HYPO ALPE ADRIA
VAŠI. Z VAMI. ZA VAS.

# ANNUAL REPORT 2011

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 (since 30 December 2009) is as follows:

- Republic of Austria (100 per cent holding).

## 1.1 Brief Review of Hypo Alpe-Adria-Bank's Operations

EUR '000

| Key highlights | 2011 | 2010 |
|---|---|---|
| Number of clients | 60,778 | 51,226 |
| Number of branch offices | 19 | 18 |
| Number of employees | 465 | 403 |
| Balance sheet total | 1,977,634 | 2,187,844 |
| Market share | 4.05 % | 4.40 % |
| Core capital | 174.037 | 174.037 |
| Total capital | 160,112 | 166,619 |
| Net income from operations | 45,807 | 59,617 |
| Pre-tax profit | (33,843) | (32,404) |
| Interest rate margin | 2.03 % | 2.39 % |
| Pre-tax return on equity (ROE) | -21.54 % | -16.56 % |
| Pre-tax return on assets (ROA) | -1.69 % | -1.53 % |
| Cost/income ratio (CIR) | 65.31 % | 39.47 % |
| Number of ordinary shares | 41,706 | 41,706 |

## 1.2 Significant events in 2011

### Januar
The Bank, together with its sister company Hypo Leasing, opened an exhibition in the Hypo Gallery to mark the 50th anniversary of the Vitranc Cup in Kranjska Gora, one of the largest international sport events in Slovenia.

### February
Hypo Alpe-Adria-International AG from Klagenfurt, the owner of the Bank, appointed new Management Board of the Bank, composed of Alexander Picker, President and Matej Falatov as member.

Slovenian Association of Friends of Youth organized a winter camp »Let's enjoy childhood vitality in the snow« in Kranjska Gora with the support and sponsorship of the Bank, Hypo Leasing, Vitranc Cup and other sponsors.

### March
Together with Hypo Leasing, the Bank sponsored the 50th jubilee of the Vitranc Cup in Kranjska Gora as the official financial partner and the main local sponsor.

With Hypo Leasing, the Bank supported the Helena Blagne and Vienna Boys Choir concert in Ljubljana.
The Bank and Hypo Leasing together participated at the agricultural fair in Komenda.

The Bank and Hypo Leasing together took part in the 2nd ProPrio Real Estate and Investment Fair.

### April
Together with Hypo Leasing, the Bank launched a new corporate image in a major advertising campaign "Seductive Solutions".

### May
The Bank started issuing Maestro business cards (besides the card, we also enable SMS informing to protect our clients from any card abuse). The Bank informed its clients who are issuers of special money order forms and direct credit users about the necessity of adjusting applications for the transition to SEPA payment schemes.

The Bank and Hypo Leasing organized a round table with the presentation of the Dictionary of Economic Terms within the "Hypo Pro Futuro" project at the Group level.

### June
The Bank launched e-invoice transactions via the Halcom network and successfully started the e-invoice acceptance process.

The Bank opened a new branch office in Moste, bringing the total number of branch office in Ljubljana to 5 and a total of 19 in Slovenia.

In Maribor, the Bank relocated the Tyrševa branch office to the very centre of Maribor, and named it the Maribor-Centre Branch.

The Bank and Hypo Leasing extended the sponsorship contract with the athlete Matic Osovnikar.

The Bank successfully completed the project "Sales Force Efficiency".

At the traditional banking games, the Bank employees took the overall 6th position among 20 Slovenian banks.

### July
The prize winners of the "Seductive prize game" were announced. The lucky winner from Ljubljana drove off in a brand new KIA pro_cee'd LX Open.

### August
The Bank and Hypo Leasing together sponsored Vlado Kreslin concert at the 60th Ljubljana Festival.

### September
The transfer of e-invoice clearing to Bankart. The Bank has become a member of the SEPA EDD B2B payment system (SEPA cross-border direct debit for legal entities).

The Bank organised for the first time a golf tournament for its clients called Hypo Alpe Adria Trophy. As the general sponsor of the 44th MOS International Trade Fair in Celje, the Bank presented the "Light Branch", i.e. a mobile bank counter to the public for the first time.

### October
On the World Savings Day, we organized a reception followed by a visit by a popular stand up comedy for Bank's clients – savers.

**November**

The Bank joined the new SEPA IDD CORE payment system (SEPA internal direct debits for retail clients) and SEPA IDD B2B (SEPA internal debits for corporate clients). The Bank offers this service as the payers' bank.

The Bank was awarded the title "Respected Employer 2011".

**December**

The Bank implemented the SEPA mass payments for its clients. In accordance with the MasterCard regulation, the Bank implemented the Money Send functionality, which enables the transfer of sums directly to a Maestro or MasterCard card number.

Starting on 1 December 2011, the Bank changed its business hours for clients by prolonging the business hours for 3.5 hours a week in all branch offices.

In accordance with a pass through agreement, as of 31 December 2011, the Bank transferred one part of loans with maturity at the end of the year 2050 to the affiliated company within the Hypo Group. On the date of transfer, the Bank disposed of the assets and transferred all the risks and benefits in the amount of €254 million to another company for consideration in the amount of €265 million. The company the assets were transferred to is not directly owned by the Bank.

A service agreement, based on which the Bank manages the transferred portfolio on behalf and for the account of the issuer, was signed.

The Bank expects the entire portfolio to be paid by the maturity (the year 2050) and that no assets will remain in the new company in respect thereof. Should any unpaid assets remain in the company, the Bank will have no liability in respect thereof. The Bank would obtain the remaining assets back without any payment.

On 22 December 2011, the General Meeting of Hypo--Alpe-Adria Bank adopted a decision to make subsequent payment, whereby each shareholder shall pay €25 million to cover the current loss or losses brought forward. On 29 December 2011, Hypo-Alpe-Adria-Bank International AG paid the additional capital of the Bank which is recognized as capital reserve.

# The Management Board

Management Board: Matej Falatov, M. Sc., President od Management Board (left), Marko Bošnjak, M. Sc., Member of Management Board (right)

**Matej Falatov, M.Sc.,** President of Management Board
**(CEO, COO, CMO)**
Internal Audit
Legal
Compliance & Security
Human Resources
Business Continuity Management
Project Management
Procurement
Operations
ORG/IT
Collection
Real Estate Management
Marketing & Corporate Communications
Sales Planning & Controlling
Corporate & Public Finance
Retail Sales Force Mgt.
Balance Sheet Management & Treasury
Segment, Product & Channel Mgt. Retail

**Marko Bošnjak, M.Sc,** Member of Management Board
**(CFO, CRO)**
Accounting & Reporting
Financial Controlling
Retail Risk Management
Credit Management
Risk Controlling
Credit Rehabilitation
Task Force Rehabilitation
Credit Processing

## 1.3 Address by the Management Board

Dear business partners and colleagues,

The past year was marked by changes – for the better. The first and major change was implemented by our owner, the parent bank Hypo Alpe-Adria-Bank International AG with its registered office in Klagenfurt, by appointing a new Management Board of Hypo Slovenia on 9 February 2011. Alexander Picker was appointed new Chairman of the Management Board, and Matej Falatov a Member of the Management Board of Hypo Banka. At the beginning of 2012, Marko Bošnjak joined this team as the second Member. Accordingly, the management of our sister company Hypo Leasing was assumed by Danijel Novak, taking the position of the General Manager, and in October Mitja Križaj joined the team as Managing Director. Together we set off on a new road, which leads to an efficient and successful future.

The key challenges we, the new management team had to face were aimed at resolving the past and taking our group to a higher level in terms of good reputation as well as quality. In 2011, our company faced intense market conditions as well as in-house issues. One of the tasks we faced last year was cleaning the portfolio as a result of incorrect decisions made in the past. We can proudly say that we are the first financial institution in Slovenia, which actually succeeded in this.

In 2011, the continued slow-down in economic activities affected the performance of banks. At the end of the year, the Bank's balance sheet total amounted to €1,978 million, which is 10 % below the 2010 level. The lower balance sheet total was affected primarily by the transfer of one part of loans to non-banking sector - a Group company. Nevertheless, we still rank among 9 largest banks in Slovenia with a 4.05 per cent market share, which is encouraging for our future. We created almost €50 million of additional impairments and provisions, thus incurring a negative operating result, a loss of total €26,866 thousand. The enviable number of our clients, exceeding that from last year by 16 per cent, shows that we are on the right track and that our financial institution has earned our clients' trust. The total number of clients exceeded 60,000 at the end of 2011. The Bank's equity dropped by 5 per cent in 2011, due to current operating loss however, the capital surplus grew due to the increase in the Bank's capital totalling €25 million. Additional capital shows the owner's trust in our operations and strong support in our strategic operations and development on the Slovenian market.

We started setting up new services and upgrading the current ones, which we will continue also in the future. All of our activities are primarily aimed at retail clients, micro-companies and SMEs. The biggest change, which we introduced, is close cooperation with our sister company Hypo Leasing and this has already showed positive results. For the first time in its history, Hypo offers all financial, banking, insurance and leasing services under one roof in Slovenia. We started introducing the "best finance office", meaning that we are qualified to advise our clients on all financial services in one place.

Such cooperation with sister companies is now being introduced also in all Hypo companies on South East European markets. The goal of such approach is to function as one international institution with the same business philosophy in all countries. Therefore, the initiatives coming from the Group bring new and improved services, which we tailor to our individual markets and clients.

All these changes made inside our Group (in Slovenia and SE Europe) have shown positive results also outside the Group. The credit for this goes primarily to our highly qualified colleagues who create constructive and trustworthy client relationships. Clients have positively responded to our actions, and the increase in their number clearly demonstrates that we are on the right track and have taken the right approach. All these efforts have made the Bank stronger and returned it its good reputation. The need for better performance also led to an increase in the number of employees – we have 62 new colleagues.

Our socially responsible activities prove that we are a market responsive company. Throughout the year, we are engaged in the social, humanitarian and cultural areas, both on the local and national levels. We support top athletes, sports and cultural events with sponsorships and donations, and also help those in need.

Our business partners and employees are regularly involved in our socially responsible activities. To our business partners, this definitely represents an upgrade of our relationship, and to our employees an additional encouragement and motivation.

In 2012, we will stay focused on development. Based on measures taken last year we expect a successful business year. We will finish the organisational process and continue acting as one with our sister company Hypo Leasing. Together we will remain the third largest Slovenian financial institution. We want to take the leading position in offering high-quality, effective and client-tailored services.

We believe that the good work of our highly qualified employees will bring the forecast results and that we will meet our vision and strategy despite these difficult times. We want to be SUPPORTIVE partners, working together with you in a FRIENDLY manner and, above all, FAIR and invite you to continue to stay with us in the future.

The Management Board

**Marko Bošnjak, M. Sc.**
Member of the Management Board

**Matej Falatov, M. Sc.**
President of the Management Board

Note: 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.

## 1.4 Report by the Chairman of the Supervisory Board

In 2011, 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 2011. The Report will also be presented to the Bank's Meeting of Shareholders. In accordance with Article 230 of the Companies Act, the Supervisory Board approved the proposal by the Management Board regarding appropriation of the net profit and recommended it for adoption at the Bank's General Meeting of Shareholders.

With the aim to strengthen the Bank in Slovenia as well as its sister company Hypo Leasing, d. o. o., which remains an important part of the Hypo Alpe Adria Group in the Alps-Adria region, the Supervisory Board decided to appoint a new management of Hypo Slovenia at the beginning of 2011. On 9 February 2011, Alexander Picker was appointed new Chairman of the Management Board, and Matej Falatov a Member of the Management Board of Hypo Banka. At the beginning of 2012, Marko Bošnjak joined this team as the second Member. The management of our sister company Hypo Leasing was taken over by Danijel Novak, assuming the position of General Manager, and Mitja Križaj joined him in October as Managing Director.

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 Chairman of the Management Board, and as of that date, his function was assumed by Matej Falatov, previously the Member of the Management Board.

Financial markets remained turbulent in 2011. 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 form impairments and provisions, 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, thus delivering higher safety of operations particularly to its clients.

We believe that the managements of both Hypo Slovenia companies 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, M.Sc.**
Chairman of the Supervisory Board

# 2 Introduction of Hypo Alpe-Adria-Bank in Slovenia

## 2.1 Mission and vision of Hypo Alpe-Adria-Bank

The mission of Hypo Alpe-Adria-Bank is to provide excellent financial services that will satisfy both the clients and the shareholders.

Our vision is to, with a highly motivated team, rank among the first five banks in terms of reputation, market share and profitability.

Our mission as well as our vision is directed towards the most important element – our target clients who are our prime concern in all respects.

A client is anyone needing our services and/or products. The Bank deals with external and internal clients and we constantly strive to ensure their satisfaction.

We are focused on our target clients as they are the centre of our operations.

## 2.2 Milestones in the Company'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
2003 – Hypo Alpe-Adria-Bank d. d., Branch Tyrševa, Maribor
2003 – Hypo Alpe-Adria-Bank d. d., Business Unit Kranj
2004 – Hypo Alpe-Adria-Bank d. d., Ljubljana – new headquarters of the Bank
2004 – Hypo Alpe-Adria-Bank d. d., Branch Trg Osvobodilne fronte, Ljubljana
2004 – Hypo Alpe-Adria-Bank d. d., Business Unit Murska Sobota
2005 – Hypo Alpe-Adria-Bank d. d., Branch Domžale
2005 – Hypo Alpe-Adria-Bank d. d., Business Unit Novo mesto
2006 – Hypo Alpe-Adria-Bank d. d., Business Unit Nova Gorica
2007 – Hypo Alpe-Adria-Bank d. d., Branch Ptuj
2007 – Hypo Alpe-Adria-Bank d. d., Branch Center, Ljubljana
2008 – Hypo Alpe-Adria-Bank d. d., Branch Trbovlje
2008 – Hypo Alpe-Adria-Bank d. d., Branch Šiška, Ljubljana
2008 – Hypo Alpe-Adria-Bank d. d., Branch Brežice
2008 – Hypo Alpe-Adria-Bank d. d., Branch Velenje
2009 – Hypo Alpe-Adria-Bank d. d., Branch Jesenice
2011 – Hypo Alpe-Adria-Bank, d. d., Branch Moste
2011 – Hypo Alpe-Adria-Bank, d. d., Branch Trg Leona Štuklja (change of venue)

## 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.

According to the Articles of Association, the **Management Board** is composed of two or more members appointed by the Supervisory Board. As at 31 December 2011, the Management Board includes Alexander Picker, President of the Management Board, and Matej Falatov as Member of the Management Board.

On 9 February 2012, Marko Bošnjak was appointed member of the Management Board thus joining the management team.

**As at 31 December 2011, the Supervisory Board is composed of four members as follows:**

- Johannes Leopold Proksch, M. Sc. – Chairman,
- Wolfgang Edelmüller, M. Sc. – Deputy Chairman,
- Dr. Sebastian Firlinger – Member,
- Blaž Brodnjak – Member.

### Shareholders' Meeting

The Management Board convenes the Shareholders' Meeting in cases laid down by law or in the Articles of Association or when this benefits the Bank. Four General Meetings of Shareholders were convened in 2011, namely in February and April, in August when the regular General Meeting of Shareholders was held, and in 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-Bank International AG holds a 100 percent interest in the Bank).

**Advisory bodies of the Management Board:**

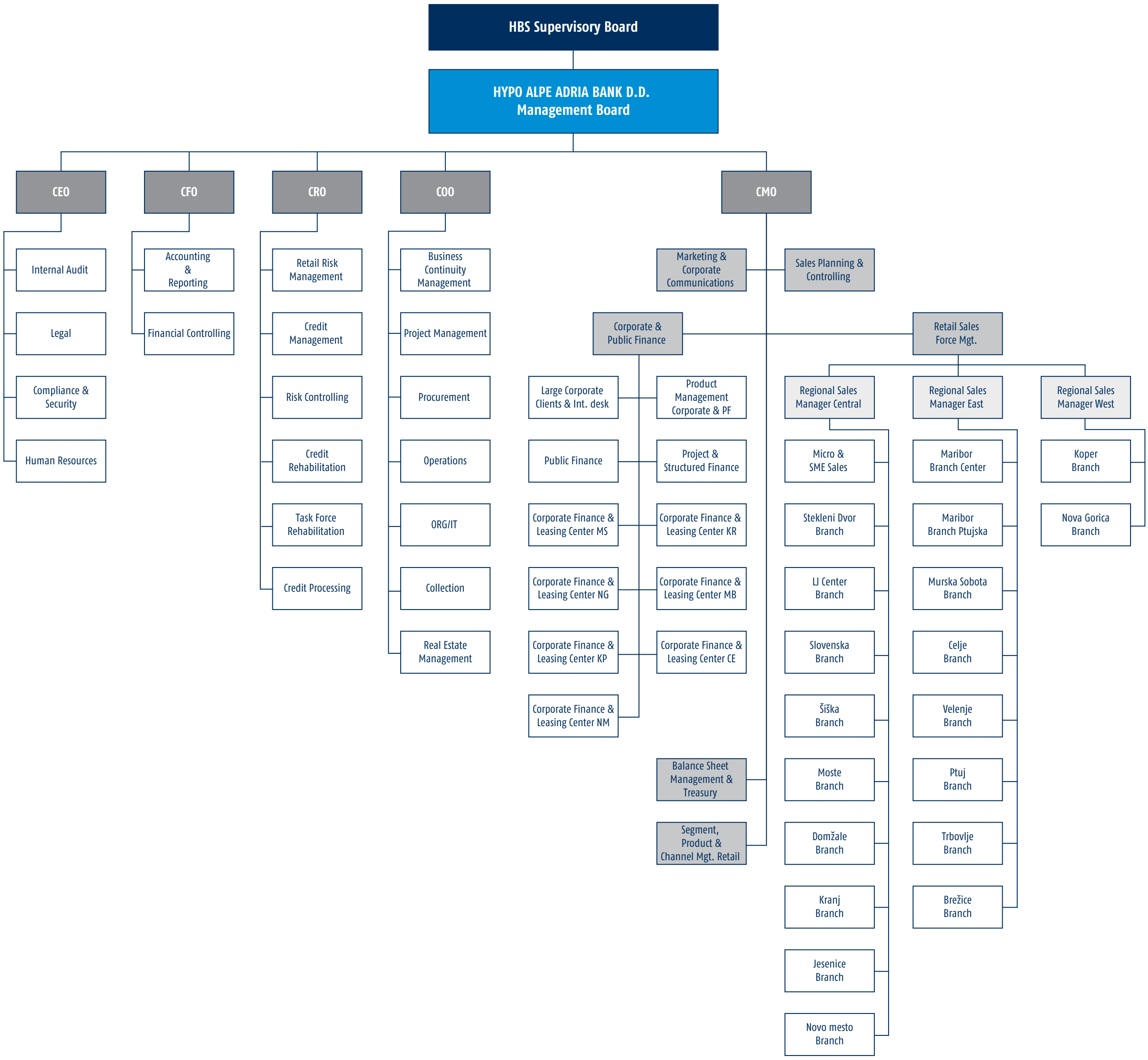
- Management Committee

**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.

The objectives, tasks, authorizations and composition of committees are laid down in the Rules on Organization and Job Systematization of the Bank, as well as in the Rules on the Powers, Authorization and Signatories in the Bank, while the operation of the Bank's corporate bodies is governed by individual rules of procedure.

