21,928
Reversed	3,440	18,895	112	0	111	-	-	22,558
Utilised	-	-	-	7	44	-	-	51
Balance at 31 December 2011	**3,957**	**2,365**	**261**	**93**	**-**	**-**	**-**	**6,676**
Set aside	2,646	10,535	-	19	-	342	540	14,082
Reversed	3,433	10,485	4	-	-	-	-	13,929
Utilised	-	-	0	7	-	-	-	-
Balance at 31 December 2012	**3,170**	**2,415**	**257**	**105**	**-**	**342**	**540**	**6,829**

30. Deferred tax

EUR '000

	31.12.2012	31.12.2011
Tax rate	**15%**	**20%**
Available-for-sale financial assets	321	745
Available-for-sale financial assets (impairment)	2,283	2,390
Different depreciation rates for operating and tax purposes	108	96
Provisions for employee benefits	65	39
Tax loss	8,789	10,556
Unutilised tax allowances	206	125
Total deferred tax assets	**11,772**	**13,951**
Available-for-sale financial assets (through special capital revaluation reserve)	565	-
Different depreciation rates for operating and tax purposes	1	3
Total deferred tax liabilities	**566**	**3**
Net deferred tax assets / liabilities	**11,206**	**13,948**
Included in the profit or loss	(1,753)	6,977
Available-for-sale financial assets (impairment)	(107)	2,196
Different depreciation rates for operating and tax purposes	14	28
Provisions for employee benefits	26	(19)
Tax loss and reliefs	(1,686)	4,772
Included in equity	**(989)**	**1,160**
Revaluation of available-for-sale financial assets through statement of comprehensive income	(989)	1,160

Deferred tax is recognised on account of temporary differences using the balance sheet liability method. Tax rates applicable in the period when temporary differences are reversed are used; in 2012, the tax rate was 15% (2011: 20%).

31. Other liabilities

EUR '000

	31.12.2012	31.12.2011
Tax and contributions payable	603	381
Deferred income	725	1,132
TOTAL	**1,328**	**1,513**

In 2012, the Bank of Slovenia amended its Decision on books of account and annual reports of banks and savings banks (O G RS No. 17/2012. Accordingly, the items and balances should be classified as defined in the Guidelines for the implementation of the Decision on reporting of monetary financial institutions. In line with the amendments, other financial liabilities, which were recognised under other liabilities and deposits measured at amortised cost, are now reclassified to Financial liabilities at amortised cost. As a consequence, the Bank also reclassified the comparable data for the financial year 2011 (€3,491 thousand). Please see Note 28.

32. Equity

EUR '000

	31.12.2012	31.12.2011
Share capital	174,037	174,037
Capital surplus	2,696	27,696
Revaluation reserve	1,386	(2,981)
Revenue reserves (including retained earnings)	(13,640)	(11,774)
– obligatory reserves	1,862	1,862
– retained earnings / (accumulated loss)	(15,502)	(13,636)
Net profit/loss for the year	(11,416)	(26,866)
Total	**153,063**	**160,112**

The Bank's sole owner (100 per cent) is Hypo Alpe-Adria-Bank International AG, with its headquarters in Klagenfurt, Austria.

a) Share capital

Share capital is recorded in the nominal value and has been subscribed and paid-up by the owners.

There were no changes of share capital in 2012 as compared to 2011.

The last increase in the share capital was carried out in 2008, when the Bank raised €60,000 thousand by issuing 14,378,489 of no-par value shares representing 52.61 per cent increase in the subscribed capital.

A total of 41,706,318 no-par value shares labelled HYPG are registered with the central register of book-entry securities. In terms of their rights, all shares are ordinary registered no-par value shares.

b) Capital surplus

The share premium of the Bank comprises €93 thousand of surplus capital paid-up above the minimum amount of share issue (31 December 2011: €93 thousand) and amounts resulting from reversal of the general capital revaluation adjustment of total €2,603 thousand (31 December 2011: €2,603 thousand).

In 2011, the share premium was increased by €25,000 thousand of additional capital paid-in by the owner.

c) Revaluation reserve

The revaluation reserve relates to enhancement or impairment of available-for-sale financial assets.

As at 31 December 2012, the revaluation reserve is positive in the amount of €1,385 thousand (31 December 2011: €2,980 thousand).

d) Revenue reserves

Revenue reserves may only be made from the amounts of net profit for the year and retained earnings. They are intended primarily for settlement of potential losses in the future. They are classified as obligatory reserves, reserves for treasury shares, treasury shares, statutory reserves and other revenue reserves.

According to the provisions of the Companies Act, the amount of the Bank's legal reserves, which comprise obligatory reserves and capital surplus, has to be equal to 10% of the share capital of the Bank or equal to a higher percentage if so defined by the statute. When obligatory reserves and capital surplus together do not amount to the above stated amount of the share capital, the Bank has to transfer 5% of the net profit less the amount used to cover potential losses brought forward, to the obligatory reserves at the balance sheet preparation.

Revenue reserves in the amount of €1,862 thousand (31 December 2010: €1,862 thousand) represent obligatory reserves. As at 31 December 2011, the Bank did not recognise any other revenue reserves (31 December 2010: the bank had no other revenue reserves).

Capital surplus and obligatory reserves (time reserves) may only be used under the following conditions:

a) If the total amount of these reserves does not reach the percentage of the share capital determined by law or the articles of association, they may only be used:
   - to cover a net loss for the financial year if it cannot be covered from retained earnings or from other revenue reserves;
   - to cover a loss brought forward if it cannot be covered from the net profit for the financial year or from other revenue reserves;

b) If the total amount of these reserves exceeds the percentage of the share capital determined by law or the articles of association, the surplus amount of these reserves may be used:
   - to increase the share capital from the Bank’s assets;
   - to cover a net loss for the financial year if it cannot be covered from retained earnings, provided that revenue reserves are not simultaneously used for a payout of profit to the members, and
   - to cover a net loss brought forward if it cannot be covered from net profit for the financial year, provided that revenue reserves are not simultaneously used for a payout of profit to the members

Other revenue reserves may be used for any purpose, unless stated otherwise in the statute.

e) Net profit / loss for the year

Net profit for the year may be used to:

- Create obligatory reserves,
- Create reserves for treasury shares,
- Create statutory reserves and
- Create other revenue reserves.

The table below shows the appropriation of distributable profit:

EUR '000

	2012	2011
Net profit /(loss) for the year	(11,416)	(26,866)
Total distributable profit / (loss)	**(11,416)**	**(26,866)**

The Bank has recorded a loss for the financial year 2012 in the amount of €11,416 thousand (2011: net loss in the amount of €26,866 thousand).

The Bank's Supervisory Board approved the Management Board's proposal to settle the net loss of 2012 with €2,696 million of the capital surplus and €1,862 million of legal reserves, and proposed it for adoption at the Bank's General Meeting of Shareholders.

33. Contingent liabilities and assumed financial obligations

EUR '000

	31.12.2012	31.12.2011
Guarantees	**82,230**	**86,281**
Service guarantees	**55,844**	**54,728**
Short-term	14,183	11,447
Long-term	41,661	43,281
Financial guarantees	**26,386**	**31,553**
Short-term	12,787	15,104
Long-term	13,599	16,449
Assumed obligations from approved loans	**76,621**	**88,801**
Approved loans	**26,036**	**32,618**
Short-term	23,754	28,131
Long-term	2,282	4,487
Approved credit lines	**50,585**	**56,183**
Derivatives	**368,632**	**354,162**
TOTAL	**527,483**	**529,244**

Assumed liabilities from approved loans can be withdrawn within one year at the latest.

Residual maturities of financial guarantees are presented in Note "Financial risk management – liquidity risk".

Other notes

34. Fiduciary accounts

In accordance with the local legislation (Decision on disclosures of banks and savings banks (O G RS No. 100/2011), this note includes presentation of assets and liabilities of clients resulting from intermediary operations. As at 31 December 2012, the Bank managed assets of total €1,022 thousand (31 December 2011: €764 thousand) on account of intermediary operations. These assets are recorded separately from the Bank's own assets in the off-balance-sheet records as authorised operations.