## 2.4 Organizational structure



## 2.5 Business network

# 3 Business report

## 3.1 General economic environment in 2011

### Economic environment

In the third quarter of the year, poor economic recovery continued in the Euro area, and the prospects for the future growth are worsening. As compared to the second quarter of 2011, the GDP of the Euro area increased by 0.2 %, mainly due to quite favourable growth levels in Germany and France. In November, the economic growth forecasts for the Euro area were gloomy, in particular for the year 2012, mainly on account of the debt crisis and the increasingly obvious signs of the deteriorating world conjuncture. In the most recent forecasts for next year, the European Commission, OECD and Consensus expect growth of a half percent or less. In November, the ECB decreased the key interest rate by 0.25 percentage point to 1.25 %.

The deterioration in the conditions of the international environment is evident also in the Slovenian economic activity, which has in the third quarter of the year decreased by 0.2 % compared to the second quarter, since the activity of the manufacturing industry declined in a quarterly period along with further decrease in the domestic consumption. GDP dropped by 0.5 % during the year. Due to a faster decline in the annual growth of exports compared to imports, the exchange with foreign countries dropped, as did the increase in supplies. Fewer building investments and the crisis in the construction industry have continued. Due to limited possibilities for the growth of domestic demand, and since the foreign demand indicators further decreased in the last quarter of the year, the prospects for the future economic growth have severely deteriorated.

In December 2011, the costs of living decreased by 0.6 % on the average compared to November. At the end of the year, the annual inflation stood at 2.0 % (previous year 1.9 %), and the average annual inflation at 1.8 % (the same as the year before). The reason for a limited rise of the basic inflation is in the decline in the purchasing power of the population. According to Eurostat, the costs of living in the Euro area increased by 3.0 % in 2011.

In the third quarter of the year, the situation on the labour market deteriorated. In October, the number of registered unemployed rose to 110,905. The increase was much lower than in the previous years due to a smaller number of first-time employment seekers. Simultaneously, fewer job positions were registered, and the registered unemployment rate stood at 11.5 % in September, while the rate of unemployment among the surveyed population increased to 7.0 % in the third quarter of the year. The intensified economic situation remains evident in gradual decline in the growth of average salaries and wages, and in the decrease in the number of employed in the private sector, which among other things also decreases the purchasing power of the population.

At the end of the second quarter of the year, the national deficit under the ESA 95 methodology stood at 6.5 % GDP, while the Report on the deficit and debt forecasts a 5.5 % deficit.

In 2011, the Ljubljana Stock Exchange faced the challenges of low market liquidity, declining prices of securities, and consequent decrease in the market capitalization. The SBI TOP Index dropped by 30.7 % in 2011. The value of SBI TOP amounted to 589.58 points on the last trading day. The total turnover on LJSE was €470.1 million, and the non bundled transactions €321.9 million, which is less than in 2010. In 2011, the market capitalization of all shares on LJSE decreased, amounting to €4,872.8 million, which is mainly due to lower share prices.

## Banking environment

The negative economic growth of the third quarter of 2011 shows that the forecasts of a long period of low economic growth in Slovenia may become true. The economic situation in Slovenia is affected by several factors. The first factor is the very fierce conditions on international financial markets. In the autumn of 2011, Slovenia was more dependent on international markets than at the end of 2010 due to an increase in the net foreign debt, stricter financing conditions and a decrease in the credit ratings of the state and some banks. The second factor is the over-indebted sector of non-financial corporations in Slovenia. The third is low capital adequacy of the Slovenian banking system, an increase in bad investments and a decrease in the volume of loans, as compared to the Euro area. And the fourth factor is the non-competitiveness of the Slovenian business environment and too sluggish implementation of structural reforms.

The decrease in banking system's balance sheet total that started at the beginning of 2011 continued throughout the year. At the end of October 2011, the annual growth of the balance sheet total stood at -1.9 %. During the first ten months of the year, the volume of the balance sheet total decreased by €728 million at the end of October 2011 to €49,591 million. The slowdown in the growth of balance sheet total coincides with the decrease in the growth of loans and a decrease in securities, as well as with the deleverage of banks on wholesale markets.

After loans to the non-banking sector started increasing in 2010, the situation in 2011 again intensified. The volume of loans started shrinking for the first time after Slovenia's independence. The annual increase in loans to non-banking sector was negative from June on, amounting to €-830 million in October. Thus, the annual growth of loans to non-banking sector was -2.4 %. In terms of maturity, the volume of short-term loans to non-banking sector decreased in particular, with the annual growth in October amounting to -12 %. The annual growth of long-term loans was slowing down, yet it remained positive. As regards banks, the drop in the volume of loans is the highest with large domestic banks. The reasons for a smaller demand for loans can be found in the Euro debt crisis, poorer credit ratings and higher financing costs, the macroeconomic situation, the crisis in the construction industry, high corporate indebtedness, lack of payment discipline, etc.

The deleveraging process of banks abroad continued in 2011. The annual growth of liabilities to foreign banks in October stood at -13 %, and the growth of liabilities from issued securities at -7.9 %. In October 2011, non-banking sector deposits grew at a 3.7 % annual level, and household deposits only at 2.4 %. An increase in non-banking sector deposits by €0.7 billion in the first ten months of 2011 was contributed mostly by government deposits of €0.43 billion. The net increase in household deposits in the same period amounted to only €168 million and was the lowest in the recent years.

Capital adequacy of the Slovenian banking system stood at 12.1 % in September, which was 0.8 percentage point more than at the end of the previous year. The core capital quotient in the same period increased by 0.9 percentage point reaching the highest level in the last years with 9.9 %. The change of quotients was mainly affected by the recapitalization of some banks, and partly by the decrease in capital reserves due to loan growth stagnation. The highest capital adequacy in September 2011 was recorded by large domestic banks.

Along with the negative growth of the net interest and a decrease in the volume of balance sheet total, the 2011 interest margin in the banking system remained practically unchanged – calculated to the balance sheet total by the end of October, it was 2.05 %. The decrease in net interest is a consequence of a higher increase in interest expenses of banks (+16.3 %) than in interest income of banks (+7.4 %). The increase in interest expenses and income is mainly a result of higher interest rates. Operating expenses did not change significantly as compared to 2010. The annual drop between October 2010 and October 2011 was 0.3 %. The loss in the banking system amounted to €124 million in the first ten months of 2011, which was in particular affected by the growth of impairments and provisions. As a result, banks generated a €211 million lower result than in the same period of the previous year.

## 3.2 Business results

### Financial highlights

EUR '000

| INDICATORS | 31.12.2011 | 31.12.2010 | 31.12.2009 |
|---|---|---|---|
| **1. BALANCE SHEET** | | | |
| Balance sheet total | 1,977,634 | 2,187,844 | 2,331,730 |
| Aggregate amount of deposits by non-banks | 713,632 | 525,135 | 479,041 |
| a) legal and other persons | 484,691 | 336,254 | 304,192 |
| b) retail | 228,941 | 188,881 | 174,849 |
| Aggregate amount of loans to non-banks | 1,750,240 | 1,940,562 | 1,984,083 |
| a) legal and other persons | 1,172,123 | 1,389,004 | 1,468,833 |
| b) retail | 578,117 | 551,558 | 515,251 |
| Total capital | 160,112 | 166,619 | 194,446 |
| Impairment of financial assets at amortized cost, and provisions | 56,225 | 123,141 | 55,167 |
| Off-balance-sheet items | 880,539 | 570,226 | 772,663 |
| **2. INCOME STATEMENT** | | | |
| Net interest | 40,587 | 50,593 | 46,584 |
| Net non-interest income | 3,939 | 9,441 | 9,714 |
| Labour costs, general and administrative expenses | 27,500 | 21,566 | 22,718 |
| Amortization/depreciation | 2,417 | 1,967 | 2,000 |
| Impairments and provisions | (49,734) | (68,488) | (27,749) |
| Pre-tax profit/loss from ordinary and discontinued operations | (33,843) | (32,404) | 3,831 |
| Income tax from ordinary and discontinued operations | 6,977 | 6,113 | 1,118 |
| **3. PERFORMANCE RATIOS** | | | |
| **a) Capital** | | | |
| Capital adequacy | 12.81 % | 11.26 % | 12.11 % |
| **b) Quality of assets** | | | |
| Impairment of financial assets at amortized cost and provisions for commitments/reclassified items | 2.73 % | 5.10 % | 2.29 % |
| **c) Profitability** | | | |
| Interest margin | 2.03 % | 2.39 % | 2.05 % |
| Financial intermediation margin | 2.22 % | 2.83 % | 2.48 % |
| Pre-tax return on assets | -1.69 % | -1.53 % | 0.17 % |
| Pre-tax return on equity | -21.54 % | -16.56 % | 1.89 % |
| Return on equity after tax | -17.10 % | -13.44 % | 1.34 % |
| **d) Operating costs** | | | |
| Operating costs/average assets | 1.49 % | 1.11 % | 1.09 % |
| **e) Liquidity** | | | |
| Average liquid assets/average short-term deposits of non-banks | 13.59 % | 14.99 % | 13.54 % |
| Average liquid assets/average assets | 3.26 % | 3.16 % | 2.15 % |
| **4. EMPLOYEES** | | | |
| At year-end | 465 | 403 | 396 |
| **5. SHARES AT YEAR-END** | | | |
| Number of shareholders | 1 | 1 | 1 |
| Number of shares | 41,706 | 41,706 | 41,706 |
| Book value per share | 3.84 | 4.00 | 4.66 |

Performance ratios are calculated using the Bank of Slovenia methodology.

## Financial situation

At 31 December 2011, **the Bank's balance sheet total** amounted to €1,978 million, representing a 10 per cent nominal decline as compared to 2010, and which is due to the transfer of a portion of non-banking sector loans to an enterprise in the Group.

The **structure of assets** is similar to the one recorded in 2010. The share of loans to non-banks accounts for 89 percent, 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 raising to 36 per cent, whereas bank deposits and loans dropped from 62 to 44 per cent. Structural changes of other liabilities were only minor.

**Loans to banks** increased by 42 percent in 2011 to €20 million at the year-end. At the end of 2011, loans to banks comprised sight deposits of total €10 million, with short-term loans and long-term loans accounting for the remaining €10 million.

**Loans to non-banks** fell in 2011 by €194 million or 10 per cent, primarily due to the transfer of a portion of non-banking sector loans to an enterprise in the Group. As at 31 December 2011, loans to non-banks amounted to €1,750 million.

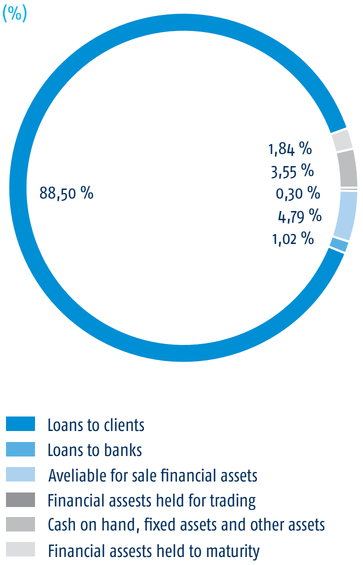
**Financial assets held for trading** decreased by 61 per cent in 2011 as a result of revaluation and disposal of certain financial assets and shares. By the end of the year, financial assets held for trading amounted to €9 million.

**Available-for-sale financial assets** remained at the level recorded in 2010. The portfolio balance at the end of 2011 amounted to €94 million, accounting for 4 per cent in the structure of total assets.

Structure of assets

2011

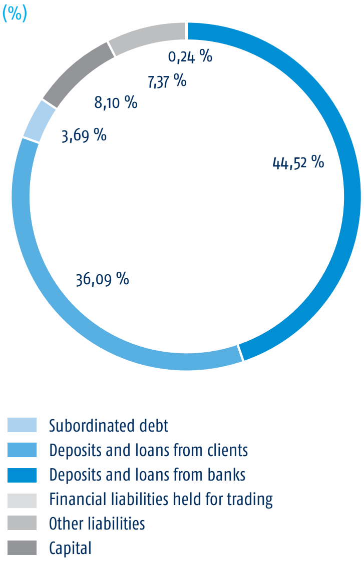
(%)




Structure of liabilities and equity

2011

(%)



**Financial assets held to maturity** dropped by 14 per cent in 2011 to €36 million at the end of the year.

**Financial liabilities to banks** represent the largest share in the total structure of liabilities and capital with 48 per cent, and have, compared to the previous year, decreased by €487 million as a result of the transfer of a portion of non-banking sector loans to enterprises in the Group. At the end of 2011 they amounted to €953 million, the majority of which represents deposits and loans from the parent bank, while minor amount relates to loans and deposits from other banks. The subordinated liabilities amounted to €73 million at the year-end.

**Financial liabilities to non-banks** increased by €188 million or 36 per cent to €713 million at the end of 2011. This increase is of great strategic importance, especially in times of difficult conditions on international monetary markets and validates the efforts to increase the primary resources.

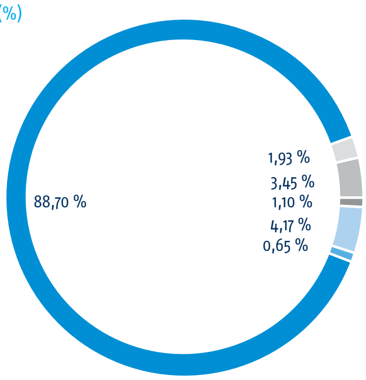
**Financial liabilities to the Central Bank** increased by 3-fold in 2011, amounting to €120 million at the year-end..

**The equity** of the Bank decreased in 2011 by 5 per cent as a result of the operating loss; on the other hand, capital surplus was increased on account of €25 million of additional capital raised by the Bank.

**Structure of assets**

2010

(%)

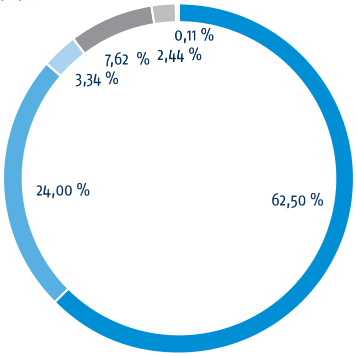



- Loans to clients
- Loans to banks
- Aveliable for sale financial assets
- Financial assests held for trading
- Cash on hand, fixed assets and other assets
- Financial assests held to maturity

**Structure of liabilities and equity**

2010

(%)




- Subordinated debt
- Deposits and loans from clients
- Deposits and loans from banks
- Financial liabilities held for trading
- Other liabilities
- Capital

### Financial result

In line with the conditions in the Slovenian economic environment and reduction in the overall banking market, the volume of operations of the Bank decreased slightly in 2011 when compared with 2010.

The Bank's net income of €45,807 thousand represents a decrease of 23 per cent compared to 2010. Administrative costs, labour costs and costs of depreciation and amortization amounted to €29,917 thousand, which is an increase of 27 per cent over the previous year. The impairment of financial assets not measured at fair value through profit or loss and provisions for off-balance-sheet items totalled €49.550 thousand at the year-end.

At the end of 2011, the result of the Bank's financial and operating activities was a loss of € 26,866 thousand and represents a slight improvement compared to the loss of €26,292 thousand reported in 2010. The loss is largely due to a 23 per cent increase in loan impairments in 2011 as compared to the year 2010.

Net interest amounted to €40,587 thousand at the end of 2011 and represents a 20 per cent decrease over the previous year. Net interest income represented, with 87 per cent, the majority of total net income. In the net income structure, the share of net interest dropped by 20 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 5 percentage points. Net result from financial assets held for trading also dropped as a consequence of circumstances on capital markets and economic environment in 2011, and a more conservative policy pursued by the Bank in this area.

Drop in the net interest resulted in lower interest margin which decreased from 2.39 per cent in 2010, to 2.20 per cent in 2011.

In 2011, the Bank recorded €946 thousand of dividend income, total amount of which was derived from available--for-sale financial assets. Dividends received in 2011 rose by 4 per cent.

Net received fees and commissions amounted to €8,496 thousand at the year-end and accounted for 13 per cent of the Bank's net income. Compared to 2010, they fell by 5 per cent. In nominal and real terms, the major decrease was a consequence of lower volume of fees and commissions from securities. The achieved net fees and commissions covered 31 per cent of the Bank's administrative costs, which represents a reduction of 2 per cent compared to the previous year. If only labour costs are considered, the coverage amounts to 56 per cent.

Realized loss from financial assets and liabilities not measured at fair value through profit or loss amounted to €91 thousand at the end of 2011 and reflects a decrease in income from the sale of shares from the Bank book.

Net loss from financial assets and liabilities held for trading amounted to €2,308 thousand, which is a major improvement compared to previous year and is to a large extent a reflection of a rather modest volume of trading in shares in 2011 and also the result of trading in derivatives, some of which were in 2011 largely effected by a decline in share prices on the secondary securities market.

The Bank realized €725 thousand of net gains from foreign exchange differences as a consequence of a significant exchange rate volatility experienced during 2011. Other net operating loss amounted to €2,601 thousand, a further decrease of 326 per cent as compared to 2010.

In 2011, administrative costs amounted to €27,500 thousand, representing approximately 28 per cent increase against 2010. A major portion of administrative costs is attributable to labour costs which accounted for 55 per cent or €15,146 thousand. General and administrative expenses accounted for the remaining 41 per cent or €12,354 thousand.

The depreciation costs amounted to €2,417 thousand in 2011, which represents an increase of 23 per cent over the previous year.

The newly created net provisions in the amount of €630 thousand, represented provisions for off-balance-sheet liabilities. As compared to 2010, they represent a decrease of 85 per cent.

At the end of 2011, the net impairments of loans amounted to €50,364 thousand, representing a decrease of 20 per cent. The off-balance-sheet total of adjustments of loan values decreased by 57 per cent to €49,550 thousand as compared to the previous year.

As a result of the realized loss, the assessed income tax for 2011 equals nil.

## 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 2011, did not materialize. While certain sectors such as export-oriented companies and automotive industry recorded certain levels of growth, business was much slower for companies in the construction sector, real estate and financial sector. On the other hand, in 2011 the banks were subjected to more expensive sources of financing than in the years prior to the economic crisis. The consequence of this was a more conservative and cautious lending policy that resulted in a decline in lending to clients in the Corporate Banking sector. At the end of 2011, Slovenian banks reported 5.7 per cent decline in loans to corporates as compared to 2010.

The volume of loans approved to clients in the Corporate Banking sector by Hypo Alpe-Adria-Bank in 2011 fell against the volume reported in 2010, as is true for corporate banking sector of all banks. Irrespective of this, increasing the market share of the loan portfolio remains the objective of this sector also in the future.

Increasing the share of non-interest income in total income of the sector, remains one of the key orientations of the sector. In 2011, non-interest income from the Corporate Banking sector amounted to €4,975 thousand, which accounts for 45.1 per cent share of total non-interest income of the Bank. An increase 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.

In the Corporate Banking sector, client deposits represent an important element in managing the Bank's liquidity. At the end of 2011, the volume of deposits rose by 20.7 per cent as compared to the end of 2010. Our market share also rose in terms of the total amount of deposits.

The project of introducing a single strategy of the Corporate Banking sector to the entire Hypo Group characterized a large portion of 2011 and established a solid foundation for further operations. In 2011 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 2011 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 client needs and requirements. We are sure that in the forthcoming year, which is expected to be another challenging one, 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 in 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 that will bring improved added value to the Bank and increase the volume of operations primarily on account of non-interest income.

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 bank and client. Marketing of banking services with direct contact between bank adviser and 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 obtain also those clients who prefer more sophisticated type of operations.

### Objectives for 2012

We will continue our successful operations of the Corporate Banking sector of the past years also in 2012. 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--sized 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 Hypo Leasing clients' potential and achieve majority of objectives set for 2012;
- 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;
- Developing highly experienced and professional employees and adapting business processes and their optimization.

## Retail banking

### New organisation

The year 2011 was very lively in terms of the introduction of new services as well as the new organisation. We divided the retail banking segment in two areas, namely the large part called sales force, which comprises the entire selling/business network of 19 branch offices for transactions with retail clients, small enterprises and sole proprietors, and the production management that comprises support to operations in the area of transactions with retail clients and development of new services.

Throughout 2011, we carried out activities to finally unite the retail banking and the leasing sector into a single unit of the Bank and Hypo Leasing.

### Poslovna strategija

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 to increase the number of clients and the number of sold products per client.

In the first half year, the Bank introduced a new management concept, i.e. SFE – Sales Force Effectiveness in order to increase the sales of services per client particularly with a different work organisation and an increase in the productivity especially in the following areas:

- Sales organization: extension of the opening times; sales support was introduced in branch offices.
- 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 obtaining new clients show that the SFE project had a positive impact on the improved efficiency of the sales network.

Furthermore, we introduced a new concept of advising to affluent clients, which we call Hypo Advisory Banking. It represents an expansion of a special relationship with more demanding clients and a unification with the segment of the former private banking. 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 increase client loyalty,
- To keep and stabilise the existing asset portfolio of clients at the Bank,
- To increase the cross-sale indicator with a special client approach,
- To obtain new clients,
- To increase the revenues.

We also started the preparations for a new concept of approaching clients in the segment of micro enterprises and SMEs, i.e. a new concept of the offer for small-size enterprises and sole proprietors. We set up 8 business centres where custodians take care for the quality of services, to increase the volume of services for micro clients, and at the same time to increase the sale of services for retail clients. The entire organization and project is intended to increase the number of existing and obtain new micro clients with the aim of ensuring individual clients can take care of personal and corporate finance in one place.

This year we further strengthened the cooperation with our sister company Hypo Leasing, in particular in terms of the joint approach on the market and cross-sales for existing and new clients.

### Transactions in 2011

The results of the modified strategy with these segments are evident in the number of sold services per client, per employee as well as per branch office. In 2011, the Bank obtained 28 % more clients than in 2010, and sold 47 % more services than in 2010.

With the changed working method, we managed to increase the sales coefficient per client from 2.26 in 2010 to 2.39 in 2011. By doing so, we also increased the return per client.

**Retail banking** – Commission income resulting from a higher number of services per client and more frequent use of individual services grew by more than 9 % in 2011 as compared with the year before. The highest growth was recorded in the commission income from transaction accounts (23 %), payment transactions (13 %), and card transactions (8 %).

**Banking with micro-enterprises** - Commission income resulting from a higher number of services per client and more frequent use of individual services grew by over 21 % in 2011 as compared with the year before. The highest growth was recorded in the commission income from loan granting (30 %), transaction accounts (17 %), and payment transactions (6 %).

### Operation support, product management and sales channels

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 cleaning of inactive client bases continued in 2011, both in the segment of retail clients as well as the segment of micro enterprises and sole proprietors. By cleaning bases we ensured a good foundation for a more intensive marketing of our services and a real growth of the number of active clients in the future. We have developed a special MDM tool that provides support to the Bank's business, product management and sales channels, and which will be used primarily for client checking and classification, as well as providing support to sales promotions.

The Bank upgraded the HYPOnet e-bank with services expected and desired by clients. One of the services is the upgrading of HYPOnet with a new e-invoice service.

The cooperation between the retail banking and leasing sector further strengthened. For this purpose we finished at the end of the year the preparations to join the product and sales channels at Hypo Leasing with the banking into one department, which will represent even more harmonious operations and consequently better and more coordinated services and activities.

In 2011 we further upgraded the Loyalty programme, which the Bank started marketing intensively in 2010. The prize catalogue contained services offered by the Bank as well as benefits ensured by the Bank in cooperation with contractual partners. This year we finalized our agreements and included Hypo Leasing into the Loyalty programme, calling it the Hypo Club. We are also preparing a hard copy of the catalogue.

We made a step further in the area of informing our clients and in August we started sending newsletters to clients. Such messages are sent electronically to 9,000 addresses.

We developed a number of new services for individual segments, following the current trends such as supplementing the range of financial services with the offer of investment gold - brokerage services in buying/redeeming gold as investment.

### New business hours

At the Bank, we are aware of the changed market conditions and extended business hours of our clients and consequent problems they have when trying to visit branch offices in person after the end of their long working days. For this reason, we made a decision on 1 December 2011 to change and extend the business hours in all of our branch offices by 3.5 hours a week with the same number of employees.

### Our objectives for 2012

We will continue with the segmental client treatment following the principle and the projects started in 2011. We are starting with 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 to shorten the approval process, which will be reflected in lower operating costs.

We pay special attention to the quality of our portfolio and will keep this area as one of our priorities.

We will pay special attention to the development of services for micro-companies and sole proprietors. The main target is further increase in the number of clients in all segments, which will be achieved with intensive sale of all types of services, by obtaining new custodians and improving return on clients.

The area of insurance services sale has been revised. In the new year, we will launch extended and renewed sales of such services, which will be given the central focus in the next year. By doing so, we have achieved the main milestones of thorough modernization of the retail clients sector.

The main focus in the next year will be put on increasing the quality of sales, which will be achieved with further training of employees, a comprehensive offer of the Bank and Hypo Leasing, risk management, return on sales and cutting costs.

## Financial markets

### Investment Banking

In 2011, the Bank recorded a downfall in the revenues in the area of investment banking as compared to 2010. The cause for this is a marked deterioration of the situation on capital markets, poor market liquidity, lack of domestic investors' interest in financial markets, high passive interest rates, and most of all in an intensified economic picture in the EU and the USA (the European debt crisis, the USA debt). In October we offered our clients the trading via a new foreign implementing assistant, which will become the basis for additional services in the area of electronic services (trading platforms). The biggest emphasis in the department was put on the Asset Management segment, where marketing activities and the increase of this service to a high professional level were at the forefront. At the end of the year, we successfully took over the clients and services of the brokerage firm Certius BPH d.o.o., which will constitute the central part of 2012 marketing activities.

In 2012, the greatest emphasis will thus be put on increasing the revenues from stock brokerage on foreign markets (the optimization of Slovenian and Balkan portfolios), introduction on custodian services (for large domestic and foreign investors), sales promotion through direct marketing, introduction of new electronic services for clients, the attempt to take over other brokerage firms, and in particular on increasing the number of clients and assets in the Asset Management department.

### Treasury Sales

After successful year 2010, the department of Treasury Sales focused its attention on high quality client advisory services and to extend the base of target clients. We additionally strengthened the cooperation with other departments, which have direct contacts with clients, and moreover, we focused our market activities into cross-selling services. Alongside of this we also upgraded the cooperation project with Hypo Leasing. The general situation on financial markets in 2011 deteriorated, risks were increasing and liquidity planning became uncertain. With the measures taken and the correspondingly tailored strategy, the department of Treasury Sales ended 2011 very successfully, even with above-average realized plans. Furthermore, we realized all the targets.

The trends on financial markets are about to experience a downfall in 2012; therefore we assess business opportunities as being similar to those experienced in 2011 and this will require other services, better tailored to such market conditions. In order to meet this demand, we will introduce new services at the start of 2012, combine them with the current ones and further upgrade our range of services. We will put higher emphasis on education and training of Bank employees, as well as on up-to-date informing of employees about the possibilities offered by the Treasury Sales department as means of an upgrade and supplement to their services. For 2012 we plan to expand our department's offer of services to the area of marketing services to retail clients.

### Management of Bank's balance

In 2001, the department of the management of Bank's balance provided the Bank's liquidity balancing in accordance with the adopted policy and within certain limits. The Bank had 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 balance sheet in terms of the currency and interest rate risk. We have modernized banking book management processes and upgraded financial risk management.

### Transaction banking

#### 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 2011 proved to be another dynamic year in this particular sector.

As early as in 2008, we signed the agreement to join the SEPA payment schemes with the help of the Bank of Slovenia, which provided availability, and on 28 January we ensured, as an in-direct participant, fulfilment of obligations for the accession to the credit payments scheme. Thus we have provided clients with the option of SEPA cross-border payments of up to EUR 50,000 since 28 January 2008.

In 2009, these transfers were migrated to the new, so called SIMP (Sepa infrastructure small value transfers) infrastructure via Bankart. These transfers are called SEPA EKP (SEPA external credit transfers).

By establishing SIMP in Slovenia in 2009, we established an infrastructure also for the domestic clearing and settlement of SEPA credit transfers, which started operating on 4 March 2009. This system is called SEPA internal credit transfers (SEPA IKP), which enables execution of domestic small value (up to EUR 50,000) credit transfers among the system participants.

We joined the system immediately and thus offered our clients domestic SEPA credit transfers, which are executed 5 times a day in known settlements. The migration of payments from the Giro clearing system to SEPA IKP was completed on 31 July 2009, when the Giro clearing system officially stopped operating.

In 2010, we successfully executed the migration of payments with standing orders to SEPA IKP system.

On 1 November 2010, we successfully introduced a universal payment order which will gradually replace a special payment order.

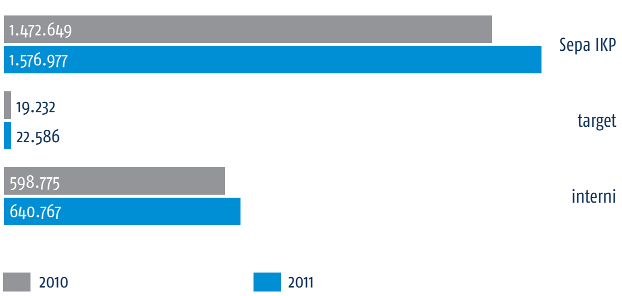
In 2011 we devoted great efforts to communicate to our clients the withdrawal of the special payment order PP02, payment order BN02 and payment order for regulated payments RP01 and their migration to the universal payment order UPN. Furthermore we implemented bulk payment services allowing clients migration of standing orders including pensions to SEPA bulk payments system.

In line with the plan of the Bank Association of Slovenia, in 2012 the Bank will carry out migration of pensions to SEPA payments and began adapting internal transactions application to the SEPA system.

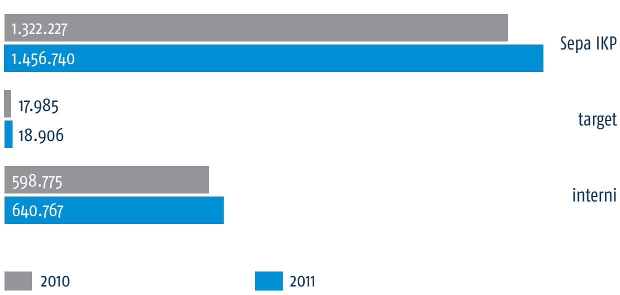
The Bank will continue monitoring the changes, which will be introduced by the Regulation of the European Parliament and of the Council establishing technical requirements for SEPA CT and SEPA DD. After the Regulation has been adopted, we will again inform our clients about the cancellation of the old standards and the transition to new SEPA standards (from TKDIS to XML).

As of 1 November 2010, we have ensured our clients the access to SEPA EDD CORE (SEPA external direct debit for retail clients).

Internal payments – outflows




Internal payments – inflows



In September 2011, we joined the SEPA EDD B2B payment system (SEPA external direct debit for legal entities), on 19 November 2011 SEPA IDD B2B (SEPA internal direct debit for corporate clients) and SEPA IDD CORE (SEPA internal direct debit for retail clients). We offer this service to our clients - payers.

In February 2012, we will offer SEPA Direct Debits of the B2B and CORE scheme to our clients – payment recipients. In accordance with the plan coordinated at the level of the Bank Association of Slovenia, we will implement migration of existing mandates to debtors under the SEPA DD system.

In 2010, we opened the E-invoice project, which was successfully completed in 2011. In June 2011, we offered our clients the service of e-invoice transfer from the payer to the issuer.

In 2011, we offered our corporate clients the Maestro business card. We also enable SMS informing to protect our clients from any abuse.

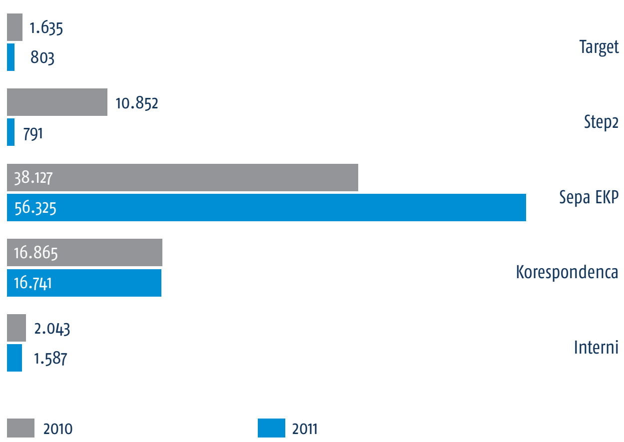
In 2011, we were working with the Social Work Centre on setting up the electronic connection between the Centre and the Bank. We estimate that the solution will be implemented together with the Centre in January 2012, which will contribute to the effectiveness of obtaining quality information for the needs of the Social Work Centre.

As regards the domestic payment transactions, we recorded a 7 % increase in the number of transactions on the outflow side compared to the year before, and an 8 % increase on the inflow part. On the other side, the volume of payments decreased by 30 %, in particular on account of payments via the Target2 system. The Bank realized payments of €16.8 billion, which is €9.8 billion less than in 2010. The number of SEPA transactions in terms of domestic payment transactions increased by 6 % on the outflow and 9 % on the inflow side, and 5 % or 2.5 % considering the sum.

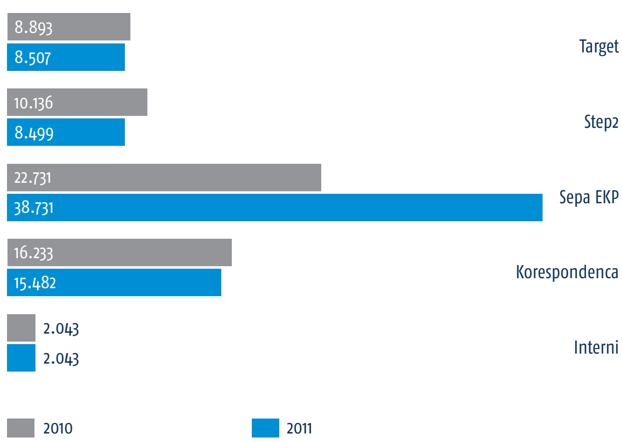
In terms of the number, the volume of cross-border and other payments increased by 9 % or 18 %, and considering the total sum of payments by 3 % or 7 %. A large increase in SEPA payments was recorded as regards the number of transactions, namely by 32 % on the outflow side and 41 % on the inflow side. The number of payments via the STEP2 system dropped significantly, which was expected due to the cancellation of the common access point through the Bank of Slovenia; all payments were directed via SEPA EKP already since the start of the year if the recipient bank was a SEPA member. The amount of SEPA EKP outflows in 2011 was €415 million, while the total of outflows via STEP2 system was only €2.3 million.

Compared to the year before, no major changes were noted in payment transactions made by the Bank via the correspondence network. A minor drop was recorded only on the inflow part, which is understandable, as new banks, i.e. SEPA members, have been emerging.

Cross-border and other payments – outflows




Cross-border and other payments – inflows



## Bank's Internal Development

### 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 reorganization of the company both at the organizational as well as infrastructural level in 2011.

In the organizational area, we recruited new staff in the Business Intelligence department and IT Operations department, and reorganized the night control of system operation by ensuring physical presence of staff.

In terms of development, we continued to decrease the number of minor developmental claims and increase the emphasis on the project approach to the development, which was started in 2010. Primarily, we supported projects connected with the applied and organizational restructuring in the Hypo Group.

We ensured support to all statutory and regulatory requirements, and in the business sector we introduced improvements in the areas of the reminder procedure, universal cash payment order, supplements to the disputable receivables module, optimisation of statement processing, Bankart Money send, changed reporting (unwinding), implementation of the new IFRS process, development of e-invoices for retail clients and custody module for securities.

We also introduced the CDI-MDM application, which focuses on the client and enables progressive upgrading of various functionalities, or ensures data for other specialized solutions. In 2011, we introduced the module for the support of sales promotions, presentation of operating flow on various organizational levels, and the monitoring of working tasks of employees dealing with end clients.

In the area of systems and communication management, we updated disc fields, as well as the equipment used in personal computers and printing, and introduced a solution for safekeeping of logs.

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

### Real estate management

In 2011, several projects to expand the Bank's operating network were completed in the segment of Real Estate Management. On 1 June 2011, the Moste branch office opened in Ljubljana, and in Maribor the existing branch office moved from Tyrševa Street to a new location in the centre of the city – Leona Štuklja Square on 10 June 2011.

Other activities in the Real Estate Management segment were focused on optimal management of real estate and cost reduction both as regards maintenance as well as other costs associated with real estate management.

## 3.4 Expectations for the future

In 2011, the Bank continued to maintain the concept of a universal bank and for the future it plans coherent and stable business growth in all business areas. The foundation for the future strategy is the continuance of the offer of comprehensive financial services, where we are setting new foundations for a modern financial business by using the synergies of the HYPO financial group. The basis for future strategies, regardless of their form, is an improved level of cooperation between HBS and HLS. Only above-average use of the particular and individual advantages of both companies can lead to an above-average accomplishment of joint goals. Alongside the Bank's endeavours for greater diversity and quality of our services, we pursue the principle of security and profitability in business. The obligation of the Bank in forming a safe and dependable environment is the basic starting point for all our business activities.

The Bank will in the next medium-term period continue its independent, organic, but balanced business growth. We aim to keep the existing high structural share of loans and with a greater scope of business maintain the appropriate level of the quality portfolio. At the same time, the Bank plans to strengthen significantly the acquisition of funds or deposits from non-banking clients. With the help of a motivated team, we wish to reach the top five banks by reputation and profitability by 2014. The key goals for the future periods are:

- Increase of primary sources
- Improvement of cost efficiency
- Maintenance of the existing interest margin
- Effective control of credit portfolio
- Increase of the non-interest income
- Greater number of clients
- Better quality for existing products and development of new products with regard to the market needs which the Bank already offers or plans to offer to both existing and potential clients. An all-round offer to clients in all areas of the financial business and use of the effects of the cross--market.
- Better responsiveness and adaptability of the Bank to changes occurring in the environment.

### Key success factors

Because cooperation and use of advantages of the Bank and Hypo Leasing are key factors for achieving the strategic goals and because only the employees can make this quality jump, for the Bank this implies that the key success factors have remained the same as in the previous period, but are now in a different set order. Our primary focus is in accordance with the new goals and circumstances of human resources management.

The Bank plans to achieve the strategic goals by a constant slow growth of the Bank's balance sheet with the goal to preserve the market share. The main goal is to increase the profitability of the capital with a moderate growth of the risk weighted asset (RWA). The foundation of the business strategy is a structural adaptation of the Bank's balance focusing on the increase of the number of quality clients and display of presented products, which will be the foundation for the long-

Key success factors

| | |
|---|---|
| Human resource management | We take care of the systematic development and learning of all employees. |
| Development of services or products | We are quick to follow and a niche leader. |
| Sales | We take care of continuously obtaining new clients and of having the biggest number of sold services per target client. |
| Leadership | We support target leadership with authorisations and responsibility on all levels. |
| Organization and operating processes | We take care of the current adaptation to growth and development of the company. |
| Information support | We support transparency and effectiveness of operations. |

-term cooperation between the Bank and clients. The business strategies of the Bank do not plan to take over competitive companies in the financial industry, but rather to focus on above-average advisory services with the help of experienced sales staff and quality financial services in all sales channels to the clients and to ensure quick and accurate support of back-office services of the Bank.