EUR '000

	31.12.2012	31.12.2011
ASSETS	**1,022**	**764**
Receivables of the settlement account or transaction accounts for clients' assets	**199**	**71**
From financial instruments (31.a.)	33	47
To Central Securities Clearing Corporation or bank's settlement account for financial instruments disposed of	118	1
To other settlement systems and institutions for sold (clients') financial instruments	48	23
Clients' cash	**823**	**693**
On the settlement account for client's assets	823	693
LIABILITIES	**1,022**	**764**
Liabilities of the settlement account or transaction accounts for clients' assets	**1,022**	**764**
To clients from cash and financial instruments	989	717
To Central Securities Clearing Corporation or bank's settlement account for purchased financial instruments	12	-
To other settlement systems and institutions for purchased (suppliers') financial instruments	11	41
To bank or bank's settlement account for commission, costs and similar items	10	6

a) Receivables of the settlement account or transaction accounts for clients' financial instruments

EUR '000

	31.12.2012	31.12.2011
Off-balance-sheet records		
1. Clients' financial instruments, separately by services	33	47
Receiving, brokerage and processing orders	33	47

35. Related party transactions

Bank's exposure to entities in special relationship with the Bank

EUR '000

	Members of the Management Board and their close family members, staff with individual contracts of employment and the members of management of related parties	
	2012	2011
Granted loans		
Balance at 1 January	**2,296**	**2,076**
New loans	1,479	994
Repayments	820	774
Balance at 31 December	**2,955**	**2,296**
Interest and fee and commission income	66	68
Received deposits		
Balance at 1 January	**599**	**725**
Balance at 31 December	**786**	**599**
Interests expense	3	25
Approved overdrafts and loans		
Balance at 1 January	**110**	**183**
Balance at 31 December	**195**	**110**
Earnings		
Salaries and other short-term benefits	1,557	1,937
Bonuses	4	41
Attendance fees and annual allowance	-	-
Provisions for employees benefits	41	71

In accordance with the Rules of procedure of the Supervisory Board of Hypo Alpe-Adria-Bank, members of the Supervisory Board who are employed in the Hypo Group Alpe Adria, are not entitled to attendance fees or incentives.
In 2012 and 2011, members of the Supervisory Board were not clients of the Bank.

Remunerations of the Management Board in 2012

EUR '000

	Falatov Matej (Member)	Bošnjak Marko (Member)	Heribert Fernau President
Salaries	160	135	-
Variables	-	-	-
Reimbursement of costs	1	1	-
Other (additional pension insurance)	3	-	-
On assignment	-		304

Marko Bošnjak was appointed member of the Management Board in 2012 and was issued a licence to hold function of a member of the Management Board on 1 March 2012.

Heribert Fernau, President of the Management Board assumed his function on 1 June 2012 when he was granted a licence to hold the function. He is employed by the parent bank Hypo Alpe–Adria–Bank International AG and is on assignment in the Bank.

Bank's exposure to its related parties

EUR '000

	Controlling entity		Related parties	
	2012	2011	2012	2011
ASSETS				
Financial assets held for trading				
Balance at 1 January	239	375	189	-
Balance at 31 December	-	239	579	189
Sight deposits				
Balance at 1 January	7,801	4,798	184	290
Balance at 31 December	37,284	7,801	249	184
Loans				
Balance at 1 January	6,581	-	-	-
New loans	75,623	66,283	-	-
Repayments	82,204	59,702	-	-
Balance at 31 December	-	6,581	-	-
Other financial assets				
Balance at 1 January	-	-	-	-
Balance at 31 December	-	-	2	-
Other assets				
Balance at 1 January	-	-	101	37
Balance at 31 December	3	-	667	101
LIABILITIES				
1. Financial liabilities held for trading				
Balance at 1 January	4,221	2,005	67	58
Balance at 31 December	7,177	4,221	20	67
Sight deposits				
Balance at 1 January	11	4	730	1,309
Balance at 31 December	13	11	24,244	730
Current deposits				
Balance at 1 January	70,414	21,501	45,730	5,747
Increase	257,298	115,493	-	-
Decrease	72,375	66,580	-	-
Balance at 31 December	255,337	70,414	28,084	45,730
Non-current deposits				
Balance at 1 January	650,161	1,178,258	-	-
Increase	23,155	210,877	-	-
Decrease	261,161	738,974	-	-
Balance at 31 December	412,155	650,161	-	-
Subordinated debt				
Balance at 1 January	73,012	73,005	-	-
Increase	1,341	1,544	-	-
Decrease	1,350	1,537	-	-
Balance at 31 December	73,003	73,012	-	-

	Controlling entity		Related parties	
	2012	2011	2012	2011
Other liabilities				
Balance at 1 January	1,242	35	11,042	6
Balance at 31 December	334	1,242	664	11,042
OFF-BALANCE-SHEET RECORDS				
Issued guarantees				
Balance at1 January	158	270	1,448	1,793
Balance at 31 December	2,094	158	492	1,448
PROFIT AND LOSS				
Interest income	42	167	1	1
Interest expense	13,312	21,553	1,401	260
Fee and commission income	-	-	723	85
Fee and commission expense	1,736	1,659	26	34
Other income	-	-	-	41
Other expenses	700	1,460	1,660	1,567
Trading result	(5,132)	(3,529)	551	123

The Bank is a wholly owned subsidiary of Hypo Alpe Adria International AG with registered office in Klagenfurt, Austria, and has no investments in subsidiaries, associates, or banks. However, the Bank is indirectly related with the banks and enterprises in the Hypo Group through its parent bank.

The Bank cooperates with its parent bank, related banks and enterprises in transactions involving loans, deposits, issuing of letters of credit and guarantees as shown in the table above.

In accordance with Article 545 of the Companies Act, we hereby declare that to the extent of circumstances known to it, the Bank performs services between related parties under the market conditions.

In all transactions with the parent bank and other related parties, the Bank has obtained appropriate payments and has not suffered any loss as a result of related party transactions.

4.5 Financial risk management

Risk awareness and proactive focus on risk management are the two key elements, which are reflected in the operating activities of the Hypo Group.

Risk management procedure in Hypo Alpe-Adria-Bank d.d. comprises three components:

- The controlling component, which consists of identification, measurement (analysing, valuation) and monitoring of risks from portfolio's point of view and risk reporting,
- The risk limiting component,
- The risk managing component, which consists of risk acceptance, risk avoidance and mitigation, transfer and risk diversification.

Pursuant to the HAA risk management policy, in 2012 the Bank set up a united organisational structure where risk management responsibilities for individual section are segregated and responsible directly to the CRO (member of the Management Board responsible for risk management). Furthermore, an independent unit responsible for the management of risks related to retail clients was set up. Its main task is to identify, measure and actively be involved in the process of loan approval to retail clients.

Organisational structure of the risk management stream:

- Credit Risk Management
- Credit Rehabilitation
- Task Force Management
- Risk Controling
- Retail Risk Management
- Credit Processing

All the above are continually involved in active monitoring and assessment of the risk management process in order to:

- Identify individual risk exposure
- Define methods used to measure risks that are materially significant
- Define risk management policies pertaining to individual risks
- Propose individual risk exposure limits and
- Perform other tasks to mitigate risks which the Bank is exposed to.

The Bank's Management Board defines the Bank's strategy and goals and is responsible for assumed risks (within the Group's strategy and goals). The strategy is explained in more details at the ALCO (Asset and Liabilities Committee) meetings. Business departments are responsible for implementing business goals and are liable for risk management related to these goals. Risk is managed actively on all levels and within the valid risk limits (defined by departments/functions that are independent in respect of operating sectors) by performing activities for assuming risk, avoiding risk and mitigating, transferring and diversifying risk.

In 2012, the Bank continued the appropriate internal capital adequacy assessment process as defined by the second pillar of the new equity directive (Basel II). The Bank monitored some specific key indicators of economic development (GDP, consumer's spending index, industrial orders and similar) through its RECO (Risk Executive Committee) committee that deals with all important risks comprehensively and in one place. The Bank's intention was to identify potential exposure to the most risk related industrial sectors, segments, types of collateral, delays etc, where the enterprises faced the biggest problems that influenced their ability to service granted loans thus increasing the risk level in the Bank's credit portfolio. On the basis of this information, the committee suggested guidelines for adjustment of the Bank's operating policy and its risk management strategy.