The key strategy in client relations is that we always justify the client's trust in the Bank with a professional attitude, quality service and confidentiality of the relationship. Only services of this type of the Bank and the employees can in combination with appropriate marketing and sales processes and the knowledge of strengths and weaknesses of our products, achieve the expected result in this area, which will consequently lead to achieving the Bank's results. The basic intention and key path in strategy implementation of the Bank is to offer full support of the Bank to loyal customers. On the other hand, there is the goal to avoid non-profitable and socially controversial bank clients. The key for client cooperation is to set up a long-term relationship with the client on the basis of mutual trust, regardless of external circumstances in which the Bank or client conducts business.

The central focus of the Bank's activities in 2012 will take place in the area of retail banking and in the segment of SMEs, as well as sole proprietors, where we will continue the Bank's focus on the integral consulting approach to clients, with which we wish to round off the long-term partner cooperation. The Bank plans to preserve the attention and care, which we offer to our clients, along with the programmes for ensuring high quality of services and preparation of business policies that will enable comprehensive treatment of business processes and to put forward the satisfaction of the customer. In this area, the Bank will continue its strategy of segmented approach, where by unique consulting approach it will offer an above-average user experience. Additionally, the modification of the credit policy will enable all clients a faster and better quality treatment of their needs, while making sure that we ensure the adequate quality of the portfolio of products and services.

The all-round approach in dealing with client demands will be rounded off by creating value added products with solutions for contractual business partners, where we will continue our policy of cohesion in the area of insurance operations, retail and telecommunications. The contractual partners with their sales network are the ones, which will represent one of the pillars in the expansion of the Bank's operation; therefore we will place a great deal of attention to adequate training and support of the operation of alternative sales routes.

In the area of corporate clients, our future focus in 2012 in the segment of SMEs will be to ensure integral treatment of all financial needs of clients by redefining sales teams and by maintaining the long-term partnership cooperation. The strategy behind the all-round management of client relations therefore remains one of the main priority areas in the upcoming year, where the personal approach of sales teams will ensure that clients will receive an overall offer of structured services – from simple banking services of a current account and payment transactions to complex products of financial markets. The key element in realizing the strategy bases on the development of experienced and professional staff, therefore we will continue with adequate training, simplification, and optimization of business processes.

Because we will place also in the future greater concern to the maintenance of a quality portfolio, activities directed to perfecting the portfolio of insurances, will continue.

## 3.5 Social responsibility

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 to employees

For the second time, in 2011 employment portal Mojedelo.com voted Hypo Alpe Adria the »High ranking employer«. This award is acknowledgement of our efforts to maintain good relations and constructive dialogue between employees.

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 2011, the Bank had 465 employees, representing a 15 per cent increase in the number of employees compared to the previous year.

Movement of employees during the years is shown in the table below:

| Year | No. of employees at 31 December |
|---|---|
| 2011 | 465 |
| 2010 | 403 |

### Educational structure

Educational structure of our staff is at a very high level and over 63 per cent of employees have either higher education or university degree.

| | Employees by educational structure | |
|---|---|---|
| Educational level | in 2011 | in 2010 |
| IV. | 3 | 3 |
| V. | 167 | 163 |
| VI. | 39 | 26 |
| VII./1 | 105 | 91 |
| VII./2 | 131 | 108 |
| VIII. | 20 | 12 |
| 31.12 | 465 | 403 |

### Staffing structure

In 2011, the Bank focused its efforts towards a revised and unified staffing structure. As part of integration of the banking and leasing activities, job positions were reconciled and standardized, forming a basis for the future structure of Hypo.

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 organizational structure, with four levels of staff career development for each job position. In close cooperation with his seniors, an individual will in future be able to develop his 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 organizational unit. Priority is given to the internal labour market, and the desires and ambitions of employees are taken into account. The selection of employees is systematized in several circles of structured interviews carried out with the job applicants. Where certain 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 organize various internal trainings in accordance with our needs. In 2011, we focused primarily on training in the area of sales and continued with language courses. All trainings and courses vary significantly in terms of topics and are intended for a wider circle 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 organized by 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, towards the end of 2011 we organized an international training "Business learning excellence for development". This and similar trainings 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, organized 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. Besides the above-mentioned, the Bank often co-finances the part-time studies or educational courses 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 optimization, 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.

### Yearly interviews and management by objectives

The aim of yearly 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 systematic professional and personal development of the managerial staff and associates. The yearly interview is first held by the head with their superior or the Management Board, and is followed by an interview of the head with the subordinates. After the conclusion of the interviews, the head and the subordinate are responsible for the implementation of the agreed targets, while the human resources department provides for the organization of agreed trainings and implementation of the development plans in line with the strategy of the Bank. Target interviews are being held twice a year and development interviews once a year.

### Remuneration 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. Even though we have fewer assets for remuneration than in the previous years, we believe it is important to keep the remuneration system, which contributes to more successful operations of the Bank.

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

### Measuring of organizational climate and satisfaction

In 2011 we included all employees in the measurement of organizational climate and satisfaction. In the Bank, we are aware that employees cannot be motivated only externally, but that such atmosphere and conditions can be created, that contribute to the well-being of the employees and to successful achievement of objectives. The results of measurement will be known in the beginning of 2012 however, we have recently noted trend of declining staff satisfaction. The reasons lie in general uncertainties present in the environment where we operate as well as in events and changes that occurred within the Bank.

We will continue to measure organizational 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 socializing also contributes to the well-being of employees; therefore the Bank organizes numerous events where staff can meet socially. Through donations, the Bank actively contributes to the development of Hypo Sports and Culture Association, which enables its members to participate in chosen sports and cultural activities at very favourable prices. By doing this, we strengthen the relations and cooperation of employees also outside of the working environment.

### Plans for the future

The revised staffing structure will be completed in 2012 with new employment contracts. We will continue to direct our human resources activities towards long-term benefit of our staff as they are the solid foundations for our further development and prosperity in the future.

### 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 realized profit to reserves and did not pay out dividends. In 2010 and 2011, the Bank failed to realize the profit.

| | 2011 | 2010 |
|---|---|---|
| Dividend payout in thousand EUR | 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 present 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 organization 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

| | 2011 | 2010 |
|---|---|---|
| Advertising expenses | 587 | 674 |

### Responsibility to the wider community

The resources that the Bank dedicated to sponsorship and donations in 2010 and 2011 are presented in the following table.

EUR '000

| | 2011 | 2010 |
|---|---|---|
| Sponsorships | 222 | 263 |
| Donations | 14 | 69 |

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.

At the initiative of Dr. Gottwald Kranebitter, President of the Management Board of Hypo Alpe-Adria-Bank International AG, we started with the project called "Hypo Pro Futuro", which operates as social and cultural network in seven European countries, where Hypo is present.

Each company of the Hypo Group selected a humanitarian project to help children in their country with a special, one-time donation. We are aware that there are too many children who never come to see the sunny side of life; hence we want to bring a smile to their face. In Slovenia, we decided to support the project "Let's enjoy childhood vitality on the snow" – a winter camp for children from socially deprived families. Donation by Hypo Slovenija ensured them accommodation in Kranjska Gora, teacher attendance and organization of entertaining and animated workshops to enrich days and evenings. This project was also supported by the Vitranc Cup, which has been our partner in the sponsorship area for a number of years and which in 2011celebrated its golden jubilee.

As part of the Hypo Pro Futuro project, the Bank and Hypo Leasing, in collaboration with research institute »The Austrian Economic Centre« in Vienna, issued a Dictionary of Economic Terms The dictionary (Slovene version includes English-Slovene and Slovene-English dictionary) was issued in seven languages that are spoken in countries where Hypo is present. The dictionary is the result of acknowledgement that education plays a key role in further development and success of Hypo as indicated by Tanja Štumberger, the translator involved in the project: »Economic literacy is of key importance not only for understanding of the causes and consequences of economic and financial crisis, but also in searching for methods to overcome the crisis and ensure economic prosperity.« The Bank and Hypo

Leasing donated dictionaries to major libraries and educational institutions in Slovenia.

The Bank intended 54 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 organization of humanitarian fund raising events.

We understand the support of sports and sporting activities as our contribution for healthier and better quality life. With sponsorship funds, we are included in the lives of those who represent our country in Europe and worldwide. In this way we demonstrate our support to athletes, their endurance, discipline, competitiveness, and desire to accomplish goals. Thus, the Bank dedicated 36 per cent of all donations to sports activities. We also supported with sponsorship funds the Slovenian football team, the fastest Slovenian Matic Osovnikar, the Vitranc Cup and other local sport events and athletes. To them, we dedicated 70 per cent of total sponsorship funds.

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 2011, nearly 10 per cent of our donation funds and 19 per cent of sponsorship funds were allocated to cultural activities or organizations.

Furthermore, the Bank is supporting any activities that promote economic development. We have for several years cooperated with the Celje Fair and are sponsors of the International Trade Fair. In 2011 we dedicated 7 per cent of total sponsorship funds to this event.

### 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 2010 and 2011, are presented in the following table.

EUR '000

| | 2011 | 2010 |
|---|---|---|
| Auditing and consulting costs | 2,936 | 217 |

The share of audit fees and advisory fees in total above mentioned costs amounts to €118 thousand (for year 2010 €57 thousand) (refer to note to financial statements 8.A)

The biggest share of the above costs represents the costs of consultation services relating to the implementation of a number of different systems in the Bank such as the SFE, Wind Down and GTFR projects).

### Internal control system

The Bank endeavours for coherent operation in accordance with applicable legislation, regulations, rules, codes, standards of best practice and possible other rules with regular and effective execution of the function of ensuring compliance of business. By preventive operation, it 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, and
- 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.

The compliance monitoring is coordinated and run by the Business compliance services with the support of all the Bank's organizational units and employees. Some of its most important tasks are according to the adopted strategy as follows:

- Conformity with internal procedures, which represents the "Control plan", regular self-assessment of key internal controls;
- Provision of quality data, which is ensured by regular control of logical accuracy and conformity of data of financial reports and risk reports;
- Ensuring safety, which is guaranteed by regular monitoring of physical and technical safety and information and personal data protection;
- Business conformity with legislation and standards of good practice (Banking Act, Payment Services and Systems Act, Prevention of Money Laundering and Terrorist Financing Act, Financial Instruments Market Act, Consumer Credit Act with all subordinate regulations and other laws, which influence the operation of a bank);
- Ensuring conformity with accounting standards by regular compliance monitoring of accounting procedures with standards.

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

In 2011, the Bank redefined its internal controls with the updated survey of certain key business processes.

## Internal audit

The Internal Audit department, in accordance with the Banking Act, reports to the Supervisory Board about the realization of annual plan, adequacy and efficiency of risk management, adequacy and efficiency of internal controls system operations, and about important findings and their realization. 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 2011. 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 harmonized operations and reporting. The Internal Audit department employs 6 internal auditors; 2 of them have 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 2011, the Internal Audit department of the parent bank carried out external assessment of all internal audit functions 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.

# 4 Financial Report

## 4.1 Statement of Management Board's responsibilities

The Management Board approves the financial statements for the year ended 31 December 2011, and the used accounting policies, estimates and notes to 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 2011. 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.

Tax authorities can in following 5 years from calculation of income tax for financial year end review company's operation which can consequently cause additional tax liabilities, delay penalties and penalties from tax income or other taxes. Management of the company 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 income tax declarations for the financial years 2008, 2009 and 2010.

The Management Board

**Marko Bošnjak, M. Sc.**
Member of the Management Board

**Matej Falatov, M. Sc.**
President of 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, 2011, 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, 2011, 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 30, 2012

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

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

Primož Kovačič
Certified Auditor

## 4.3 Financial statements

### Income statement

EUR '000

| | Notes | 2011 | 2010 |
|---|---|---|---|
| Interest and similar income | 1 | 85,813 | 85,203 |
| Interest and similar expenses | 1 | (45,226) | (34,610) |
| **Net interest income** | | **40,587** | **50,593** |
| Dividend income | 2 | 946 | 911 |
| Fee and commission income | | 11,031 | 10,489 |
| Fee and commission expenses | | (2,535) | (2,434) |
| **Net fee and commission income** | **3** | **8,496** | **8,055** |
| Realized gains (losses) on financial assets and liabilities not measured at fair value through profit or loss | 4 | (91) | (104) |
| Net gains / (losses) on financial assets and liabilities held for trading | 5 | (2,308) | (1,750) |
| Net gains / (losses) on currency translation differences | 6 | 725 | 762 |
| Net gains / (losses) on derecognition of assets excluding non-current assets held for trading | | 53 | (1) |
| Other net operating income / (losses) | 7 | (2,600) | 1,151 |
| Administrative costs | 8 | (27,500) | (21,566) |
| Depreciation and amortization | 9 | (2,417) | (1,967) |
| Provisions | 10 | 630 | (4,192) |
| Impairments | 11 | (50,364) | (64,296) |
| **LOSS FROM ORDINARY ACTIVITY** | | **(33,843)** | **(32,404)** |
| Income tax | 12 | 6,977 | 6,112 |
| **NET LOSS FOR THE YEAR** | | **(26,866)** | **(26,292)** |

The accompanying notes on pages 46 to 91 form an integral part of the financial statements and should be read in conjunction with them.

### Statement of comprehensive income

EUR '000

| | Notes | 2011 | 2010 |
|---|---|---|---|
| **NET LOSS FOR THE YEAR** | **30** | **(26,866)** | **(26,292)** |
| **OTHER COMPREHENSIVE INCOME AFTER TAX** | | **(4,641)** | **(1,535)** |
| **Net losses recognized as revaluation reserve relating to available-for-sale financial assets** | | **(5,801)** | **(1,919)** |
| Gains / (losses), recognized as revaluation reserve | | 5,162 | (2,887) |
| Transfer of gains / (losses) from revaluation reserve to profit and loss | | (10,963) | 968 |
| **Income tax relating to components of other comprehensive income** | **28** | **1,160** | **384** |
| **TOTAL NET COMPREHNSIVE INCOME FOR THE YEAR** | | **(31,507)** | **(27,827)** |

The accompanying notes on pages 46 to 91 form an integral part of the financial statements and should be read in conjunction with them.

## Statement of financial position

EUR '000

| | Notes | 31.12.2011 | 31.12.2010 |
|---|---|---|---|
| Cash and balances with Central Bank | 13 | 39,753 | 55.507 |
| Financial assets held for trading | 14 | 5,898 | 24.092 |
| Available-for-sale financial assets | 15 | 94,638 | 91.280 |
| Loans | | 1,770,346 | 1.954.752 |
| - to banks | 16 | 20,107 | 14.191 |
| - to clients | 17 | 1,750,239 | 1.940.561 |
| Financial assets held to maturity | 19 | 36,462 | 42.315 |
| Property, plant and equipment | 20 | 5,605 | 6.016 |
| Intangible assets | 21 | 4,122 | 4.216 |
| Income tax assets | | 13,951 | 6.564 |
| - tax assets | | - | 308 |
| - deferred tax assets | 16 | 13,951 | 6.256 |
| Other assets | 22 | 6,859 | 3.101 |
| **TOTAL ASSETS** | | **1,977,634** | **2.187.843** |
| | | | |
| Financial liabilities to Central Bank | 23 | 120,147 | 40.010 |
| Financial liabilities held for trading | 24 | 4,721 | 2.450 |
| Financial liabilities measured at amortized cost | 25 | 1,667,096 | 1.965.469 |
| - deposits from banks | 25a | 720,837 | 1.218.646 |
| - deposits from clients | 25a | 713,632 | 524.302 |
| - borrowings from banks | 25b | 159,615 | 148.683 |
| - borrowings from non-banks | 25b | - | 833 |
| - subordinated liabilities | 26 | 73,012 | 73.005 |
| Provisions | 27 | 6,676 | 7.357 |
| Income tax | | 44 | 445 |
| - income tax liabilities | | 41 | - |
| - deferred tax liabilities | 28 | 3 | 445 |
| Other liabilities | 29 | 18,838 | 5.493 |
| TOTAL LIABILITIES | | 1,817,522 | 2.021.224 |
| Share capital | 30a | 174,037 | 174.037 |
| Capital surplus | 30b | 27,696 | 2.696 |
| Revaluation reserve | 30c | (2,981) | 1.660 |
| Revenue reserve | 30d | 1,862 | 1.862 |
| Retained earnings / (accumulated loss) (including net profit / (loss) for the year) | 30e | (40,502) | (13.637) |
| TOTAL EQUITY | | 160,112 | 166.619 |
| **TOTAL EQUITY AND LIABILITIES** | | **1.977.634** | **2,187,843** |

The accompanying notes on pages 46 to 91 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. approved the financial statements and notes thereto.

Uprava Banke

**Marko Bošnjak, M. Sc.**
Member of the Management Board

**Matej Falatov, M. Sc.**
President of the Management Board

Ljubljana, 30 March 2012

## Statement of changes in equity

EUR '000

| EUR '000 | Notes | Share capital | Capital surplus | Revaluation reserve | Revenue reserve | Retained earnings (including net profit /loss for the year | Total equity |
|---|---|---|---|---|---|---|---|
| | | | | | | | |
| **Balance at 1 January 2010** | **30** | **174,037** | **2,696** | **3,196** | **1,862** | **12,655** | **194,446** |
| Net comprehensive income for the year | | - | - | (1,535) | - | (26,292) | (27,827) |
| Balance at 31 December 2010 | 30 | 174,037 | 2,696 | 1,660 | 1,862 | (13,637) | 166,619 |
| Additional capital paid | | - | 25,000 | - | - | - | 25,000 |
| **Net comprehensive income for the year** | | **-** | **-** | **(4,641)** | **-** | **(26,866)** | **(31,507)** |
| Balance at 31 December 2011 | 30 | 174,037 | 27,696 | (2,981) | 1,862 | (40,502) | 160,112 |
| **Stanje 31. december 2010** | | **174.037** | **2.696** | **1.660** | **1.862** | **(13.637)** | **166.619** |

The accompanying notes on pages 46 to 91 form an integral part of the financial statements and should be read in conjunction with them.