The Bank continued with the implementation and improvement of its credit process pursuant to the guidelines and the parent bank's policies. Most of the Bank's attention was put on managing non-performing loans, as the poor payment discipline of companies consistently aggravated throughout 2012. A new Task Force Management department was established for a certain group of risk clients all of whom represent high risk. Furthermore, legal proceedings are in progress against the majority of these high-risk clients and both these factors mean that they are closely monitored by the new department. In spite of this, in 2012 there was an increase of clients and default exposures, deterioration in the Bank's loan portfolio, and consequently high value of impairments.

In 2012, the credit risk management integration process of the Bank and the leasing company was completed. The new integrated process is more complex and has a number of additional controls. Furthermore, the risk management process was divided into two highly specialised departments: Financial analysis and Credit risk assessment. This provides the basis for preparation of improved and high quality credit opinions as specialisation allows for better risk management of individual sectors.

In 2011, the Bank made an in-depth analysis of the loan portfolio within the framework of the project managed by the parent bank. Corporate monitoring department participated in the project whose main goal was regular monitoring and early identification of potential default clients in order to prevent and mitigate the number of default clients. As a continuation of the project implemented in 2011, in the financial year under review, Corporate monitoring department was involved in the following key projects: introduction of the committee for monitoring problematic investments, improvement of the recovery process, reduction in the portfolio of monitored investments, reconciliation of the credit committee and investment monitoring committee, all with a view of improved management of individual risk areas..

Department for Credit risk management support was established at the end of 2011 as part of the credit process in accordance with the HGAA policies and principles. Its main tasks are to ensure better transparency and monitoring of the credit process, as well as to reduce potential for errors or deficiencies. The process of monitoring compliance with commitments was also improved.

The main purpose of these measures was to ensure recognition of sufficient amount of impairments and capital adequacy management. In the financial year under review, the Bank continued to pursue its objectives of efficient management and control of risk weighted assets and its optimisation, to ensure quality capital management. As part of the optimisation process and monitoring of limits, the Bank set up a Counterparty Risk Management process (CPRM). Its tasks is setting annual limits and monitoring of maximum allowed credit risk exposure in terms of individual sector's exposure, internal credit ratings in order to mitigate credit risk and ensure sufficient amount of capital for all credit risks.

The Bank is aware of the effect the global decline of economic activity has on collateralised assets, above all on values of real estate property and securities; this is why it regularly runs the so-called "stress scenarios" in respect of decrease of the credit collateral and studies the results of these simulations. Once the value of the collateral falls below the internally defined minimum ratio, the Bank calls upon its clients to either provide additional collateral or repay the loan. Management of collateral is the key to managing the Bank's equity and recognition of the required impairments of the Bank's credit portfolio. One of the fundamental tasks of the new department that was set up is also to monitor and ensure appropriate collateral.

In respect of the liabilities related to obtaining additional financing sources, the Bank acts pursuant to instructions of the parent bank in Austria. The agreed credit lines are compliant with the plans for continuing growth of the credit portfolio. On the other hand, the Bank plans to acquire new assets for financing of investments through received deposits from legal entities as well as individuals, as set in the planned goals. This will provide the resources for financing the assets as the growth in assets will be conditional to the growth of liabilities.

The Bank does not expect a significant improvement of financial markets and economic environment in 2013. Active monitoring and risk management (above all credit and liquidity risk) in respect of the clients and collateral continues to be the Bank's primary task for the future.

The Bank manages its capital adequacy from a regulatory perspective as well as from the internal planning perspective (ICAAP – International Capital Adequacy Assessment Process) on a monthly basis. Monthly credit portfolio monitoring allows appropriate measures to be taken in the event when the set limit exposures are exceeded. To ensure appropriate level of capital adequacy, the Bank has set the RWA (Risk Weighted Assets) limits for control of the capital adequacy ratio. The Capital Steering Committee which was set up by the Bank meets on a monthly basis or more often if and when the need arises. Its task is to ensure compliance with the minimum standards prescribed by the supervisor and setting up internal limits.

As part of its risk management activities, the Bank closely monitors all legislative changes and guidelines. As a response to the forthcoming implementation of the new capital directive CRD IV/CRR (Basel III), the Bank has been actively working on setting up all the necessary processes and measures. The Bank closely monitors any changes made to »Basel III« directives, and has been assessing its potential effects on the current and future operations of the Bank in line with the strategy.

Credit risk

Credit risk is a risk of financial loss resulting from the debtor's inability to fulfil his financial or contractual obligation towards the Bank in part or in full for any reason. Credit risk management is a key component of the Bank's diligent and safe operations. Diligent credit risk management comprises prudent management of the relationship between risk and return and supervision and reduction of credit risk through different perspectives, such as quality, concentration, currency, maturity, collateral and type of loans.

Throughout the duration of the credit relationship with the client, the Bank monitors client's operations and quality of the financial asset's collateral or the assumed liability.

The starting point for monitoring and classification of clients is a systematic review of the Bank's portfolio. The Bank classifies the financial assets measured at amortised costs or assumed liabilities in the off-balance sheet items on the basis of the internal methodology.

In 2010, the Bank had, in accordance with International Financial Reporting Standards (IFRS) adopted by the EU and the decisions of the Bank of Slovenia, considered all the exposures, where the Bank's exposure to a single debtor exceeded €150,000, as individually relevant financial asset or assumed liability in the off-balance-sheet items and had regularly and individually assessed them.

Other key indicators of the potential impairment of the financial asset, which are used by the Bank as criteria for individual assessment of the debtor, are:

- The client is in delay with repayment of its obligations in the materially important amount for at least 90 days;
- Bankruptcy or compulsory settlement of the client;
- Proof of client's serious financial problems, including amongst other reprogramming due to the client's economic, legal or other problems, irregular settlement of liabilities within the group of related entities and significant economic problems in the client's industry.

For clients that represent individually insignificant exposure for the Bank or for clients for which the Bank estimates, upon individual assessment, that individual impairment of the financial asset is not required, a collective calculation of the portfolio impairment of the financial asset is made in accordance with of IFRS' requirements. The Bank recognises the percentage of the group impairment as loss for the year.

The Bank has adopted additional measures designed to ensure the appropriate supervision over credit risks. New tools were implemented to the investment decision procedure in this respect; these tools are used for credit rating classification of clients. The table of the Bank's internal credit ratings mapped pursuant to the credit ratings of external credit rating agencies.

Internal rating	PD	S&P	Moodys	Fitch	Description of the grade
1A	0.000%	AAA, AA+, AA, AA–	Aaa, Aa1, Aa2, Aa3	AAA, AA+, AA	Investment grade
1B	0.03%				Investment grade
1C	0.07%	A+	A1	AA–	Investment grade
1D	0.15%	A+	A1	A+	Investment grade
1E	0.3%	A	A2	A+	Investment grade
2A	0.5%	A–	A3	A	Investment grade
2B	0.8%	BBB+	Baa1	A–	Standard monitoring
2C	1.2%	BBB	Baa2	BBB+	Standard monitoring
2D	1.7%	BBB–	Baa3	BBB+	Standard monitoring
2E	2.3%	BBB–	Baa3	BBB–	Standard monitoring
3A	3%	BB+	Ba1	BBB–	Standard monitoring
3B	3.9%	BB	Ba2	BB+	Standard monitoring
3C	5%	BB	Ba3	BB	Standard monitoring
3D	6.3%	BB–	Ba3	BB–	Standard monitoring
3E	7.5%	B+	B1	BB–	Standard monitoring
4A	9%	B+	B1	B+	Standard monitoring
4B	11%	B	B2	B	Standard monitoring
4C	14%	B–	B3	B	Standard monitoring
4D	19%	B–	B3	B–	Standard monitoring
4E	25%	CCC+, CCC, CCC–, CC, C	Caa1, Caa2, Caa3, Ca, C	CCC+, CCC, CCC–, CC, C	Special monitoring
5A	100.000%	D	D	D	Default
5B	100.000%	D	D	D	Default
5C	100.000%	D	D	D	Default
5D	100.000%	D	D	D	Default

The Bank also places much attention to identification and monitoring of credit risk concentration. The risk management department prepares regular monthly reports on risks in the credit portfolio of the Bank for the decision makers; part of this report is notification on exposure to excessive concentration above all in specific industries, credit rating groups and type of collateral.

The total exposure of the Bank from the credit risk as at 31 December 2012 amounts to €2,073,948 thousand. The capital requirement in respect of the credit risks is presented in the Equity calculation table.

Different outlines of the credit risk exposures as at 31 December 2012 are presented below:

a) The highest (maximum) credit risk exposure without taking into consideration the collateral or other improvements (the carrying value of the receivable decreased for potential impairment losses; in the case of financial assets at fair value, the amounts in the table below show present fair value and not the risk resulting from the future change of the fair value).

EUR

			2012			2011
	Gross	Adjustment	Net	Gross	Adjustment	Net
I. Balance sheet items	**1,967,632**	**64,733**	**1,902,899**	**2,021,919**	**52,034**	**1,969,885**
1. Cash and balances with Central Bank	47,638	0	47,638	39,753	0	39,753
2. Loans to banks	1,305	45	1,260	4,001	0	4,001
3. Loans to clients	1,747,263	64,688	1,682,575	1,799,727	52,034	1,747,693
3a. Loans to individuals	578,874	4,055	574,819	591,753	3,394	588,358
-Housing loans	441,020	1,679	439,340	447,749	1,220	446,529
-Consumer credits	122,843	1,871	120,972	131,183	1,752	129,431
-Other	15,011	504	14,507	12,821	422	12,399
3b. Corporate loans	1,168,389	60,634	1,107,755	1,207,974	48,639	1,159,335
-Large enterprises	354,326	9,669	344,657	376,464	19,092	357,372
-Small and medium enterprises	306,568	13,897	292,671	327,056	10,955	316,101
-Other	507,494	37,067	470,427	504,454	18,592	485,862
4. Financial assets held for trading	11,741	0	11,741	19,697	0	19,697
5. Financial assets held to maturity and available-for-sale financial assets	136,647	0	136,647	128,202	0	128,202
6. Other financial assets	23,038	0	23,038	30,537	0	30,537
II. Off-balance-sheet items	**106,316**	**3,259**	**103,057**	**115,487**	**3,811**	**111,676**
1. Financial guarantees	26,176	844	25,332	31,553	1,419	30,135
2. Undrawn loans	80,140	2,415	77,725	83,934	2,393	81,541
Total maximum exposure to credit risk	**2,073,948**	**67,992**	**2,005,956**	**2,137,406**	**55,845**	**2,081,561**

b) Summarised exposure and impairment percentage for individual credit ratings segments

		2012		2011
Credit rating	Gross (%)	Impairment (%)	Gross (%)	Impairment (%)
Investment grade	35.26%	10.45%	12.76%	4.93%
Standard monitoring	48.99%	13.67%	75.35%	32.46%
Special monitoring	3.05%	1.13%	2.59%	1.21%
Default	12.70%	74.75%	9.30%	61.40%
	100.00%	**100.00%**	**100.00%**	**100.00%**

The Bank values the received collateral pursuant to the internal manual on management and valuation of collateral. The value of collateral depends above all on market conditions, time remaining to the realisation of the collateral and related costs. Conditions for the appropriate insurance of the exposures are defined in the Bank's internal acts. The Bank pays special attention to continuous compliance with all conditions for legal executability of collaterals. In the case of the payment default the Bank is entitled to sell the assets received as collateral in accordance with the contractual and applicable legal provisions.

c) Credit risk concentration as per geographic location

2012

EUR

31.12.2012	Slovenia	EU member states	Countries of former Yugoslavia	Other	Total
Content					
I. Balance sheet items	**1,934,047**	**30,681**	**2,775**	**124**	**1,967,628**
1. Cash and balances with Central Bank	47,638	0	0	0	47,638
2. Loans to banks	1,302	3	0	0	1,305
3. Loans to clients	1,715,993	28,435	2,775	59	1,747,263
3a. Loans to individuals	578,341	383	91	59	578,874
-Housing loans	440,847	114	0	59	441,020
-Consumer credits	122,732	33	77	0	122,843
-Other	14,761	236	14	0	15,011
3b. Corporate loans	1,137,653	28,052	2,684	0	1,168,389
-Large enterprises	354,326	0	0	0	354,326
-Small and medium enterprises	306,568	0	0	0	306,568
-Other	476,759	28,052	2,684	0	507,494
4. Financial assets held for trading	9,432	2,244	0	65	11,741
5. Financial assets held to maturity and available-for-sale financial assets	136,647	0	0	0	136,647
6. Other financial assets	23,038	0	0	0	23,038
II. Off-balance-sheet items	**102,315**	**3,917**	**18**	**67**	**106,316**
1. Financial guarantees	25,625	551	0	0	26,176
2. Undrawn loans	76,690	3,367	18	67	80,140
Total maximum exposure to credit risk	**2,036,366**	**34,599**	**2,793**	**191**	**2,073,948**

2011

EUR

31.12.2011	Slovenia	EU member states	Countries of for-mer Yugoslavia	Other	Total
Content					
I. Balance sheet items	**2,008,660**	**10,609**	**2,580**	**69**	**2,021,919**
1. Cash and balances with Central Bank	39,753	0	0	0	39,753
2. Loans to banks	4,001	0	0	0	4,001
3. Loans to clients	1,792,404	4,673	2,580	69	1,799,727
3a. Loans to individuals	591,229	240	214	69	591,753
-Housing loans	447,550	130	0	69	447,749
-Consumer credits	130,934	42	207	0	131,183
-Other	12,745	68	8	0	12,821
3b. Corporate loans	1,201,175	4,433	2,366	0	1,207,974
-Large enterprises	376,464	0	0	0	376,464
-Small and medium enterprises	327,056	0	0	0	327,056
-Other	497,655	4,433	2,366	0	504,454
4. Financial assets held for trading	13,761	5,936	0	0	19,697
5. Financial assets held to maturity and available-for-sale financial assets	128,202	0	0	0	128,202
6. Other financial assets	30,537	0	0	0	30,537
II. Off-balance-sheet items	**115,326**	**0**	**160**	**2**	**115,487**
1. Financial guarantees	31,538	0	15	0	31,553
2. Undrawn loans	83,787	0	145	2	83,934
Total maximum exposure to credit risk	**2,123,985**	**10,609**	**2,740**	**71**	**2,137,406**

d) Credit risk concentration as per industry sector

2012

EUR

31.12.2012	Financial institutions	Manufactu-ring	Real estate	Wholesale and retail trade	Public sector	Other industries	Individuals	Total
I. Balance sheet items	**153,660**	**220,613**	**311,921**	**157,032**	**184,637**	**360,891**	**578,874**	**1,967,628**
1. Cash and balances with Central Bank	47,638	0	0	0	0	0	0	47,638
2. Loans to banks	1,305	0	0	0	0	0	0	1,305
3. Loans to clients	76,083	218,615	311,632	136,473	73,519	352,066	578,874	1,747,263
3a. Loans to individuals	0	0	0	0	0	0	578,874	578,874
-Housing loans	0	0	0	0	0	0	441,020	441,020
-Consumer credits	0	0	0	0	0	0	122,843	122,843
-Other	0	0	0	0	0	0	15,011	15,011
3b. Corporate loans	76,083	218,615	311,632	136,473	73,519	352,066	0	1,168,389
-Large enterprises	60,894	101,214	45,098	66,341	0	80,780	0	354,326
-Small and medium enterprises	12,490	75,754	48,049	51,311	2,286	116,679	0	306,568
-Other	2,699	41,648	218,485	18,822	71,234	154,607	0	507,494
4. Financial assets held for trading	2,272	1,998	289	1,685	0	5,498	0	11,741
5. Financial assets held to maturity and available-for-sale financial assets	3,324	0	0	18,874	111,118	3,331	0	136,647
6. Other financial assets	23,038							23,038
II. Off-balance-sheet items	**4,544**	**23,147**	**18,155**	**16,229**	**9,448**	**16,340**	**18,454**	**106,316**
1. Financial guarantees	551	5,503	534	10,551	9,037		0	26,176
3.Undrawn loans	3,993	17,644	17,621	5,678	411	16,340	18,454	80,140
Total maximum exposure to credit risk	**158,204**	**243,760**	**330,076**	**173,261**	**194,085**	**377,235**	**597,328**	**2,073,948**