## Cash flow statement

EUR '000

| | 2011 | 2010 |
|---|---|---|
| **CASH FLOWS FROM OPERATING ACTIVITIES** | | |
| Net profit (loss) before tax | (33,843) | (32,404) |
| Depreciation and amortization | 2,417 | 1,967 |
| Net (gains) / losses from currency translation | (725) | (762) |
| Net (gains) / losses on sale of property, plant and equipment and investment property | (53) | 1 |
| Other (profit) / loss from investing | 4,387 | (1,669) |
| Other (profit) / loss from financing | (22,927) | 1,676 |
| Net unrealized profit in equity or from revaluation reserve of available-for-sale financial assets (excluding the deferred tax effect) | 5,801 | 1,919 |
| Other adjustments of profit before tax | 12,641 | 6,909 |
| **Operating cash flows before changes of operating assets and liabilities** | **(32,302)** | **(22,363)** |
| **(Increase) / decrease of operating assets (excluding cash equivalents)** | **193,177** | **122,732** |
| Net (increase) / decrease of assets with Central Bank | (2,480) | (1,101) |
| Net (increase) / decrease of financial assets held for trading | 15,885 | 12,221 |
| Net (increase) / decrease of available-for-sale financial assets | (20,121) | (2,698) |
| Net (increase) / decrease of loans | 203,646 | 114,275 |
| Net (increase) / decrease of other assets | (3,753) | 35 |
| **Increase / (decrease) of operating liabilities** | **(193,754)** | **(184,548)** |
| Net increase / (decrease) of financial liabilities to Central Bank | 80,137 | (40,266) |
| Net increase / (decrease) of financial liabilities held for trading | 2,270 | (413) |
| Net increase / (decrease) of deposits and loans measured at amortized cost | (289,456) | (143,291) |
| Net increase / (decrease) of other liabilities | 13,295 | (578) |
| **Cash flow from operating activities** | **(32,879)** | **(84,179)** |
| **(Paid) / reimbursed corporate income tax** | **350** | **2,545** |
| **Net cash flow from operating activities** | **(32,529)** | **(81,634)** |
| **CASH FLOWS FROM INVESTING ACTIVITIES** | | |
| **Receipts from investing activities** | **2,292** | **1,855** |
| Proceeds from sale of property, plant and equipment and investment property | 826 | 389 |
| Other proceeds from investing activities | 1,466 | 1,466 |
| Disbursements from investing activities | (2,684) | (2,781) |
| **(Disbursements for acquisition of property, plant and equipment and investment property)** | **(1,733)** | **(1,600)** |
| (Disbursements for acquisition of intangible assets) | (951) | (1,181) |
| Net cash flow from investing activities | (392) | (926) |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| **Proceeds from financing activities** | **25,000** | **-** |
| **Other proceeds from financing activities** | **25,000** | **-** |
| **Expenses for financing activities** | **(2,067)** | **(1,676)** |
| (Repayments of subordinated debt) | (2,067) | (1,676) |
| Net cash flow from financing activities | 22,933 | (1,676) |
| Effects of exchange-rate changes on cash and cash equivalents | (2,331) | 1,820 |
| **Net increase of cash and cash equivalents** | **(9,988)** | **(84,236)** |
| Cash and cash equivalents at the beginning of period | 55,031 | 137,447 |
| **Cash and cash equivalents at the end of period** | **42,712** | **55,031** |

The accompanying notes on pages 46 to 91 form an integral part of the financial statements and should be read in conjunction with them.

EUR '000

| | Notes | 2011 | 2010 |
|---|---|---|---|
| **Cash and cash equivalents comprise:** | | | |
| Cash and balances with Central Bank | 13 | 26,605 | 44,840 |
| Loans to banks with maturity up to three months | 16 | 16,107 | 10,191 |
| **TOTAL** | | **42,712** | **55,031** |

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

### Cash from incomes and dividends

EUR '000

| | 2011 | 2010 |
|---|---|---|
| Interest paid | 33,855 | 8,382 |
| Interest received | 68,904 | 72,268 |
| Dividends received | 946 | 1,037 |

## 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 headquarters or on their web pages:

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

**Hypo Alpe-Adria-Bank International AG**
Alpen-Adria-Platz 1
9020 Klagenfurt
Avstrija
www.hypo–alpe-adria.com

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

## Significant accounting policies

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

### 1. Basis for the preparation of the financial statements

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. Under these assumptions, the effects of transactions and other business events are recognized 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 informati-on 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 realization 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 Group 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 Group 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.

Following the acquisition of 100 % of the shares in the Hypo Alpe-Adria-Bank International AG by the Republic of Austria completed on 30 December 2009, Hypo Alpe-Adria-Bank International AG and its subsidiaries (together Hypo Alpe Adria or HAA) is currently in the process of restructuring.

The previous owner of HAA made contributions towards the restructuring as part of its disinvestment. Furthermore, the Republic of Austria announced another injection of capital. This took place through the subscription of the issue of EUR 450,0 m of share certificates late in June 2010.

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 an 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. The European Commission has also announced that it will examine whether the previous owner has contributed sufficiently to the restructuring costs.

A formal restructuring plan has been prepared by the Parent for the European Union approval process for government aid.

HAA will be redimensioned 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 from 2011 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. These expenses may be considered in accordance with IFRS only when the specific criteria according to IFRS 5 are fulfilled, and especially the most likely disposal within the period of 12 months.

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.

With its decision as of 4 August 2010, the EU gave its approval for the acquisition of Hypo Alpe Adria by the Republic of Austria required under the merger control law. Hypo Alpe-Adria-Bank International AG continued to strive for completion of the EU investigation into state aid in 2011. The current restructuring plan was presented at a presentation to the European Commission in Brussels on 24 January 2011. The discussions and subsequent list of questions from the Commission suggest that the Commission is in basic agreement with the bank's new strategy. The results of these direct discussions and the answers to the questions subsequently submitted to obtain more in-depth information on aspects of the plan were incorporated into the revised version of the EU restructuring plan, which was submitted in April 2011.

In response to the sovereign debt crisis in the eurozone and its effects on the European financial sector, the worsening of economic conditions in Europe and in particular in the Hypo core regions of South-Eastern Europe and the conclusion reached by the supervisory authorities in the Joint Risk Assessment Decision (JRAD) process that there is a requirement for additional capital for the bank Own capital funds as defined by the Austrian Banking Act), Hypo Alpe-Adria-Bank International AG has sharpened its strategy. This has included adjusting planning to take account of the worsened economic forecasts and, amongst other measures, resolving to switch the subsidiaries to self-financing through local deposits from 2012 onwards.

The tightening of strategy was also reflected in the continuing dialogue with the EU Commission. In addition to submitting data to show the medium and long-term viability of Hypo Alpe-Adria-Bank International AG and its subsidiaries in South--Eastern Europe, the bank also produced a modified restructuring plan based on the forecast for the 2011 financial year. The document focuses the bank's strategy on reprivatising all saleable units and was submitted by the owner to the authorities in Brussels at the turn of the year.

On the basis of the above, the Commission will reach judgement on whether the state-aid measures are consistent with EU state aid rules. The Commission will examine whether the measures planned can return Hypo Alpe Adria to long-term profitability, whether support from the state is being kept to the required minimum, whether the level of own contribution made is appropriate and whether sufficient measures are being undertaken to limit the distortions to competition caused by the financial aid being given. The Commission has also announced that it will examine whether the previous owners have contributed sufficiently to the restructuring costs.

Hypo Alpe Adria will be redimensioned on the basis of this restructuring plan, and this will also lead to a significant number of group companies being relinquished. The current business plan for 2012–2016 has calculated in restructuring and exit costs in connection with this, which could have a negative effect on results for future periods, depending on when a given market is exited and the market conditions prevailing at the time. These expenses can only be accounted for when the specific criteria – in particular the probable exit within a period of 12 months – are met.

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. The guarantee agreement concluded at the end of December 2010 with the Republic of Austria has been provisionally approved by the European Commission and the decision was published at the start of 2012. The approval was granted subject to the Commission agreeing to the bank's restructuring plan based on the state aid provided through the emergency nationalisation in 2009.

At the time of writing, 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. As the subject of the inspection process, Hypo Alpe-Adria-Bank International AG has declared its willingness to cooperate fully with the Commission.

### 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 organization 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 recognized in the profit or loss.

Translation gains and losses resulting from the change of the amortized cost of monetary securities nominated in foreign currency that are classified as available-for-sale financial assets, are recognized 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 recognized in the revaluation reserves together with the fair value measurement effect.

Gains and losses resulting from purchase and sale of foreign currencies are recognized 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 2011 was 1 EUR=1.2939 USD (2010:1 EUR =1.3280 USD); 1.2156 CHF (2010:1 EUR=1.2475 CHF); 0.8353 GBP (2010: 1 EUR=0.8602 GBP).

### 4. Interest income and expense

Interest income from debt securities is recognized in the profit or loss using the effective interest method.

The effective interest method is a method of calculating the amortized 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 recognized 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 recognized using the rate of interest applied in discounted future cash flows. Interest income derived using the method described is unwinding and is recognized 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 recognized as interest expenses.

## 5. Fee and commission income and expense

Fees and commissions are generally recognized 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 recognized 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 recognized as interest income and expenses.

## 6. Dividend income

Dividends are recognized 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: financial assets held to maturity, available-for-sale financial assets, financial assets at fair value through profit or loss, 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 amortized cost. If the Bank sells other than in 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.

In accordance with the internal decision of the Hypo Group, in 2011 the Bank did not classify its financial instruments to financial assets held to maturity. The financial assets reported in the Statement of Financial Position as at 31 December 2011, were recognized prior to the above mentioned decision of the Group. The Bank will hold these financial assets until their maturity.

### 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, one 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 2011, 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 recognized 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 recognized either within assets or liabilities. 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 recognizing 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, and the financial assets and liabilities containing one or several embedded derivatives that could significantly impact cash flows of the host instrument.

The Bank did not classify financial instruments to a subgroup of financial assets which are upon 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 recognized on the date of trading at fair value (usually at cost), increased by (instruments that are not recognized at fair value through profit or loss) 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 recognized at fair value. Gains or losses on financial assets at fair value and held for trading are recognized 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 recognized in the comprehensive income until the asset is derecognized 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 recognized directly in profit or loss.

Loans and receivables, and financial assets held to maturity are carried at amortized 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 recognizes 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 recognized 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. The fair value at the reclassification date becomes financial instrument's new amortized cost. Reclassification of an asset from the group of financial assets held to maturity is not allowed.

In 2011, the Bank did not reclassify any of its financial instruments to another group.

### 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 the 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 valuation of financial assets that are not traded in an active market is based on an external expert's valuation. 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 recognized in the balance sheet as approved loans. The difference between the sale price and the repurchase price is recognized in the financial statements as interest income and is accrued throughout the duration of the contract.

## 8. Impairment of financial assets

### a) Financial assets at amortized cost

**General:**

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

- The necessary impairment is recognized for financial assets at amortized cost, and
- The required provisions are formed for off-balance-sheet exposures.

The method used to create the necessary impairment of financial assets at amortized 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 EUR, as individually relevant exposure.

**Distinguishing Between Different Methods of Impairment of Financial Assets at Amortized Cost**
Financial assets at amortized 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 amortized 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 amortized cost is detected;
3. All exposures where no breach of any of the objective factors indicating the impairment of the financial asset at amortized 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 amortized 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 Amortized 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 amortized 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 realization 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.

Realization of collateral is recognized as potential future cash flow in cases where the collateral fulfils the required formal criteria with regards to the degree of legal certainty and realizability. 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 (for loans that were granted at a fixed interest rate) or initial contractual interest rate (for loans that were approved at a variable 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 amortized 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 recognized for exposures that as of the balance sheet date do not violate any of the objective factors indicating the impairment of the financial asset and for individually treated exposures where no individual impairment is required. When creating group impairments, we also calculate the required scope of impairments on the basis of the mathematical formula; in this case, however, the formula reflects the fact that no objective factor, which objectively indicates the impairment of individual financial asset, has been breached. The mathematical formula derives from the Basel II methodology, adjusted for the assessment of the scope of realized but not yet identified losses in the Bank's portfolio. The adjustment relates mainly to the acknowledgment of collateral and determination of the time period in which the Bank is capable to detect 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 for:

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

The cumulative effect of all three factors, which cause that the current value of expected cash flows from realization of collateral is normally lower than it’s the current market value, is reported by the Bank in its calculations through special coefficients, in accordance with the policy of the HGAA Group.

In order for collateral to be recognized as relevant, it should fulfil at least three minimum criteria with regards the degree of legal certainty and realizability. 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 shows what part of unsecured exposure the Bank can expect to lose in the event of default. The coefficients are compliant with the HGAA Group policies and follow the conservative assessment of expected losses in the IRB approach of 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 Realization of Loss in its Portfolio**

The Bank has defined the period, in which it recognizes the realization 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 to with sufficient probability, 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 derecognized 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 recognized, 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. If the Bank assesses that loan restructuring is commercially justified and represents a part of the Bank's regular operations, the Bank does not consider such restructuring as impartial proof of impairment of financial assets; such loans are treated equally as other investments of the Bank.

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 realization 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 recognized 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 is recognized in profit or loss as an expense when incurred.

Depreciation and amortization expense is accounted for individually on a straight-line basis so that the costs of the assets are allocated to the residual value over the useful lives of the assets.

The depreciation (amortization) rates applied are as follows:

| | 2011 | 2010 |
|---|---|---|
| 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 recognized separately from the buildings. As it normally has unlimited useful life, the Bank does not depreciate it.

The assets are derecognized 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 each day of the statement of financial position, whether there is any impartial evidence that an assets might be impaired. If there are indications that an asset may be 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 recognized in profit and loss in the amount of the difference between the recoverable and carrying amount of the assets.

In 2011 the assets were not impaired.

### 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 leasee.

**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 to the duration of the contract. If operating lease is terminated prematurely all payments, requested by the lessor, are recognized as cost 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 amortized costs.

### 13. Provisions

A provision is recognized 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 recognized 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 recognizes 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 for 2011 is 20 %.

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 recognized 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 utilized.

The Bank formed 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 utilize in the current tax return due to the loss incurred.

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

In 2011, the Bank was obligated to account for the balance sheet total tax, which amounted to EUR 0.

### 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: 4.85 % annually;
- Number of employees entitled to receive the payment: 466
- Growth of the average salary in the Republic of Slovenia: 3.0 % 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 once every ten years.

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

### 16. Financial liabilities

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

### 17. Share capital and reserves

The share capital is recognized 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 recognized at fair value which is equal to the fee received under the »Other liabilities«. Fees received are amortized 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. The client assumes the operational risk. A commission charged for these services to clients is recorded in the Note number 3b. These assets are not included in the statement of financial position but are recorded in the off-balance-sheet items as authorized operations.

Assets and liabilities of clients from the intermediary operations (Note nr. 32) as well as fee and commission income and expenses related to the intermediary operations are recorded in the Note 3b 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 2011 and which are noted below.

**IFRS 1 – First time adoption of International Financial Reporting Standards: Limited Exemption from Comparative IFRS 7 Disclosures for first time Adopters (Amended)**

**IAS 24 – Related party disclosure.**

Amendments to IAS 24 define in more detail and simplify definition of a related party. Furthermore the amended standard reduces the scope of disclosures of transactions of a government owned entity with the government and other government owned entities. The amended standard is applicable for periods beginning on or after 1 January 2011 and is applied retrospectively. The adoption of this amendment has no effect on the financial statements of the Bank.

**IAS 32 – Financial instruments: Presentation – Classification of the Option to Purchase Shares (Amended).**

This amendment relates to the rights issues offered for a fixed amount of foreign currency which were treated as derivative liabilities by the existing standard. The amendment states that if certain criteria are met, these should be classified as equity regardless of the currency in which the exercise price is denominated. The amended standard is applicable for periods beginning on or after 1 February 2010. The adoption of this amendment has no effect on the financial statements of the Bank.

**IFRIC 14 – Prepayments to a Minimum Funding Requirement (Amended).**
The amendment to IFRIC 14 is effective for annual periods beginning on or after 1 January 2011 with retrospective application. The amendment provides guidance on assessing the recoverable amount of a net pension asset. The amendment permits an entity to treat the prepayment of a minimum funding requirement as an asset. The adoption of this amendment has no effect on the financial statements of the Bank.

**IFRIC 19 – Extinguishing Financial Liabilities with Capital Instruments.**
IFRIC 19 is effective for annual periods beginning on or after 1 July 2010. The interpretation clarifies that equity instruments issued to a creditor to extinguish a financial liability qualify as consideration paid. The equity instruments issued are measured at their fair value. In case that this cannot be reliably measured, the instruments are measured at the fair value of the liability extinguished. Any gain or loss is recognized immediately in profit or loss. The adoption of this interpretation will have no effect on the financial statements of the Bank.

**Improvements to IFRS**
In May 2010 the Board issued another omnibus of amendments to its standards, primarily with a view to removing inconsistencies and clarifying wording. These amendments are effective for annual periods beginning on 1 July 2010 or 1 January 2011.

**IFRS 1 – First Adoption of International Financial Reporting Standards.**
This improvement clarifies the treatment of accounting policy changes in the year of adoption after publishing an interim financial report in accordance with IAS 34 Interim Financial Reporting. It allows first-time adopters to use an event-driven fair value as deemed cost and expands the scope of 'deemed cost' for property, plant and equipment or intangible assets to include items used subject to rate regulated activities.

**IFRS 3 – Business Combinations**
The measurement options available for non-controlling interest (NCI) were amended. Only components of NCI that constitute a present ownership interest that entitles their holder to a proportionate share of the entity's net assets in the event of liquidation should be measured at either fair value or at the present ownership instruments' proportionate share of the acquiree's identifiable net assets. All other components are to be measured at their acquisition date. These amendments are effective for periods beginning on or after 1 July 2010.

The second improvement applies to contingent consideration that arose from business combinations whose acquisition dates precede the application of IFRS 3R (as revised in 2008) and clarifies that these contingent considerations should be accounted for in accordance with IFRS 3 adopted in 2005.

Finally, it requires an entity (in a business combination) to account for the replacement of the acquiree's share-based payment transactions (whether obliged or voluntarily), i.e., split between consideration and post combination expenses.

**IFRS 7 – Financial Instrument: Disclosures.**
The amendment was intended to simplify the disclosures provided by reducing the volume of disclosures around collateral held and improving disclosures by requiring qualitative information to put the quantitative information in context. The amendment is effective for periods beginning on or after 1January 2011.

**IAS 1 – Presentation of Financial Statements.**
This amendment clarifies that an entity will present an analysis of other comprehensive income for each component of equity, either in the statement of changes in equity or in the notes to the financial statements. The amendment is effective for periods beginning on or after 1 January 2011.

**IAS 27 – Consolidated and Separate Financial Statements.**
This improvement clarifies that the transitional amendments from IAS 27R made in 2008 also apply for subsequently amended standards. The amendment is effective for periods beginning on or after 1 July 2010.

**IAS 34 – Interim Financial Reporting.**
This improvement requires additional disclosures for fair values and changes in classification of financial assets, as well as changes to contingent assets and liabilities in interim condensed (consolidated) financial statements.

**IFRIC 13 – Customer Loyalty programmes.**
This improvement clarifies that when the fair value of award credits is measured based on the value of the awards for which they could be redeemed, the amount of discounts or incentives otherwise granted to customers not participating in the award credit scheme, is to be taken into account. The amendment is effective for periods beginning on or after 1 January 2011.

The adoption of these amendments and new interpretations did not result in any changes in the Bank's accounting policies.

### Standards and Interpretations not yet effective

The Bank did not apply early any standards or interpretations that are not yet effective.

The following amended IFRSs will be adopted in future periods as required by International Financial Reporting Standards and EU:

**IFRS 7 – Financial Instruments: Disclosure – Transfer of Financial Assets.**
The amendment is effective for annual periods beginning on or after 1 July 2011. The amendment requires additional disclosure about financial assets that have been transferred but not derecognised as well as disclosures about continuing involvement in derecognised assets The amendment is to be applied retrospectively.

The following amended and revised standards and interpretations will be adopted in future periods as required by International Financial Reporting Standards, if endorsed by the EU:

**IFRS 7 – Financial Instruments: Disclosures (Amended) – Offsetting Financial Assets and Financial Liabilities.**
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 retrospectively applied. This amendment has not yet been endorsed by the EU.

**IFRS 9 – Financial Instruments.**
The new standard is effective for annual periods beginning on or after 1 January 2015 and replaces IAS 39 . Phase 1 of IFRS 9 sets new requirements for the classification and measurement of financial assets. This standard has not yet been endorsed by the EU.

**IFRS 10 – Consolidated Financial Statements**
The new standard is effective for annual periods beginning on or after 1 January 2013. IFRS 10 replaces the portion of IAS 27 Consolidated and Separate Financial Statements that addresses the accounting for consolidated financial statements. IFRS 10 establishes a single control model that applies to all entities including special purpose entities. The changes introduced by IFRS 10 will require management to exercise significant judgment to determine which entities are controlled, and therefore, are required to be consolidated by a parent. Furthermore, the new standard changes definition of a controlling entity. This standard has not yet been endorsed by the EU..

**IFRS 11 – Joint Arrangements.**
The new standard is effective for annual periods beginning on or after 1 January 2013. IFRS 11 replaces IAS 31 Interests in Joint Ventures and SIC-13 Jointly-controlled Entities — Non-monetary Contributions by Venturers. IFRS 11 identifies only two types of joint investments that can be jointly controlled: joint operations and joint ventures. Furthermore, IFRS 11 removes the option to account for jointly controlled entities (JCEs) using proportionate consolidation. Instead, JCEs that meet the definition of a joint venture must be accounted for using the equity method. This standard has not yet been endorsed by the EU.

**IFRS 12 – Disclosures of Involvement in Other Entities.**
The new standard is effective for annual periods beginning on or after 1 January 2013. IFRS 12 includes all of the disclosures that were previously in IAS 27 related to consolidated financial statements, as well as all of the disclosures that were previously included in IAS 31 and IAS 28. These disclosures relate to an entity's interests in subsidiaries, joint arrangements, associates and structured entities. A number of new disclosures are also required in particular those related to assumptions used in determination of whether an entity controls another entity. This standard has not yet been endorsed by the EU.

**IFRS 13 – Fair Value Measurement.**
The new standard is effective for annual periods beginning on or after 1 January 2013. IFRS 13 establishes a single source of guidance under IFRS for all fair value measurements. IFRS 13 does not change when an entity is required to use fair value, but rather provides guidance on how to measure fair value under IFRS when fair value is required or permitted. This standard has not yet been endorsed by the EU.

**IAS 1 – Financial Statement Presentation: Presentation of Items of Other Comprehensive Income.**
The amendment is effective for annual periods beginning on or after 1 July 2012. The amendments to IAS 1 change the grouping of items presented in OCI. Items that could be reclassified (or 'recycled') to profit or loss at a future point in time (for example, upon derecognition or settlement) would be presented separately from items that will never be reclassified. This amendment has not yet been endorsed by the EU.

**IAS 12 – Deferred tax (Amended).**
The amendment is effective for annual periods beginning on or after 1 January 2012. The amendment clarified the determination of deferred tax on investment property measured at fair value. The amendment introduces 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. Furthermore, it introduces the requirement that deferred tax on non-depreciable assets that are measured using the revaluation model in IAS 16 always be measured on a sale basis of the asset. This amendment has not yet been endorsed by the EU.

**IAS 19 – Employee Benefits (Amended).**
In June 2011 the IASB issued numerous amendments to IAS 19. These range from fundamental changes such as removing the corridor mechanism for the recognition of changes made to defined benefits plan. Now, all changes are recognized when they are made either in the profit or loss or the statement of comprehensive income, depending on the type of changes. The amendment is effective for annual periods beginning on or after 1 January 2013. This amendment has not yet been endorsed by the EU.

**IAS 27 – Separate Financial Statements.**
The Standard was issued in May 2011 and is effective for annual periods beginning on or after 1 January 2013. As a consequence of the new IFRS 10 and IFRS 12, what remains of IAS 27 is limited to accounting for subsidiaries, jointly controlled entities, and associates in separate financial statements. The new standard has not yet been endorsed by the EU.

**IAS 28 – Investments in Associates and Joint Ventures.**
The Standard was issued in May 2011 and is effective for annual periods beginning on or after 1 January 2013. As a consequence of the new IFRS 11 and IFRS 12, IAS 28 has been renamed IAS 28 Investments in Associates and Joint Ventures, and describes the application of the equity method to investments in joint ventures in addition to associates. This amendment has not yet been endorsed by the EU.

**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. This amendment has not yet been endorsed by the EU...

**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. This interpretation has not yet been endorsed by the EU. The interpretation has no impact on the financial position or operations of the Company. IFRIC 20 has not yet been endorsed by the EU. The new interpretation will not impact the Bank's financial position or its operations.

The Bank is reviewing the not yet effective standards and interpretations and at this stage cannot reasonably assess the impact of the new requirements. The Bank will comply with new standards and interpretations as and when 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 amortized 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 amortized 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 realization 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.

Key assumptions affecting the need for additional impairment in 2011 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. As a result, the Bank assesses a possibility of further deterioration of PD in credit portfolio where an average PD could increase by 40 %. This would lead to an estimated EUR 9.7 million of additional impairments. Applying sensitivity of PD increased by 50 % or 60 % would lead to an estimated €12.1 million or €14.6 million of additional 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 put huge efforts on improving the current portfolio collateralization rate. For this reason, the Bank is considering the possibility to increase the portfolio collateralization by 20 %. This would lead to an estimate of €7.3 million of lower impairments. Applying sensitivity of portfolio collateralization increased by 30 % or 40 % would lead to an estimate of €11.9 million or €15.05 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 8 Significant accounting policies – Available-for-sale financial assets

Key assumptions affecting the need for additional impairment in 2011:

Instruments tied to equity securities;

1. 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 EU area.

#### c) Going concern

The Bank compiled these financial statements on a going concern basis. In making this judgment, the Management considered the Bank's financial position, current intentions, profitability of operations and access to financial resources, substantial part of which is provided by the Bank's parent company, and analyzed the impact of the recent financial crisis on the future operations of the Bank.

### 22. Events after the balance sheet date

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

The Supervisory Board approved this Annual report on 12 April 2012.

## Notes to the income statement

### 1. Interest income and expense

EUR '000

| | 2011 | 2010 |
|---|---|---|
| **Interest income and similar income** | | |
| Deposits with Central Bank | 208 | 231 |
| Financial assets held for trading | 1,442 | 1,654 |
| Available-for-sale financial assets | 2,716 | 2,135 |
| Bank loans and deposits | 290 | 524 |
| Loans and deposits from clients | 79,604 | 78,841 |
| Temporary purchased securities | - | 18 |
| Financial assets held to maturity | 1,455 | 1,669 |
| Other financial assets | 98 | 131 |
| **Total interest income and similar income** | **85,813** | **85,203** |
| | | |
| **Interest expense and similar expenses** | | |
| Bank sight deposits | - | 1 |
| Sight deposits from clients | 299 | 119 |
| Bank deposits | 19,755 | 16,796 |
| Deposits from clients | 15,604 | 10,077 |
| Deposits from Central Bank | 856 | - |
| Bank loans | 5,302 | 4,353 |
| Interest on financial liabilities held for trading | 1,328 | 1,573 |
| Subordinated debt | 2,073 | 1,676 |
| Interest on other financial liabilities | 9 | 15 |
| **Total interest expense and other expenses** | **45,226** | **34,610** |
| | | |
| **NET INTEREST** | **40,587** | **50,593** |

The Bank changed the method of reporting interest due from impaired clients in 2011. For group impairments, interest income is recognized in contractual amounts, whereas for individually impaired clients, technical interest is recognized.

In 2010, interest income was recognized on the amounts expected to be repaid for group impairments and individually impaired clients.

### 2. Dividend income

EUR '000

| | 2011 | 2010 |
|---|---|---|
| Dividends from financial assets held for trading | - | 112 |
| Dividends from available-for-sale financial assets | 946 | 799 |
| **Total dividend income** | **946** | **911** |

### 3. Fee and Commission Income and Expense

EUR '000

| | 2011 | 2010 |
|---|---|---|
| Total fee and commission income | 11,031 | 10,489 |
| Total fee and commission expense | 2,535 | 2,434 |
| **Net fee and commission** | **8,496** | **8,055** |

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

EUR '000

| | 2011 | 2010 |
|---|---|---|
| **Fee and commission income** | | |
| Payment transactions | 5,206 | 4,973 |
| Loan transactions | 1,851 | 2,028 |
| Granted warranties | 991 | 848 |
| Other transactions | 2,786 | 2,450 |
| **Total fee and commission income** | **10,834** | **10,299** |
| | | |
| **Fee and commission expense** | | |
| Payment transactions | 699 | 595 |
| Loan transactions | 3 | 3 |
| Other transactions | 1,739 | 1,767 |
| **Total fee and commission expense** | **2,441** | **2,365** |
| | | |
| **NET FEE AND COMMISSION FROM TRANSACTIONS FOR BANK'S ACCOUNT** | **8,393** | **7,934** |

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

EUR '000

| | 2011 | 2010 |
|---|---|---|
| **Fee and commission income from investing and auxiliary investing services and operations for clients' account** | | |
| Receiving, brokerage and processing of orders | 96 | 138 |
| Financial instruments' management | 30 | 5 |
| Book-entry securities account management for clients | 69 | 47 |
| Consultation services to corporates on capital structure, business strategy and similar requests and M&A consultancy services | 2 | - |
| **Total fee and commission from investing and auxiliary investing services and operations for clients' account** | **197** | **190** |
| | | |
| **Fee and commission expense from investing and auxiliary investing services and operations for clients' account** | | |
| Fee and commission paid to KDD and similar organizations | 48 | 28 |
| Fee and commission paid to the stock exchange and similar organizations | 46 | 41 |
| **Total fee and commission expense from investing and auxiliary investing services and operations for clients' account** | **94** | **69** |
| | | |
| **NET FEE AND COMMISSION FROM INVESTING AND AUXILIARY INVESTING SERVICES AND OPERATIONS FOR CLIENTS' ACCOUNT** | **103** | **121** |

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

EUR '000

| | 2011 | 2010 |
|---|---|---|
| Available-for-sale financial assets | (28) | (35) |
| Other financial assets and liabilities | (63) | (69) |
| **TOTAL** | **(91)** | **(104)** |

Gains and losses from available-for-sale financial assets comprise realized gains and losses on derecognition; gains and losses resulting from changes of fair value of available-for-sale financial assets are recognized directly in the Statement of Comprehensive Income.

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

EUR '000

| | 2011 | 2010 |
|---|---|---|
| Equity securities | 4,588 | (8,289) |
| Foreign currency purchase and sale | (104) | 151 |
| Derivatives | (6,792) | 6,389 |
| Other financial assets | - | (1) |
| **TOTAL** | **(2,308)** | **(1,750)** |

### 6. Net Gains (Losses) from Currency Translation

EUR '000

| | 2011 | 2010 |
|---|---|---|
| Items in foreign currency | (8,623) | (45,481) |
| Items in foreign exchange | 9,348 | 46,243 |
| **TOTAL** | **725** | **762** |

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

### 7. Other net operating income (expenses)

EUR '000

| | 2011 | 2010 |
|---|---|---|
| **Other operating income** | | |
| Non-banking services | 137 | 60 |
| Other | 649 | 1,505 |
| **Total other operating income** | **786** | **1,565** |
| | | |
| **Other operating expenses** | | |
| Membership fees | (76) | (95) |
| Taxes and other duties | (3,035) | (147) |
| Other | (275) | (172) |
| **Total other operating expenses** | **(3,386)** | **(414)** |
| | | |
| **NET OTHER OPERATING INCOME (EXPENSES)** | **(2,600)** | **1,151** |

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 assets earmarked as donations.

The most significant item under »Taxes and other duties« is withholding tax paid on interest on loans syndication.

## 8. Administrative expenses

EUR '000

| | 2011 | 2010 |
|---|---|---|
| **Employee costs** | **15,146** | **13,268** |
| Gross wages and salaries | 10,604 | 9,371 |
| Social security contributions | 705 | 624 |
| Pension insurance contributions | 951 | 842 |
| Other contributions levied on gross wages and salaries | 74 | 65 |
| Other labour costs | 2,812 | 2,366 |
| – Meal and travel allowance | 924 | 832 |
| – Bonuses | 1,088 | 803 |
| – Pay for annual leave | 702 | 713 |
| – Other | 98 | 18 |
| **General and administrative expenses** | **12,354** | **8,298** |
| Costs of materials | 1,190 | 888 |
| Costs of rentals | 1,536 | 1,431 |
| Services provided by third persons | 2,603 | 1,486 |
| Costs of business trips | 94 | 94 |
| Costs of maintenance | 1,809 | 1,583 |
| Costs of advertising | 1,207 | 1,064 |
| Costs of hospitality | 168 | 211 |
| Costs of consultations, audit and legal fees | 2,936 | 712 |
| Education fees | 224 | 225 |
| Insurance premiums | 411 | 400 |
| Other administrative costs | 176 | 204 |
| **Total administrative expenses** | **27,500** | **21,566** |

As at 31 December 2011, the Bank employed 465 staff (31 December 2010: 403)

Rental expenses of €1,536 thousand relate to real estate (2010: €1,107 thousand). The Bank has no non-cancellable lease contracts. Agreements have been concluded for an indefinite period; rentals are adjusted to 3-monthly Euribor.

The main item of costs of consulting services, audit fees and legal services relates to consulting services provided to the Bank on implementation of various systems such as SFE, Wind Down and GTFR projects)

### Stroški Audit fees

EUR '000

| | Ernst & Young | | Other auditing companies | |
|---|---|---|---|---|
| | 2011 | 2010 | 2011 | 2010 |
| Audit of the annual report | 106 | 45 | - | 45 |
| Other consulting services | 12 | 12 | - | - |
| Tax consultations | - | - | - | - |
| Other non-audit services | - | - | - | - |
| **Total audit fees** | **118** | **57** | **-** | **45** |

### 9. Depreciation and amortization expense

EUR '000

| | Notes | 2011 | 2010 |
|---|---|---|---|
| Property, plant and equipment | 20 | 1,371 | 1,334 |
| Intangible assets | 21 | 1,046 | 633 |
| **Total depreciation and amortization expense** | | **2,417** | **1,967** |

### 10. Provisions

EUR '000

| | Notes | 2011 | 2010 |
|---|---|---|---|
| Provisions for off-balance-sheet receivables | 27 | 419 | (4,161) |
| Provisions for employee benefits | 27 | 211 | (31) |
| **Total provisions** | | **630** | **(4,192)** |

### 11. Impairment

EUR '000

| | Notes | 2011 | 2010 |
|---|---|---|---|
| Available-for-sale financial assets | 15a | (10,963) | (968) |
| Financial assets at amortized cost | 18 | (39,401) | (63,328) |
| - Government | | 10 | (23) |
| - General public | | (1,319) | (6,189) |
| - Other clients | | (38,092) | (57,116) |
| **Total impairment** | | **(50,364)** | **(64,296)** |

### 12. Income Tax

EUR '000

| | Notes | 2011 | 2010 |
|---|---|---|---|
| Corporate income tax | | – | – |
| Deferred tax | 28 | (6,977) | (6,112) |
| **Total corporate income tax** | | **(6,977)** | **(6,112)** |
| | | | |
| Difference between the income tax and tax determined using basic tax rate: | | | |
| Loss before tax | | (33,843) | (32,404) |
| Tax calculated using the applicable tax rate of 20 % | | (6,769) | (6,481) |
| Income not recognized for tax purposes | | (2,885) | (470) |
| Expenses not recognized for tax purposes | | 2,667 | 828 |
| Income that increases the tax basis | | 10 | 9 |
| Tax on tax relief utilized | | – | – |
| **Total corporate income tax** | | **(6,977)** | **(6,112)** |

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

The bulk of expenses not recognized for tax purposes relates to exemption of financial assets revaluation, donations, hospitality costs and other costs.

The effective tax rate for 2011 is 20.61 per cent (2010: 18.87 per cent).

## Notes to the statement of financial position

### 13. Cash and Balances with Central Bank

EUR '000

| | 31.12.2011 | 31.12.2010 |
|---|---|---|
| Cash | 6,525 | 6,019 |
| Balances with Central Bank excluding obligatory reserves | 20,080 | 38,820 |
| **Cash and cash equivalents** | **26,605** | **44,839** |
| | | |
| Other short-term deposits at Central Bank – guarantee scheme | 879 | 1,612 |
| Obligatory reserves with Central Bank | 12,269 | 9,056 |
| **Total cash and balances with Central Bank** | **39,753** | **55,507** |

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 2 per cent for all deposits with maturity of up to 2 years.

### 14. Financial assets held for trading

EUR '000

| | 31.12.2011 | 31.12.2010 |
|---|---|---|
| **Derivatives** | | |
| **Forward contracts** | **486** | **5,930** |
| – foreign exchange | 258 | 109 |
| – equities | 228 | 5,821 |
| **Options** | **237** | **-** |
| – interest | 237 | - |
| **Swaps** | **4,808** | **2,524** |
| – interest | 4,808 | 2,524 |
| **Total derivatives** | **5,531** | **8,454** |
| | | |
| **Securities** | | |
| Shares | 348 | 15,598 |
| Other securities | 19 | 40 |
| **Total securities** | **367** | **15,638** |
| | | |
| **Total financial assets held for trading** | **5,898** | **24,092** |

As at 31 December 2011 and 2010, the Bank did not pledge any securities designated as held for trading as collateral.

Of the total value of the securities portfolio classified as held for trading, the securities in the amount of €348 thousand were quoted on the stock exchange as at 31 December 2011 (31 December 2010: €9,205 thousand).

The contractual values of derivatives are presented in Note 31a.

€228 thousand represents accrued interest on futures for securities purchased..

### 15. Available-for-sale financial assets

EUR '000

| | 31.12.2011 | 31.12.2010 |
|---|---|---|
| **Bonds** | **70,147** | **65,091** |
| – Republic of Slovenia | 49,678 | 20,328 |
| – banks | 7,851 | 30,636 |
| – other issuers | 12,618 | 14,127 |
| **Shares** | **30,727** | **27,157** |
| – banks | 160 | 280 |
| – other issuers | 30,567 | 26,877 |
| **Treasury shares** | **4,727** | **-** |
| – Republic of Slovenia | 4,727 | - |
| **Impairment through profit or loss** | **10,963** | **968** |
| **TOTAL** | **94,638** | **91,280** |

Of the total amount of available-for-sale securities, €93,034 thousand was quoted on the stock exchange as at 31 December 2011 (31 December 2010: €89,648 thousand).

a) Movement of available –for-sale financial assets

EUR '000

| | Notes | 2011 | 2010 |
|---|---|---|---|
| **Balance on 1 January** | | **91,280** | **91,470** |
| Purchases | | 43,247 | 4,994 |
| Sales | | (2,538) | - |
| Maturity | | (21,674) | (2,403) |
| Interest accrued | | 435 | 107 |
| Interest paid | | 652 | - |
| Fair value changes | | (5,801) | (1,920) |
| Impairment | 11 | (10,963) | (968) |
| **Balance on 31 December** | | **94,638** | **91,280** |

b) Revaluation reserve for AFS financial assets

EUR '000

| | Notes | 2011 | 2010 |
|---|---|---|---|
| **Balance on 1 January** | | **1,660** | **3,196** |
| Net gains/losses on fair value changes | | 5,162 | (2,888) |
| Transfer of (gains)/losses to profit or loss on disposal or impairment of securities | | 10,963 | 968 |
| Deferred tax | 28 | 1,160 | 384 |
| **Balance on 31 December** | | **(2,981)** | **1,660** |

## 16. Loans and deposits to banks

EUR '000

| | 31.12.2011 | 31.12.2010 |
|---|---|---|
| Sight deposits | 9,522 | 6,291 |
| Term deposits | 6,585 | 3,900 |
| Loans | 4,000 | 4,000 |
| **TOTAL** | **20,107** | **14,191** |

Loans to banks in the amount of €4,000 thousand (31 December 2010: €3,912 thousand) mature within a period of more than twelve months.