2011

EUR

31.12.2011	Financial institutions	Manufactu-ring	Real estate	Wholesale and retail trade	Public sector	Other industries	Individuals	Total
I. Balance sheet items	**356,546**	**249,868**	**319,677**	**157,397**	**77,619**	**372,117**	**591,753**	**2,124,977**
1. Cash and balances with Central Bank	39,753	0	0	0	0	0	0	39,753
2. Loans to banks	4,001	0	0	0	0	0	0	4,001
3. Loans to clients	60,016	248,171	319,563	156,170	73,738	350,316	591,753	1,799,727
3a. Loans to individuals	0	0	0	0	0	0	591,753	591,753
-Housing loans	0	0	0	0	0	0	447,749	447,749
-Consumer credits	0	0	0	0	0	0	131,183	131,183
-Other	0	0	0	0	0	0	12,821	12,821
3b. Corporate loans	60,016	248,171	319,563	156,170	73,738	350,316	0	1,207,974
-Large enterprises	30,190	129,052	47,468	80,383	0	89,370	0	376,464
-Small and medium enterprises	28,030	87,193	48,759	52,120	2,602	108,353	0	327,056
-Other	1,796	31,926	223,335	23,667	71,137	152,593	0	504,454
4. Financial assets held for trading	5,936	1,697	115	1,226	0	10,723	0	19,697
5. Financial assets held to maturity and available-for-sale financial assets	113,243	0	0	0	3,881	11,078	0	128,202
6. Other financial assets	30,537							30,537
II. Off-balance-sheet items	**1,827**	**33,231**	**18,896**	**16,196**	**1,243**	**44,093**	**0**	**115,487**
1. Financial guarantees	15	5,771	1,624	10,706	12	13,426	0	31,553
3.Undrawn loans	1,812	27,460	17,273	5,490	1,232	30,667	0	83,934
Total maximum exposure to credit risk	**255,314**	**283,100**	**338,574**	**173,593**	**78,862**	**416,210**	**591,753**	**2,137,406**

As at 31 December 2012, the total Bank exposure to credit risk amounted to €2,073,944. The credit risks exposure towards clients amounted to €1,747,258. The biggest share of the loans to individuals represents housing loans (76.2%); in the corporate segment, the biggest share belongs to the other industry sectors (30.1%). The biggest share of receivables relates to enterprises located in the Republic of Slovenia and accounts for 99.6% of the total exposure.

The Bank continuously monitors the movement of its credit portfolio and assesses the possibilities of excessive concentration in individual industries by using SWOT analysis of individual industries. These analyses are the basis for adoption of business decisions affecting the Bank's investment policy in respect of reduction of excessive exposure to industries with identified increased credit risk. Thorough analyses are prepared on a quarterly basis as a part of regular reporting and discussion at the risk management committee.

e) Overview of the credit risk for »Loans to banks« and »Loans to clients«

EUR

	2012		2011	
Exposure	Loans to banks	Loans to clients	Loans to banks	Loans to clients
Exposure that is neither past due nor impaired	127	479,675	3,796	407,682
Exposure that is past due but is not individually impaired	0	36,459	0	73,545
Exposure that is not past due and is grouply impaired	852	1,160,496	0	1,295,571
Exposure that is individually impaired	22	139,336	0	138,384
Total	**1,001**	**1,815,966**	**3,796**	**1,915,182**
Value of adjustments (impairments)	**45**	**64,688**	**0**	**53,482**
Net	**955**	**1,751,278**	**3,796**	**1,861,699**
Individual impairments	0	42,335	0	23,404
Group impairments	45	22,353	0	30,079
Total	**0**	**64,688**	**0**	**53,482**

* The table includes the balance sheet and off-balance sheet exposure, excluding guarantees.

f) Loans and advances neither past due nor impaired

EUR

							Loans to clients	
31.12.2012			Loans to individuals			Corporate loans		
Credit rating	Housing loans	Consumer credit	Other	Large enterprises	Medium and small enterprises	Other	Total loans to clients	Loans to banks
Investment grade	48,856	52,659	6,482	68,101	16,300	37,862	230,259	49
Standard grade	105,000	41,146	13,615	4,214	30,086	22,158	216,218	78
Special monitoring	6,285	5,600	1,677	5,402	0	3,243	22,207	0
Default class	1,091	699	182	-573	7,328	2,265	10,991	0
Total	**161,232**	**100,103**	**21,955**	**77,144**	**53,713**	**65,527**	**479,675**	**127**

							Loans to clients	
31.12.2011			Loans to individuals			Corporate loans		
Credit rating	Housing loans	Consumer credit	Other	Large enter-prises	Medium and small enterprises	Other	Total loans to clients	Loans to banks
Investment grade	5,026	24,761	496	3,531	43,758	2,893	80,466	0
Standard grade	144,017	74,685	19,734	6,785	38,844	34,447	318,511	3,796
Special monitoring	2,106	462	238	0	1,865	3,217	7,889	0
Default class	500	193	124	0	0	0	816	0
Total	**151,649**	**100,101**	**20,592**	**10,316**	**84,466**	**40,557**	**407,682**	**3,796**

* The tables include the balance sheet and off-balance sheet exposure, excluding guarantees.

g) Loans and advances past due but not impaired

EUR

31.12.2012			Loans to individuals
	Housing loans	Consumer credits	Other
Delay up to 30 days	100	214	1,368
Delay from 31 to 60 days	6,106	3,186	210
Delay from 61 to 90 days	29	0	95
Total	**6,235**	**3,400**	**1,673**
Internal collateral value	6,234	3,400	1,101
Unsecured part of the exposure	0	0	572

31.12.2012			Corporate loans
	Large enterprises	Small and medium enterprises	Other
Delay up to 30 days	17	5,552	4,169
Delay from 31 to 60 days	5,833	3,542	4,502
Delay from 61 to 90 days	0	1,435	2,718
Total	**5,850**	**10,529**	**11,389**
Internal collateral value	5,402	10,393	10,794
Unsecured part of the exposure	448	136	594

31.12.2011			Loans to individuals
	Housing loans	Consumer credits	Other
Delay up to 30 days	881	366	2,873
Delay from 31 to 60 days	4,611	2,386	112
Delay from 61 to 90 days	126	36	62
Total	5,618	2,788	3,046
Internal collateral value	5,597	2,749	2,551
Unsecured part of the exposure	21	40	496

31.12.2011			Corporate loans
	Large enterprises	Small and medium enterprises	Other
Delay up to 30 days	0	869	4,207
Delay from 31 to 60 days	0	68	2,811
Delay from 61 to 90 days	0	0	1,146
Total	0	938	8,164
Internal collateral value	0	739	8,062
Unsecured part of the exposure	0	199	102

Collateral value is calculated up to the exposure value of the loan. In cases where unsecured part of the exposure is 0, the amounts of past due loans are fully collateralised.

* The tables include the balance sheet and off-balance sheet exposure, excluding guarantees.

h) Loans and advances to clients past due and impaired

Only individually impaired assets are taken into consideration. Collective impairments are calculated and treated as portfolio risk provisions.

EUR

	Loans to individuals			Corporate loans			
	Housing loans	Consumer credit	Other	Large enter-prises	Small and medium enterprises	Other	Total
31.12.2012							
Individually impaired exposure	2,199	2,400	166	15,965	28,490	91,345	140,566
Individual impairments	518	1,746	166	3,588	10,085	26,242	42,345
Internal collateral value	1,162	395	5	3,360	7,354	38,955	51,231
31.12.2011							
Individually impaired exposure	1,478	1,696	152	18,696	16,441	99,921	138,384
Individual impairments	394	1,572	249	7,395	6,155	7,638	23,404
Internal collateral value	1,478	1,696	152	621	7,677	58,251	67,982

The table consists of:

- Exposure of loans which are individually impaired before taking collaterals into consideration
- Amounts of individual impairments
- Internal value of collateral for loans which are individually impaired up to the exposure.

The share of exposure that is not past due and is not impaired represents 26.4% of the total exposure of “Loans to clients”. Exposures that are past due but are not impaired represent 2.0% of the total exposure of “Loans to clients”.

* The tables include the balance sheet and off-balance sheet exposure, excluding guarantees.

i) Loans and advances renegotiated

EUR

Renegotiated loans and advances to clients (in thousand Euro)	2012	2011
Balance January 1	81,828	318,308*
Increase/Decrease	13,072	-236,480
Balance December 31	94,900	81,828

*including contracts carved out from balance sheet

j) Debt securities

The tables below present an analysis of securities by rating grades.

EUR

	Available-for-sale financial assets	Financial assets classified as held to maturity
Investment grade	64,179	36,462
Standard monitoring	10,694	
Total	**74,873**	**36,462**

EUR

	Available-for-sale financial assets	Financial assets classified as held to maturity
Investment grade	24,243	81,562
Standard monitoring	1,026	8,939
Total	**25,269**	**90,501**

k) Repossessed collateral

EUR

	31.12.2012	31.12.2011
Nature of assets	Carrying amount	Carrying amount
Quoted shares (Ljubljana Stock Exchange)	-	24.557

In general, the Bank will dispose of assets, which are not readily convertible in cash, when it is estimated that the highest possible selling price for these assets can be achieved with the goal to secure the highest possible repayment of the Bank's claims or even achieve additional profit. The Bank in general does not use these assets in its operations.

l) Fair value of collateral

EUR '000

		2012		2011
	Retail	Corporate	Retail	Corporate
Collateral – individual impairment	**1,911**	**153,104**	**1,433**	**75,946**
Mortgages	1,494	126,540	1,424	70,796
Securities	391	3,023	0	2,883
Other	26	23,541	9	2,267
Collateral – collective impairment	**498,767**	**926,318**	**346,256**	**178,304**
Mortgages	307,587	676,564	257,749	52,121
Securities	4,411	97,661	5,090	38,650
Other	186,769	152,093	83,417	87,533
Total	**500,678**	**1,079,422**	**347,689**	**254,250**

*Collateral represents weighted amount of the collateral value. For calculation purposes, the value of collateral up to the loan exposure is taken into account for individual transaction.

Liquidity risk

Liquidity risk is a risk that the Bank will not be able to timely and continually fulfil its financial obligations. It derives from time inconsistency between received assets and cash flows to settle its liabilities. The importance of effective controlling and managing of the liquidity risk has increased at the time of the financial crisis.

The Bank has developed internal tools used for the purpose of monitoring future liquidity needs of the Bank, as follows:

- Short term liquidity tool
- LRT - liquidity ratio tool

The Bank manages short-term liquidity risk on the basis of weekly cash flows planning for the period of one year. Based on the contractual maturity of assets and liabilities and planned cash flow, and considering the requirements of liquidity reserves, the new system support "Short-term Liquidity Tool" enables reporting on requirements for additional liquidity sources on the basis of different scenarios for general and special liquidity crisis prepared in advance.

LRT is the basis for the analysis of structural liquidity as it classifies cash flows to individual time pockets (also in the long-term) at actual contractual plans, which allows for more realistic presentation of the deterministic cash flows in addition to stochastic cash flows, which result from modification of certain assets and liabilities that have no maturity and are not liquid. By using the LRT tool, planned cash flows and the Bank's liquidity potential that includes assets designated for liquidity requirements, are classified to time pockets in accordance with the adopted model.

The Bank's liquidity is managed by Balance Sheet Management Dept where all known liquidity flows are recorded. Liquidity calculations and reporting are the responsibility of the Market and liquidity risk control department.

Realisation of the liquidity management is reviewed at monthly ALCO meetings, where the following information is presented:

- The amount and compliance with the obligatory reserve,
- Achieved liquidity ratios,
- Status of refinancing by the parent bank and
- Access to the primary liquidity of the Central Bank.

The table below presents the cash flows of financial assets and financial liabilities by residual maturities at the year-end. The amounts disclosed in the table are the contractual and undiscounted cash flows. Financial guarantees are presented as gross contractual amounts per the earliest date they could be called.

Balance sheet items as per mismatch of terms at 31 December 2012

EUR '000

	Sight	Up to 30 days	From 31 up to 90 days	From 91 days up to 1 year	From 1 up to 5 years	Over 5 years	Total
Financial assets							
Loans to financial institutions	96,572						96,572
Loans to clients	2,173	38,447	90,667	308,467	763,488	373,054	1,576,296
Investments		833	2,032	13,362	79,034	45,045	140,306
Other assets	27	766	1,533				2,326
Total financial assets	**98,772**	**40,046**	**94,232**	**321,828**	**842,522**	**418,099**	**1,815,499**
Financial liabilities							
Financial liabilities to Central Bank					130,000		130,000
Financial liabilities held for trading	7,846						7,846
Financial liabilities measured at amortised cost	9,285	130,387	347,551	362,031	636,114	23,714	1,509,082
Other financial liabilities				1,154	73,000		74,154
Total financial liabilities	**17,131**	**130,387**	**347,551**	**363,185**	**839,114**	**23,714**	**1,721,082**
Financial guarantees		**4,719**	**7,157**	**29,263**	**26,396**	**14,513**	**82,048**
Loan commitments		**1,228**	**2,375**	**10,847**	**57,796**	**4,626**	**76,871**

Balance sheet items as per mismatch of terms at 31 December 2011

EUR '000

	Sight	Up to 30 days	From 31 up to 90 days	From 91 days up to 1 year	From 1 up to 5 years	Over 5 years	Total
Financial assets	**93,337**	**78,395**	**72,820**	**144,151**	**1,075,261**	**596,865**	**2,060,829**
Financial liabilities							
Financial liabilities to Central Bank	-	-	20,000	-	100,000	-	120,000
Financial liabilities held for trading	4,721	-	-	-	-	-	4,721
Financial liabilities measured at amortized cost	252	202,276	154,924	725,252	378,200	164,920	1,745,823
Other financial liabilities		18,839					18,839
Total financial liabilities	**4,973**	**221,115**	**174,924**	**725,252**	**478,200**	**164,920**	**1,769,384**
Financial guarantees		**16**	**1**	**127**	**85,576**	**11,689**	**97,409**
Loan commitments		**1,527**	**2,957**	**13,502**	**71,946**	**2,663**	**92,595**

The Bank calculates the liquidity ratios on a daily basis in accordance with the Decision of the Bank of Slovenia on minimum requirements for ensuring an adequate liquidity position of banks and savings banks. These ratios are calculated as the ratio between investments and liabilities under the residual value principle. First class liquidity ratio (maturity up to 30 days) must not fall below 1.

The joint liquidity ratios as per 31 December 2012 are as follows:

First class investments/assets (0–30 days)	1.43
Second class investments/assets (0–180 days)	0.48

The joint liquidity ratios as per 31 December 2011 are as follows:

First class investments/assets (0–30 days)	1.22
Second class investments/assets (0–180 days)	0.68

Market risk

Market risk represents a potential loss that occurs due to changed market conditions in respect of the Bank's exposure to individual market parameters or risk factors (currency exchange rates, interest rates, share quotations, credit yields).

Managing market risks in a bank is a procedure that comprises identification, measuring and monitoring of individual market risks designed to minimise the potential negative financial consequences. The set of rules, methodologies and responsibilities in respect of market risk management is written in the Framework Risk Policy and the Framework Manual for Market Risk Management.

The Bank is exposed to different market risks through its daily operations, amongst other to position risk, currency risk and interest risk. Considering the scale of risk, the risk is managed through daily reporting on risk levels, utilisation of limits and achieved operational results.

Market risks limits are determined pursuant to the annual plan and the appetite for assuming market risks; the competent departments of the parent bank and of the Bank work in close cooperation to determine these limits at least once a year. The procedure of confirmation of limits is formally concluded with acceptance of the suggested limits by the parent bank's management and the Management Board of the Bank.

a) Trading book

The Bank's trading book serves primarily for ensuring services to clients. The Bank offers its clients a possibility of concluding transactions with a variety of derivatives, which, in line with confirmed limits for market risk, are closed immediately at the parent bank to minimise market risks. By doing this, the Bank exposes itself to counter-party credit risk, which is mitigated with the amount of limit for credit exposure to each individual client, while it is measured and reported in accordance with the standardised approach. The Bank enters into foreign currency purchase/sale transactions in order to serve its clients and to balance its overall foreign currency position. Equity securities are mainly kept in the banking book and were acquired on account of realisation of collateral on default investments. A minor net position of the trading book is represented only by the Hypo fund. The Bank maintains the latter in the trading book for the purpose of sale to clients.