Loans to banks in the amount of €16,107 thousand (31 December 2010: €10,191 thousand) have the original maturity of up to three months and are considered cash equivalents.

## 17. Loans to clients

EUR '000

| | Notes | 31.12.2011 | 31.12.2010 |
|---|---|---|---|
| Loans | | 1,775,455 | 2,029,070 |
| Temporary purchased securities | | 290 | 4,386 |
| Credit lines | | 17,911 | 15,294 |
| Credit cards receivables | | 3,386 | 2,779 |
| Receivables for collateral granted | | 837 | 2,725 |
| Other | | 1,910 | 2,091 |
| Impairment | 18 | (49,550) | (115,784) |
| **TOTAL** | | **1,750,239** | **1,940,561** |

With regards to temporary purchased securities, the Bank acquires the security as collateral (it becomes its legal owner), whereas the coupon interest and dividends from such securities belong to the borrower.

Loans to clients in the amount of €1,127,751 thousand (31 December 2010: €1,174,556 thousand) have residual maturity of more than twelve months.

As at 31 December 2011, the Bank had pledged loans for long-term refinancing operations and settlements in relation to STEP2. The total value of pledged loans amounted to EUR 56,228 thousand (31 December 2010: EUR 39,174 thousand).

As at 31 December 2011, pursuant to the pass through agreement maturing at the end of 2050, the Bank transferred a portion of loans to a related company, member of the Hypo Group. As of the transfer date, the Bank disposed of the assets and transferred all risks and rewards of total €254 million to the related company for consideration of € 265 million. The entity to which these assets were transferred is not in a direct ownership of the Bank.

The Bank also signed service agreement for administration of the transferred portfolio on behalf and for the account of the issuer.

Expectations are that the whole portfolio will be repaid by its maturity (2050) and therefore, no assets will remain in the new company. However, if any portion of these assets remains unpaid for, the Bank has no liabilities in this respect. The remaining assets would be obtained by the Bank free-of-charge.

Other disclosures in relation to loans are presented in Notes 4.5.

### 18. Movement of Impairment of Loans to Banks, Loans to Clients and Other Assets

EUR '000

| | Balance at 1.1.2011 | Formation | Release | Utilization and unwinding | Balance at 31.12.2011 |
|---|---|---|---|---|---|
| Loans to clients | | | | | |
| -government | 27 | 1 | 11 | - | 17 |
| -general population | 8,843 | 3,337 | 2,018 | 6,731 | 3,431 |
| -other clients | 106,914 | 73,093 | 35,001 | 98,904 | 46,102 |

EUR '000

| | Balance at 1.1.2010 | Formation | Release | Utilization and unwinding | Balance at 31.12.2010 |
|---|---|---|---|---|---|
| Loans to clients | 51,990 | 89,552 | 26,224 | (466) | 115,784 |
| -government | - | 25 | 2 | (4) | 27 |
| -general population | 2,683 | 6,897 | 708 | 29 | 8,843 |
| -other clients | 49,307 | 82,630 | 25,514 | (491) | 106,914 |

In 2011 the Bank changed its method of interest reporting for impaired clients. For clients that are impaired as a group, interest income is recognized in contractual amounts, whereas for individually impaired clients, technical interest is recognized.

In 2010, interest income was recognized in the amount of expected settlement for both individually impaired clients and group impairments.

### 19. Financial assets held to maturity

EUR '000

| | 31.12.2011 | 31.12.2010 |
|---|---|---|
| Bonds issued by the Republic of Slovenia | 36,462 | 42,315 |
| **TOTAL** | **36,462** | **42,315** |

#### a) Movement of HTM financial assets

EUR '000

| | 31.12.2011 | 31.12.2010 |
|---|---|---|
| **Balance at 1 January** | **42,315** | **42,112** |
| Interest | 167 | 203 |
| Matured | (6,020) | - |
| **Balance at 31 December** | **36,462** | **42,315** |

As at 31 December 2011, financial assets classified as held to maturity in the total amount of €36,462 thousand were quoted on the stock exchange (31 December 2010: €42,315 thousand).

Financial assets classified as held to maturity in the amount of €36,462 thousand have a residual maturity of more than twelve months (31 December 2010: €36,298 thousand).

As at 31 December 2011, 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 €36,462 thousand (31 December 2010: €36,298 thousand).

Fair values of assets classified as held to maturity are disclosed in Note 4.5.

## 20. Property, plant and equipment

**2011** EUR '000

| | Notes | Land | Buildings | Computer hardware | Furniture and other equipment | Motor vehicles | Leasehold improvements | Fixed assets under construction | Total |
|---|---|---|---|---|---|---|---|---|---|
| **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** |

**2010** EUR '000

| | Notes | Land | Buildings | Computer hardware | Furniture and other equipment | Motor vehicles | Leasehold improvements | Fixed assets under con-struction | Total |
|---|---|---|---|---|---|---|---|---|---|
| **Cost** | | | | | | | | | |
| **Balance at 1 January 2010** | | **367** | **2,242** | **3,677** | **5,565** | **525** | **151** | **40** | **12,567** |
| Additions to assets under con-struction | | - | - | - | - | - | - | 1,211 | 1,211 |
| Transfer to assets | | - | - | 409 | 605 | - | 100 | (1,114) | - |
| Disposals | | - | - | (353) | (36) | - | - | - | (389) |
| **Balance at 31 December 2010** | | **367** | **2,242** | **3,733** | **6,134** | **525** | **251** | **137** | **13,389** |
| | | | | | | | | | |
| **Accumulated depreciation** | | | | | | | | | |
| **Balance at 1 January 2010** | | **-** | **(182)** | **(2,630)** | **(3,378)** | **(226)** | **(11)** | **-** | **(6,427)** |
| Depreciation | 9 | - | (56) | (528) | (639) | (103) | (8) | - | (1,334) |
| Disposals | | | - | 353 | 35 | - | - | - | 388 |
| **Balance at 31 December 2010** | | **-** | **(238)** | **(2,805)** | **(3,982)** | **(329)** | **(19)** | **-** | **(7,373)** |
| | | | | | | | | | |
| **Carrying amount** | | | | | | | | | |
| **Balance at 1 January 2010** | | **367** | **2,060** | **1,047** | **2,187** | **299** | **140** | **40** | **6,140** |
| **Balance at 31 December 2010** | | **367** | **2,004** | **928** | **2,152** | **196** | **232** | **137** | **6,016** |

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

In 2011, the Bank wrote-off property, plant and equipment with no present value (2010: €1 thousand). In the profit or loss, the write-off effect is recognized as part of net losses on derecognition of the assets excluding non-current assets held for sale.

The cost of property, plant and equipment that are fully depreciated but continue to be used by the Bank amounts to €3,831 thousand (2010: €3,599 thousand).

## 21. Intangible assets

**2011** EUR '000

| | Notes | Notes | Software | Long-term deferred development costs | Assets being developed | Total |
|---|---|---|---|---|---|---|
| **Cost** | | **Other intangible assets** | **Assets being developed** | **Total** | | |
| **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 amortization** | | | | | | |
| **Balance at 1 January 2011** | | **(3,016)** | **(32)** | **(42)** | **-** | **(3,090)** |
| Amortization | 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** |

**2010** EUR '000

| | Notes | Notes | Software | Long-term deferred development costs | Assets being developed | Total |
|---|---|---|---|---|---|---|
| **Cost** | | **Other intangible assets** | **Assets being developed** | **Total** | | |
| **Balance at 1 January 2010** | | **5,888** | **32** | **42** | **182** | **6,144** |
| Additions | | 1,359 | - | - | - | 1,359 |
| Disposals | | (19) | - | - | (178) | (197) |
| **Balance at 31 December 2010** | | **7,228** | **32** | **42** | **4** | **7,306** |
| | | | | | | |
| **Accumulated amortization** | | | | | | |
| **Balance at 1 January 2010** | | **(2,402)** | **(32)** | **(42)** | **-** | **(2,476)** |
| Amortization | 9 | (633) | - | - | - | (633) |
| Disposals | | 19 | - | - | - | 19 |
| **Balance at 31 December 2010** | | **(3,016)** | **(32)** | **(42)** | **-** | **(3,090)** |
| | | | | | | |
| **Carrying amount** | | | | | | |
| **Balance at 1 January 2010** | | **3,486** | **-** | **-** | **182** | **3,668** |
| **Balance at 31 December 2010** | | **4,212** | **-** | **-** | **4** | **4,216** |

The cost of fully amortized intangible assets which continue to be used by the Bank amounts to €735 thousand (2010: €683 thousand).

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

## 22. Other assets

EUR '000

| | 31.12.2011 | 31.12.2010 |
|---|---|---|
| **Other financial assets** | | |
| Fee and commission receivables | 299 | 230 |
| Receivables due from clients | 80 | 19 |
| Accrued income | 27 | 50 |
| Other receivables | 3,514 | 484 |
| **Total other financial assets** | **3,920** | **783** |
| | | |
| **Other non-financial assets** | | |
| Pre-payments made | 2 | 18 |
| Tax assets | 4 | 2 |
| Deferred costs | 2,933 | 2,298 |
| **Total other non-financial assets** | **2,939** | **2,318** |
| | | |
| **TOTAL** | **6,859** | **3,101** |

The main item under »Other receivables« represents receivables for withholding tax. In accordance with dual taxation avoidance agreements, the Bank will claim refund of the withholding tax from the tax authorities.

Deferred costs comprise insurance premiums, sponsorships, costs of professional literature and newspapers, lease costs, and costs of agents; these were paid in 2010 but relate to the 2011 financial year.

## 23. Financial liabilities to the Central Bank

EUR '000

| | 31.12.2011 | 31.12.2010 |
|---|---|---|
| Short-term loans | 120,147 | 40,010 |
| **Total financial liabilities to Central Bank** | **120,147** | **40,010** |

### a) ECB collateral

EUR '000

| | 31.12.2011 | 31.12.2010 |
|---|---|---|
| Assets suitable for ECB collateral | 142,813 | 125,822 |
| Assets pledged into ECB Pool | 122,000 | 42,500 |
| AFS financial assets | 55,746 | 53,092 |
| HTM financial assets | 36,462 | 36,298 |
| Loans | 50,605 | 36,432 |
| Non-pledged assets (pledge-free assets) | 20,813 | 83,322 |
| | | |
| **Value of ECB Pool** | **142,813** | **125,822** |

## 24. Financial liabilities held for trading

EUR '000

| | 31.12.2011 | 31.12.2010 |
|---|---|---|
| **Derivatives** | | |
| **Forward contracts** | **255** | **153** |
| – foreign exchange | 255 | 110 |
| – equities | – | 43 |
| **Options** | **237** | **–** |
| – interest | 237 | – |
| **Swaps** | **4,229** | **2,297** |
| – foreign exchange | – | 13 |
| – interest | 4,229 | 2,284 |
| **Total derivatives** | **4,721** | **2,450** |

The contractual values of the derivatives are presented in the Note 31a.

## 25. Deposits and borrowings

### a) Deposits of banks and clients

EUR '000

| | 31.12.2011 | 31.12.2010 |
|---|---|---|
| **Sight deposits by** | **108,799** | **102,783** |
| – banks | 248 | 350 |
| – clients | 108,551 | 102,433 |
| **Deposits received from** | **1,325,670** | **1,640,165** |
| – banks | 720,589 | 1,218,296 |
| – clients | 605,081 | 421,869 |
| **TOTAL** | **1,434,469** | **1,742,948** |

Deposits in the amount of €862,598 thousand (31 December 2010: €930,059 thousand) have a residual maturity of more than 12 months.

### b) Borrowings from banks and clients

EUR '000

| | 31.12.2011 | 31.12.2010 |
|---|---|---|
| **Current borrowings from** | **(9)** | **(13)** |
| – banks | (9) | (13) |
| **Non-current borrowings from** | **159,624** | **149,529** |
| – banks | 159,624 | 148,696 |
| – clients | – | 833 |
| **TOTAL** | **159,615** | **149,516** |

Borrowings in the amount of €144,175 thousand (31 December 2010: €131,473 thousand) have a residual maturity of more than twelve months.

## 26. Subordinated liabilities

EUR '000

| | Currency | Maturity | APR | 31.12.2011 | | 31.12.2010 | |
|---|---|---|---|---|---|---|---|
| | | | | Principal | Interest | Principal | Interest |
| Subordinated loans | EUR | 25.06.2016 | 3mEUR+0.80 % | 20,000 | 2 | 20,000 | 1 |
| | EUR | 21.02.2017 | 6mEUR+0.65 % | 38,000 | 6 | 38,000 | 2 |
| | EUR | 30.10.2018 | 3mEUR+4.00 % | 15,000 | 4 | 15,000 | 2 |
| **TOTAL** | | | | **73,000** | **12** | **73,000** | **5** |
| **TOTAL AMORTIZED COST** | | | | **73,012** | | **73,005** | |

Pursuant to the Decision on capital adequacy of banks and savings banks, subordinated non-current loans are included in bank's Tier 2 capital.

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

The subordinated liabilities of €73,000 thousand (31 December 2010: €73,000 thousand EUR) have a residual maturity of more than twelve months.

Fair values are disclosed in Note 4.5.

## 27. Provisions

EUR '000

| | Provisions for off-balance-sheet liabilities | | Provisions for employee benefits | | | Provisions for FA received free of charge | Total |
|---|---|---|---|---|---|---|---|
| | Provisions for guarantees | Provisions for undrawn loans | Termination benefits upon retirement | Jubilee awards | Management severance payments | | |
| **Balance on 1 January 2010** | **1,657** | **923** | **370** | **72** | **155** | **1** | **3,178** |
| Made during the year | 4,952 | 9,354 | 10 | 22 | - | 1 | 14,339 |
| Extinguished during the year | 3,123 | 7,022 | - | - | - | - | 10,145 |
| Utilized during the year | - | - | 7 | 6 | - | 2 | 15 |
| Balance on 31 December 2010 | 3,486 | 3,255 | 373 | 88 | 155 | - | 7,357 |
| Made during the year | 3,911 | 18,005 | - | 12 | - | - | 21,928 |
| Extinguished during the year | 3,440 | 18,895 | 112 | - | 111 | - | 22,558 |
| Utilized during the year | - | - | - | 7 | 44 | - | 51 |
| **Balance on 31 December 2011** | **3,957** | **2,365** | **261** | **93** | **-** | **-** | **6,676** |

## 28. Deferred tax

EUR '000

| | 31.12.2011 | 31.12.2010 |
|---|---|---|
| **Tax rate** | **20 %** | **20 %** |
| **Deferred tax assets** | | |
| Available-for-sale financial assets | 745 | 26 |
| Available-for-sale financial assets (impairment) | 2,390 | 194 |
| Different depreciation rates for operating and tax purposes | 96 | 69 |
| Provisions for employee benefits | 39 | 58 |
| Tax loss | 10,556 | 5,823 |
| Unutilized tax allowance | 125 | 86 |
| **Total deferred tax assets** | **13,951** | **6,256** |
| | | |
| **Deferred tax liabilities** | | |
| Available-for-sale financial assets (through special capital revaluation adjustment) | - | 441 |
| Different depreciation rates for operating and tax purposes | 3 | 4 |
| **Total deferred tax liabilities** | **3** | **445** |
| | | |
| **Net deferred tax assets / liabilities** | **13,948** | **5,811** |
| | | |
| **Included in the profit or loss** | **6,977** | **6,112** |
| Available-for-sale financial assets (impairment) | 2,196 | 194 |
| Different depreciation rates for operating and tax purposes | 28 | 13 |
| Provisions for employee benefits | (19) | (3) |
| Tax loss and reliefs | 4,772 | 5,909 |
| | | |
| **Included in equity** | **1,160** | **384** |
| Revaluation of available-for-sale financial assets through statement of comprehensive income | 1,160 | 384 |

## 29. Other liabilities

EUR '000

| | 31.12.2011 | 31.12.2010 |
|---|---|---|
| **Other financial liabilities** | | |
| Fees and commission payable | 83 | 71 |
| Payables to suppliers | 1,493 | 712 |
| Wages and salaries payable | 619 | 513 |
| Other liabilities from business relationships | 12,790 | 2,304 |
| Deferred income | 1,132 | 272 |
| **Total other financial liabilities** | **16,117** | **3,872** |
| | | |
| Other non-financial liabilities | | |
| Tax and contributions payable | 760 | 479 |
| Accrued expenses | 1,961 | 1,142 |
| **Total other non-financial liabilities** | **2,721** | **1,621** |
| **TOTAL** | **18,838** | **5,493** |

All the above stated financial liabilities are measured at amortized cost.

## 30. Equity

EUR '000

| | 31.12.2011 | 31.12.2010 |
|---|---|---|
| Share capital | 174,037 | 174,037 |
| Capital surplus | 27,696 | 2,696 |
| Revaluation reserve | (2,981) | 1,660 |
| Revenue reserves (including retained earnings) | (11,774) | 14,518 |
| – obligatory reserves | 1,862 | 1,862 |
| – retained earnings / (accumulated loss) | (13,636) | 12,656 |
| Net profit/loss for the year | (26,866) | (26,292) |
| **Total** | **160,112** | **166,619** |
| Med letom izplačane dividende | - | 15.984 |

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

### Share capital

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

There were no changes of share capital in 2011 as compared to 2010.

The last increase in share capital was carried out in 2008, when the Bank raised EUR 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.

### 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 2010: €93 thousand) and amounts resulting from elimination of the general capital revaluation adjustment of total €2,603 thousand (31 December 2010: €2,603 thousand).

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

### Revaluation reserve

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

As at 31 December 2011, the revaluation reserve is negative in the amount of €2,981 thousand (31 December 2010: €1,660 thousand).

### 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 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 recognize 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 deter-mined 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 company'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 a 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.

**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 Bank is required to cover net loss of the year within the next five years from future income and thereafter from write-offs of amounts derived from equity components.
The proposal of treatment of loss:

EUR '000

| | 31.12.2011 | 31.12.2010 |
|---|---|---|
| Net profit /loss for the year | (26,866) | (26,292) |
| **Total distributable profit (loss)** | **(26,866)** | **(26,292)** |
| – retained earnings | - | |

The Bank has recorded a loss for the financial year 2011 in the amount of €26,866 thousand (2010: net loss in the amount of €26,292 thousand). The Bank's Supervisory Board has proposed to the Bank's General Meeting of Shareholders that the net loss of 2011 in the amount of €26,866 thousand remains unsettled so that it may be covered in future years from future profits.

### 31. Contingent liabilities and assumed financial obligations

EUR '000

| | 31.12.2011 | 31.12.2010 |
|---|---|---|
| **Guarantees** | **86,281** | **86,057** |
| **Service guarantees** | **54,728** | **55,154** |
| Short-term | 11,447 | 19,013 |
| Long-term | 43,281 | 36,141 |
| **Financial guarantees** | **31,553** | **30,903** |
| Short-term | 15,104 | 17,786 |
| Long-term | 16,449 | 13,117 |
| **Assumed obligations from approved loans** | **88,801** | **107,707** |
| **Approved loans** | **32,618** | **58,844** |
| Short-term | 28,131 | 49,013 |
| Long-term | 4,487 | 9,831 |
| **Approved credit lines** | **56,183** | **48,863** |
| **Derivatives** | **354,162** | **198,592** |
| **TOTAL** | **529,244** | **392,356** |

Assumed liabilities from approved loans can be withdrawn within one year at the latest.
Residual maturities of financial guarantees are presented in Note 4.5.