For measuring position risk in the trading book, the Bank uses the value at risk (VaR) method. This method gives information with a specific level of probability (which is defined with a confidence interval) that maximum expected loss within a defined time horizon (a period of holding a position) shall not exceed the calculated amount. As a system support for calculation of risk value, the Bank uses the PMS system (Portfolio Risk and Management System), the development and improvement of which is the responsibility of the department of Information technology and Market Risk Controlling of the parent bank. In order to determine the risk parameters, the Bank uses exponentially weighted history of 250 days. The used methodology for calculation of value at risk is the Monte Carlo method with 10,000 simulations and a 99 per cent interval of trust (1-day position holding).

Movement of VaR value in 2012 (trading and bank book)

EUR

	Maximum	Minimum	Average
Equity securities	1,678	538	1,027
Derivatives	1,583	711	1,076

Movement of VaR value in 2011 (trading and bank book)

EUR

	Maximum	Minimum	Average
Equity securities	1,395	415	719
Derivatives	1,347	457	805

Besides the value at risk limits, the entire system of position risks is supplemented by volume limits, limits of the maximum permitted loss and other limits, among which are, for example, the minimum rating of the securities issuer, allowed forms of products, allowed markets for trading, and which ensure that the positions are in line with the outlined business strategy.

b) Interest rate risk in the bank book

Interest rate risk represents the risk of loss, which derives from the interest sensitive assets, which have different maturities or different dynamics of variable interest rate changing, than appropriate resources for financing these assets.
Management of the interest rate risk, which results from the trading book items, is already included in the management of positioning risk of the trading book. For the purpose of management of interest rate risk, which results from the items of the banking book and off-balance sheet items, the Bank uses methodology of interest rate gaps with respect to the date of the next change of interest rate.
The result of monthly measuring of the Bank's exposure to interest rate risk is the net present value of differences between assets and liabilities, which are subject to market interest rate change in the given time period. With respect to the Basel II guidelines, the Bank regularly checks the influence of interest rate shock in the amount of 200 basis points and internally tightens a 20% absorption effect of net equity of the Bank at the prescribed interest rate shock. Besides the described interest rate shock with the parallel shift of the yield curve, the Bank also measures the effect of other interest rate shocks on a monthly basis.
The interest rate shock in the amount of 200 basis points would absorb approximately 3.73% of the Bank's equity at the end of 2012 (2011: 2.63%).

Effect of yield curve shift by different scenarios (excluding non-interest bearing items at 31 December 2012)

EUR '000

	Effect of yield curve shift
+ 10 bps parallel shift	-459
- 10 bps parallel shift	459
+ 1 bp parallel shift	-46
− 1 bp parallel shift	46
Rotation (ON-3M -> +60BP, 3M-5Y -> -20 BP, 5Y -> -50 BP)	1,394
Rotation (ON-3M -> -60BP, 3M-5Y -> +20 BP, 5Y -> +50 BP)	-1,731

Effect of yield curve shift by different scenarios (excluding non-interest bearing items at 31 December 2011)

EUR '000

+ 10 bps parallel shift	-304
- 10 bps parallel shift	304
+ 1 bp parallel shift	-30
− 1 bp parallel shift	30
Rotation (ON-3M -> +60BP, 3M-5Y -> -20 BP, 5Y -> -50 BP)	219
Rotation (ON-3M -> -60BP, 3M-5Y -> +20 BP, 5Y -> +50 BP)	-316

c) Currency risk

Currency risk is a risk of a loss arising from mismatch of the currency sub-balance and volatility of foreign currencies.

The Bank monitors on a daily basis exposure to foreign currency risks and limits them by setting volume limits by individual currencies, groups of currencies and total open position. The measurement method is based on the principle of net open position, which is reported in the local currency. The group of volume limits is rounded up by the VaR limit on total open position. The VaR methodology is the same as the methodology in the trading book (250-day history – ECB fixed rate, weighted daily changes of exchange rate, 99-per cent confidence interval and 1-day exponentially weighted history holding period).

Narrow volume limits by individual currencies, groups of currencies and total open position indicate a conservative approach to managing currency risks. According to the regulatory capital requirement for currency risk, the Bank does not have to calculate a capital requirement for currency risk, as its total net position in foreign currencies does not exceed 2% of its capital.

Movement of VaR value for total open FX position for 2012

EUR '000

	Maximum	Minimum	Average
VaR-correlated	65,562	593	2,867

Movement of VaR value for total open FX position for 2011

EUR '000

	Maximum	Minimum	Average
VaR-correlated	70,008	655	8,665

Exposure to currency risk at 31 December 2012

EUR '000

	USD	CHF	GBP	Other currencies	EUR	Total
Financial assets						
Cash on hand and balances with Central Bank	292	13,698			47,638	61,628
Financial assets held for trading					18	18
Available-for-sale financial assets					25,744	25,744
Loans	4,323	257,636	294	807	1,440,699	1,703,759
Financial assets held to maturity					93,387	93,387
Other financial assets						29,486
Total financial assets	**4,615**	**289,334**	**294**	**807**	**1,613,184**	**1,914,022**
Financial liabilities						
Financial liabilities to Central Bank					130,000	130,000
Financial liabilities held for trading					7,846	7,846
Financial liabilities measured at amortised cost	4,743	272,139	368	834	1,311,792	1,589,876
Other financial liabilities					186,368	186,368
Total financial liabilities	**4,743**	**272,139**	**368**	**834**	**1,636,006**	**1,914,090**

Exposure to currency risk at 31 December 2011

EUR '000

	USD	CHF	GBP	Other currencies	EUR	Total
Financial assets						
Cash on hand and balances with Central Bank	1,073	981			39,753	41,807
Financial assets held for trading					5,898	5,898
Available-for-sale financial assets					89,745	89,745
Loans	5,661	315,497	465	417	1,417,268	1,739,308
Financial assets held to maturity					36,462	36,462
Other financial assets					36,093	36,093
Total financial assets	**6,734**	**316,478**	**465**	**417**	**1,625,219**	**1,949,313**
Financial liabilities						
Financial liabilities to Central Bank					100,000	100,000
Financial liabilities held for trading						
Financial liabilities measured at amortised cost	5,503	309,891	391	258	1,365,094	1,681137
Other financial liabilities	126	1			190,294	190,421
Total financial liabilities	**5,629**	**309,892**	**391**	**258**	**1,655,388**	**1,971,558**

Fair values of assets and liabilities

a) Financial instruments not measured at fair value

The table below summarises the carrying amounts and fair values of those financial assets and financial liabilities that are not reported in the Bank's statement of financial position at fair values.

EUR '000

	2012		2011	
	Carrying amount	Fair value	Carrying amount	Fair value
Financial assets				
1. Cash and balances with Central Bank	47,638	47,638	39,753	39,753
2. Loans to banks	38,843	38,843	20,107	20,107
3. Loans to clients	1,648,249	1,650,631	1,752,964	1,760,148
4. Financial assets held to maturity	90,501	91,427	36,462	32,572
5. Other financial assets	2,582	2,582	3,986	3,986
Financial liabilities				
1. Financial liabilities to Central Bank	131,299	131,299	120,147	120,147
2. Financial liabilities to banks measured at amortised cost	865,567	865,567	953,482	953,482
3. Financial liabilities to clients measured at amortised cost	727,988	736,484	713,631	721,403
4. Other financial liabilities	1,204	1,204	16,117	16,117

- Financial assets held to maturity: the fair value is based on the quoted market price;
- Loans (to banks and clients): for short-term assets, the fair value is not calculated as it is assumed that the carrying amount represents a reasonable approximation of the fair value; carrying amount of assets at variable interest also represents reasonable approximation of the fair value if the repricing dates are no longer than 12 months; for long-term assets at fixed interest, the fair value is calculated (zero coupon yield and discount factors from the PMS application are used for discounting the future cash flows).
- Liabilities measured at amortised cost: the assessed fair value is based on discounted contractual values, using the market interest rates that should be currently paid by the Bank for replacement of these liabilities by new debts with similar residual maturity
- For short-term receivables and liabilities it is expected (according to the standard) that the carrying amount is a reasonable approximation of the fair value.

b) Fair value hierarchy

IFRS 7 specifies a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources; unobservable inputs reflect market assumptions made by the Bank. The two types of inputs have resulted in the following fair value hierarchy:

- Level 1 – quoted prices (unadjusted) in active markets for identical assets or liabilities. This level includes listed equity securities on stock exchanges (for example London Stock Exchange, Frankfurt Stock Exchange, New York Stock Exchange) and traded derivatives such as futures.
- Level 2 – Inputs other than quoted prices included within Level 1; these observable inputs relate to assets and liabilities either directly (as prices) or indirectly (as derived from prices). Level 2 includes the majority of the OTC derivative contracts, traded loans and issued structured bonds. The sources of input parameters such as yield curves or the relevant increases for credit risk are Bloomberg and Reuters.
- Level 3 – Inputs for the assets and liabilities that are not based on observable market data (unobservable inputs). This level includes equity investments and debt instruments with significant unobservable components.

This hierarchy requires the use of observable market data when they are available. The Bank considers significant and observable market prices in its valuations whenever possible.

c) Financial instruments measured at fair value

The fair value assessment of financial instruments not traded in an active market is based on values obtained from an external expert. The Bank verifies the values and if confirmed, the assessed values are taken into account. Values of investments presented in Level 3 are obtained using standard valuation techniques such as discounted future cash flows, mark to market (comparative entities listed on the stock exchange – direct comparison with entities quoted in an organised market) and liquidation value approach. Final estimated value of financial instruments considers all approaches, taking into consideration different assessments of importance in respect of activity, financial stability of an entity, as well as other factors that could impact the fair value of financial instruments.

The effect of changes in key assumptions would not have a significant impact on the financial statements.

EUR '000

31 December 2012	Level 1	Level 2	Level 3	Total
Financial assets				
1. Financial assets held for trading	18	8,476	–	8,494
2. Available-for-sale financial assets	43,591	1,026	1,529	46,146
Financial liabilities				
1. Financial liabilities held for trading	–	7,846	–	7,846

EUR '000

31 December 2011	Level 1	Level 2	Level 3	Total
Financial assets				
1. Financial assets held for trading	367	8,924	–	9,291
2. Available-for-sale financial assets	87,340	5,694	1,604	94,638
Financial liabilities				
1. Financial liabilities held for trading	–	4,721	–	4,721

Changes in the portfolio value classified as Level 3 in 2012 are presented in the table below

EUR '000

	Balance at 31.12.2011	Addition	Disposal	Revaluation effect	Balance at 31.12.2012
Financial assets					
AFS financial assets	1,604			-75	1,529

For measurement of non-marketable securities the Bank uses methods prescribed in accordance with MSOV 2011.

Capital risk

The Bank is required to have adequate capital at all times, as a provision for different risks to which it is exposed in the course of its operations. This is an ongoing process of determining and maintaining a sufficient volume and quality of capital, taking into consideration the assumed risks, which is defined in the Bank's capital management policy. To this effect, in 2012 the Bank set up a Capital monitoring committee whose task is monitoring and management of capital adequacy on at least monthly basis, while pursuing the 5-year strategic business plan of the Bank.

Regulatory capital adequacy is the ratio between own funds and risk-weighted assets that has to be at least 8%.

The table below shows the calculation of regulatory capital and the capital adequacy ratio

EUR '000

Item	31.12.2012	31.12.2011
Subscribed paid-up capital	174,037	174,037
Capital surplus	2,696	27,696
Reserves and retained earnings or accumulated loss	-25,055	-38,640
- Intangible assets	-4,060	-4,122
Revaluation reserves	-	-280
- Unrecorded impairments and provisions due to recording lag	-35	-342
TIER 1 CAPITAL	**147,582**	**158,349**
Subordinated debt	57,400	69,000
Adjustment of revaluation reserve associated with available-for-sale financial assets – equity instruments	3,015	-
TIER II CAPITAL	**60,415**	**69,000**
TOTAL CAPITAL (for the capital adequacy purposes)	**207,998**	**227,349**
Capital requirement for credit risk, counter party risk and settlement risk	114,933	132,448
Capital requirement for settlement risk	-	-
Capital requirement for position risk and currency risk	672	1,213
Capital requirement for operational risk	8,115	8,290
Capital requirement for exceeding the exposure from the trading activities	-	-
TOTAL CAPITAL REQUIREMENTS	**123,721**	**141,951**
CAPITAL ADEQUACY RATIO (%)	**13.45**	**12.81**

The Bank's capital is calculated as the sum of share capital and tier II capital, whereby the share capital consists of: subscribed share capital, capital surplus, reserves and retained earnings, loss of the period and revaluation reserve; tier II capital is composed of: subordinated debt and adjustments of revaluation reserve in association with available-for-sale financial assets.
In 2012, the Bank fully complied with the legal requirements regarding capital. As at the end of year 2012, the Bank's capital amounted to €207,998 thousand, tier 1 or core capital amounted to €147,582 thousand, the capital surplus amounted to €85,398 thousand, while the capital adequacy ratio was 13.45%.

In 2012, the Bank calculated capital requirements for:
- Credit risk in accordance with the Decision on the Calculation of Capital Requirement for Credit Risk according to a standardised approach for banks and savings banks;
- Market risk in accordance with the Decision on the Calculation of Capital Requirement for Market Risks for banks and savings banks, whereby it does not use internal models;
- Operational risk in accordance with the Decision on the Calculation of Capital Requirement for Operational Risk for banks and savings banks, whereby it uses a simple approach.

The amount of an individual capital requirement is evident from the calculation of regulatory capital and capital adequacy ratio. In accordance with the process of assessing adequate internal capital of the Bank and the Bank's internal policies, the Bank regularly monitors the capital risk profile, assesses the Bank's ability to assume risk and provides capital adequacy assessments as well as internal capital requirements for all types of risks. The results are reported at monthly meetings of the ALCO.

Operational risk

The Bank includes in the definition of operational risk also legislative risk and model risk, as well as the reputation risk.

Business and strategic risks are not included in the operational risk as they are addressed separately.

To calculate the capital requirement for operational risk, the Bank applies standardised approach.

As the Bank is aware of the importance of operational risk management, it was decided that in addition to satisfying legally prescribed general standards for risk management, it will perform activities that are carried out in more advanced approaches in accordance with the decision on risk management.

Assessment and measurement of operational risk is based on the collection of damage events that are registered in the central database of damage events. This allows for a more efficient reporting of occurred damage events, their causes and proposed measures.

All damage events which present an actual direct or indirect financial loss for the Bank, are registered, regardless of whether financial damages occurred during the event or subsequently. Registered are also events which could present potential loss for the Bank.

In 2012, the Bank recorded 44 damage events. The Bank defined as damage event any event whose gross loss exceeds €5,000. At the end of the year, the balance of gross losses that are not connected with impairments or provisions resulting from credit risk amounted to €627 thousand.

Preventive assessment of potential operational risk is performed with the procedure of detecting risk scenarios and with methods of self-assessment of critical operational risk factors, whose risk profile is assessed annually with renewed assessment of business effects as part of the regular process of business continuity planning.

The Bank measures and monitors individual risk indicators on the basis of which, in the event of unacceptable deviations, it plans control activities.

Based on perceived and assessed operational risk and damage that occurred, for significant risk, the Bank plans and carries out activities to prevent, mitigate, transfer or accept the risk.

As part of the development of applicative support, the Bank upgraded the application for managing operational risk in accordance with the revised management policy.

The Bank reports regularly (quarterly) to the OpRisk Committee about all important perceived risks, risk indicators, and damage events, as well as about the status of implementation of risk control measures. In case of significant losses or exposures, the Management Board and upper management are notified immediately.

In 2012, the Bank continued to regularly upgrade the policy of the Group information protection, and at the same time continued its operational processes of information protection and processes of business continuity for the Bank's most critical functions. Furthermore, the Bank carried out functional tests of critical business functions and verified the accuracy of existing business continuity plans.

As part of the ICAAP process, the Bank believes that in terms of the risk profile, the highest risk is presented by incorrect and inappropriate actions of employees. The risk is managed by procedures described in the section Responsibility towards employees.

Subsequent events

No events occurred after the balance sheet date as a result of which the Bank's financial statements should be in any way amended.

5 Pertinent information

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