### a) Contractual and fair values of derivative financial assets and liabilities by types

EUR '000

| | Contractual value | | Fair value 31.12. 2011 | | Fair value 31.12. 2010 | |
|---|---|---|---|---|---|---|
| Type of derivatives | 31.12. 2011 | 31.12. 2010 | Assets | Liabilities | Assets | Liabilities |
| Forward contracts | 22,253 | 30,048 | 486 | 255 | 5,930 | 153 |
| – foreign exchange | 14,949 | 4,902 | 258 | 255 | 109 | 110 |
| – equities | 7,304 | 25,146 | 228 | – | 5,821 | 43 |
| Options | 14,592 | – | 237 | 237 | – | – |
| – interest | 14,592 | – | 237 | 237 | – | – |
| Swaps | 317,317 | 168,544 | 4,808 | 4,229 | 2,524 | 2,297 |
| – foreign exchange | – | 4,600 | – | – | – | 13 |
| – interest | 317,317 | 163,944 | 4,808 | 4,229 | 2,524 | 2,284 |
| **Total derivatives** | **354,162** | **198,592** | **5,531** | **4,721** | **8,454** | **2,450** |

Nominal value indicate derivatives recorded in the off-balance-sheet, whereas the fair value indicate the carrying amount of the derivative recorded in the balance sheet; the assets are included in the financial assets held for trading, and the liabilities are included in the financial liabilities held for trading and represent a negative evaluation of the derivatives.

## Other notes

### 32. Fiduciary accounts

In accordance with the local legislation, this note includes presentation of assets and liabilities of clients resulting from intermediary operations. As at 31 December 2011, the Bank managed assets of total €764 thousand (31 December 2010: €202 thousand) on account of intermediary operations. These assets are recorded separately from the bank's own assets in the off-balance-sheet records as authorized operations.

EUR '000

| | 31.12.2011 | 31.12.2010 |
|---|---|---|
| | | |
| **ASSETS** | **764** | **202** |
| **Receivables of the settlement account or transaction accounts for clients' assets** | **71** | **32** |
| From financial instruments (31.a.) | 47 | 28 |
| To Central Securities Clearing Corporation or bank's settlement account for financial instruments disposed of | 1 | 4 |
| To other settlement systems and institutions for sold (clients') financial instruments | 23 | - |
| **Clients' cash** | **693** | **170** |
| On the settlement account for client's assets | 693 | 170 |
| | | |
| **LIABILITIES** | **764** | **202** |
| **Liabilities of the settlement account or transaction accounts for clients' assets** | **764** | **202** |
| To clients from cash and financial instruments | 717 | 174 |
| To other settlement systems and institutions for purchased (suppliers') financial instruments | 41 | 24 |
| To bank or bank's settlement account for commission, costs and similar items | 6 | 4 |

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

EUR '000

| | 31.12.2011 | 31.12.2010 |
|---|---|---|
| **Off-balance-sheet records** | | |
| 1. Clients' financial instruments, separately by services | **47** | **28** |
| Receiving, brokerage and processing orders | 47 | 4 |
| Custody services | - | 24 |

## 33. 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 | | Members of the Supervisory Board | |
|---|---|---|---|---|
| | 2011 | 2010 | 2011 | 2010 |
| **Granted loans** | | | | |
| **Balance on 1 January** | **2,076** | **2,113** | **-** | **-** |
| New loans | 994 | 321 | - | - |
| Repayments | 774 | 358 | - | - |
| **Balance on 31 December** | **2,296** | **2,076** | **-** | **-** |
| Interests and fee income | 68 | 30 | | |
| **Received deposits** | | | | |
| **Balance on 1 January** | **725** | **687** | **-** | **-** |
| **Balance on 31 December** | **599** | **725** | **-** | **-** |
| Interests expenses | 25 | 2 | | |
| **Approved overdrafts and loans** | | | | |
| **Balance on 1 January** | **183** | **200** | **-** | **-** |
| **Balance on 31 December** | **110** | **183** | **-** | **-** |
| | | | | |
| **Earnings** | | | | |
| Salaries and other short-term benefits | 1,937 | 1,910 | - | - |
| Awards | 41 | 141 | - | - |
| Attendance fees and annual allowance | - | - | - | 8 |
| Provisions for employees benefits | 71 | 110 | - | - |

**Earnings of members of the Management Board in 2011 are presented in the table below**

EUR '000

| | Romih Anton – President of the Management Board 1 Jan to 9 Feb 2011 | Golob Urban – Member of the Management Board 1 Jan to 31 July 2011 | Lah Andrej – Member of the Management Board 1 Jan to 9 Feb 2011 | Matej Falatov – Member of the Management Board 9 Feb to 31 Dec 2011 |
|---|---|---|---|---|
| Salaries | 36 | 102 | 25 | 108 |
| Variables | - | - | - | - |
| Reimbursements | - | - | - | - |
| Insurance | - | - | - | 1 |
| Other (severance pay) | - | 40 | - | - |

On 9 February 2011, the Bank's Supervisory Board appointed temporary Management Board based on a decision of the relevant bodies of the parent bank. Alexander Picker was appointed the new President of the Management Board and Matej Falatov as Member. Both were issued licences for the performance of their functions by the Bank of Slovenia on 16 March 2011.

Alexander Picker, President of the Bank is employed by the parent bank Hypo Alpe – Adria – Bank International and has been posted to the Bank. In 2011, the Bank paid €371 thousand of costs associated with the secondment to the parent bank.

Remuneration of the Management Board is based on the Supervisory Board's assessment, which is based on the annual accounts of the Bank for the previous year and on the achievements of the yearly plan and agreed objectives of the Bank for the previous year.

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 Hypo Group Alpe Adria, are not entitled to attendance fees or incentives. In 2011, the member of the Supervisory Board, who is not an employee of Hypo Group Alpe Adria, waived his right to attendance fees and annual allowance.

## Bank's exposure to its related parties

EUR '000

| | Controlling entity | | Related parties | |
|---|---|---|---|---|
| Assets | 2011 | 2010 | 2011 | 2010 |
| | | | | |
| **1. Financial assets held for trading** | | | | |
| Balance on 1 January | 375 | 321 | - | - |
| Balance on 31 December | 239 | 375 | 189 | - |
| **2. Loans** | | | | |
| **2.1. Loans to banks** | | | | |
| **2.1.1. Sight deposits** | | | | |
| Balance on 1 January | 4,798 | 3,553 | 290 | 272 |
| Balance on 31 December | 7,801 | 4,798 | 184 | 290 |
| **2.1.2. Other loans** | | | | |
| Balance on 1 January | - | 25,002 | - | - |
| New loans | 66,283 | 717,998 | - | - |
| Repayments | 59,702 | 743,000 | - | - |
| Balance on 31 December | 6,581 | - | - | - |
| **3. Other assets** | | | | |
| Balance on 1 January | - | - | 37 | 33 |
| Balance on 31 December | - | - | 101 | 37 |
| **Liabilities** | | | | |
| | | | | |
| **1. Financial liabilities held for trading** | | | | |
| Balance on 1 January | 2,005 | 1,438 | 58 | - |
| Balance on 31 December | 4,221 | 2,005 | 67 | 58 |
| **2. Financial liabilities at amortized cost** | | | | |
| **2.1. Deposits** | | | | |
| **2.1.1. Sight deposits** | | | | |
| Balance on 1 January | 4 | - | 1,309 | 7,350 |
| Balance on 31 December | 11 | 4 | 730 | 1,309 |
| **2.1.2. Current deposits** | | | | |
| Balance on 1 January | 21,501 | 20,601 | 5,747 | 20,500 |
| Increases | 115,493 | 112,500 | - | - |
| Decreases | 66,580 | 110,600 | - | - |
| Balance on 31 December | 70,414 | 21,501 | 45,730 | 5,747 |
| **2.1.3. Non-current deposits** | | | | |
| Balance on 1 January | 1,178,258 | 1,317,605 | - | - |
| Increases | 210,877 | 610,700 | - | - |

| Assets | Controlling entity 2011 | Controlling entity 2010 | Related parties 2011 | Related parties 2010 |
|---|---|---|---|---|
| Decreases | 738,974 | 750,047 | - | - |
| Balance on 31 December | 650,161 | 1,178,258 | - | - |
| **2.2. Loans from banks** | | | | |
| **2.2.1. Current loans** | | | | |
| Balance on 1 January | - | 658 | - | - |
| Increases | - | - | - | - |
| Decreases | - | 658 | - | - |
| Balance on 31 December | - | - | - | - |
| **2.3. Subordinated debt** | | | | |
| Balance on 1 January | 73,005 | 73,005 | - | - |
| Increases | 1,544 | 1,676 | - | - |
| Decreases | 1,537 | 1,676 | - | - |
| Balance on 31 December | 73,012 | 73,005 | - | - |
| **3. Other liabilities** | | | | |
| Balance on 1 January | 35 | 120 | 6 | 1 |
| Balance on 31 December | 1,242 | 35 | 11,042 | 6 |
| **OFF-BALANCE-SHEET ITEMS** | | | | |
| **Issued guarantees** | | | | |
| Balance on 1 January | 270 | 406 | 1,793 | 1,250 |
| Balance on 31 December | 158 | 270 | 1,448 | 1,793 |
| **INCOME STATEMENT** | | | | |
| **Interest income** | **167** | **225** | **1** | **140** |
| **Interest expenses** | **21,553** | **19,422** | **260** | **217** |
| **Commission income** | **-** | **-** | **85** | **115** |
| **Commission expenses** | **1,659** | **1,457** | **34** | **23** |
| **Other income** | **-** | **5** | **41** | **-** |
| **Other expenses** | **1,460** | **266** | **1,567** | **1,130** |
| **Trading result** | **(3,529)** | **(559)** | **123** | **(11)** |

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 the area of loans, deposits, issuing of letters of credit and warranties 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 (analyzing, valuation), 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.

Risk management unit continues to actively assess the efficiency of the risk management procedure by:
- Identifying individual risks the Bank is exposed to;
- Defining the measurement methods for materially important risks;
- Drafting guidelines for managing individual risks;
- Suggesting limits for individual risk exposure; and
- Performing other activities aimed at managing risks 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 2011, 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 (GPD, consumer's spending index, industrial orders and similar) through its RECO committee that deals with all important risks comprehensively and in one place; the Bank's intention was to identify those industrial sectors, 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 board suggested guidelines for adjustment of Bank's operating policy and its risk management strategy.

The Bank has implemented a new credit process pursuant to the guidelines and the parent bank's policies. Most of Bank's attention was put on managing problematic investments, as the poor payment discipline of companies consistently aggravated throughout 2011. A new Specific Investment 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 2011 there was an increase of clients and default exposures, deterioration in the Bank's loan portfolio, and consequently high value of impairments.

In 2011, the Bank made in-depth analysis of the loan portfolio within the framework of the project managed by the parent bank. The Bank defined investment strategy for the period of one year for each client separately in particular by checking the credit rating of all corporate clients, their business plans and amounts of collateral. The main goals of these activities were to creating a sufficient amount of impairments and managing the Bank's equity adequacy. The key goal of the Bank for 2012 is efficient management and control of risk-adjusted assets and their optimization, and consequent equity management. In support of this, the Counterparty Risk Management project was implemented and will be used to set and monitor limits for maximum allowed credit risk exposure in relation to individual sector's exposure of internally assessed credit ratings and segments. This will allow the Bank to limit 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 collaterals, 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 required impairments of the Bank's credit portfolio. One of the fundamental tasks of the new department 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 – 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 2012. Active monitoring and risk management (above all credit 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 Procedure) 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 controlling the growth.

Especially in ICAAP process, the Bank manages its capital adequacy based on internal systems and methodology, and constant validation of the risk parameters.

### 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 amortized costs or assumed liabilities in the off-balance sheet items on the basis of the internal methodology.

In 2010, the Bank has, in accordance with 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 has regularly and individually evaluated 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. The Bank recognizes 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 2011 amounts to €2,137,406 thousand. The equity 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 2011 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).**

| | | | 2011 | | | 2010 |
|---|---|---|---|---|---|---|
| | Gross | Adjustment | Net | Gross | Adjustment | Net |
| **I. Balance sheet items** | **2,021,919** | **52,034** | **1,969,885** | **2,299,080** | **116,709** | **2,182,371** |
| 1. Cash and balances with Central Bank | 39,753 | - | 39,753 | 55,507 | - | 55,507 |
| 2. Loans to banks | 4,001 | - | 4,001 | 14,191 | - | 14,191 |
| **3. Loans to clients** | **1,799,727** | **52,034** | **1,747,693** | **2,057,271** | **116,709** | **1,940,562** |
| **3a. Loans to individuals** | **591,753** | **3,394** | **588,358** | **560,401** | **8,844** | **551,558** |
| -Housing loans | 447,749 | 1,220 | 446,529 | 405,974 | 1,025 | 404,949 |
| -Consumer credits | 131,183 | 1,752 | 129,431 | 144,191 | 7,502 | 136,690 |
| -Other | 12,821 | 422 | 12,399 | 10,236 | 317 | 9,919 |
| **3b. Corporate loans** | **1,207,974** | **48,639** | **1,159,335** | **1,496,870** | **107,866** | **1,389,004** |
| -Large enterprises | 376,464 | 19,092 | 357,372 | 537,837 | 43,404 | 494,433 |
| -Small and medium enterprises | 327,056 | 10,955 | 316,101 | 346,010 | 13,235 | 332,775 |
| -Other | 504,454 | 18,592 | 485,862 | 613,022 | 51,226 | 561,796 |
| 4. Financial assets held for trading | 19,697 | - | 19,697 | 18,619 | - | 18,619 |
| 5. Financial assets held to maturity and available-for-sale financial assets | 128,202 | - | 128,202 | 133,596 | - | 133,596 |
| 6. Other financial assets | 30,537 | - | 30,537 | 19,897 | - | 19,897 |
| **II. Off-balance-sheet items** | **115,487** | **3,811** | **111,676** | **155,012** | **3,845** | **151,167** |
| 1. Financial guarantees | 31,553 | 1,419 | 30,135 | 30,903 | 976 | 29,927 |
| 2. Undrawn loans | 83,934 | 2,393 | 81,541 | 124,109 | 2,869 | 121,240 |
| **Total maximum exposure to credit risk** | **2,137,406** | **55,845** | **2,081,561** | **2,454,092** | **120,554** | **2,333,538** |

**b) Summarized exposure and impairment percentage for individual credit ratings segments**

| | | 2011 | | 2010 |
|---|---|---|---|---|
| Credit rating | Gross (%) | Impairment (%) | Gross (%) | Impairment (%) |
| Investment grade | 12.76 % | 4.93 % | 4.16 % | 0.26 % |
| Standard monitoring | 75.35 % | 32.46 % | 71.88 % | 15.26 % |
| Special monitoring | 2.59 % | 1.21 % | 0.80 % | 0.25 % |
| Default | 9.30 % | 61.40 % | 23.16 % | 84.23 % |
| | **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 realization 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 improvement of 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

| 31.12.2011 | Slovenia | EU member states | Countries of former 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 | - | - | - | 39,753 |
| 2. Loans to banks | 4,001 | - | - | - | 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 | - | 69 | 447,749 |
| -Consumer credits | 130,934 | 42 | 207 | - | 131,183 |
| -Other | 12,745 | 68 | 8 | - | 12,821 |
| **3b. Corporate loans** | **1,201,175** | **4,433** | **2,366** | **-** | **1,207,974** |
| -Large enterprises | 376,464 | - | - | - | 376,464 |
| -Small and medium enterprises | 327,056 | - | - | - | 327,056 |
| -Other | 497,655 | 4,433 | 2,366 | - | 504,454 |
| 4. Financial assets held for trading | 13,761 | 5,936 | - | - | 19,697 |
| 5. Financial assets held to maturity and available-for-sale financial assets | 128,202 | - | - | - | 128,202 |
| 6. Other financial assets | 30,537 | - | - | - | 30,537 |
| **II. Off-balance-sheet items** | **115,326** | **-** | **160** | **2** | **115,487** |
| 1. Financial guarantees | 31,538 | - | 15 | - | 31,553 |
| 2. Undrawn loans | 83,787 | - | 145 | 2 | 83,934 |
| **Total maximum exposure to credit risk** | **2,123,985** | **10,609** | **2,740** | **71** | **2,137,406** |

| 31.12.2010 | Slovenia | EU member states | Countries of former Yugoslavia | Other | Total |
|---|---|---|---|---|---|
| **Content** | | | | | |
| **I. Balance sheet items** | **2,290,076** | **6,458** | **136** | **2,410** | **2,299,080** |
| 1. Cash and balances with Central Bank | 55,507 | - | - | - | 55,507 |
| 2. Loans to banks | 14,191 | - | - | - | 14,191 |
| **3. Loans to clients** | **2,051,709** | **3,015** | **136** | **2,410** | **2,057,271** |
| **3a. Loans to individuals** | **559,947** | **241** | **136** | **77** | **560,401** |
| -Housing loans | 405,764 | 134 | - | 76 | 405,974 |
| -Consumer credits | 144,012 | 53 | 126 | 1 | 144,191 |
| -Other | 10,172 | 54 | 10 | - | 10,236 |
| **3b. Corporate loans** | **1,491,762** | **2,774** | **-** | **2,333** | **1,496,870** |
| -Large enterprises | 537,837 | - | - | - | 537,837 |
| -Small and medium enterprises | 346,010 | - | - | - | 346,010 |
| -Other | 607,915 | 2,774 | - | 2,333 | 613,022 |
| 4. Financial assets held for trading | 15,176 | 3,443 | - | - | 18,619 |
| 5. Financial assets held to maturity and available-for-sale financial assets | 133,596 | - | - | - | 133,596 |
| 6. Other financial assets | 19,897 | - | - | - | 19,897 |
| **II. Off-balance-sheet items** | **154,547** | **235** | **229** | **2** | **155,012** |
| 1. Financial guarantees | 30,456 | 235 | 212 | - | 30,903 |
| 2. Undrawn loans | 124,091 | - | 17 | 2 | 124,109 |
| **Total maximum exposure to credit risk** | **2,444,623** | **6,693** | **365** | **2,412** | **2,454,092** |

### d) Credit risk concentration as per industry sector

| 31.12.2011 | Financial institutions | Manufacturing | 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 | - | - | - | - | - | - | 39,753 |
| **2. Loans to banks** | **4,001** | **-** | **-** | **-** | **-** | **-** | **-** | **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** | **-** | **-** | **-** | **-** | **-** | **-** | **591,753** | **591,753** |
| -Housing loans | - | - | - | - | - | - | 447,749 | 447,749 |
| -Consumer credits | - | - | - | - | - | - | 131,183 | 131,183 |
| -Other | - | - | - | - | - | - | 12,821 | 12,821 |
| **3b. Corporate loans** | **60,016** | **248,171** | **319,563** | **156,170** | **73,738** | **350,316** | **-** | **1,207,974** |
| -Large enterprises | 30,190 | 129,052 | 47,468 | 80,383 | - | 89,370 | - | 376,464 |
| -Small and medium enterprises | 28,030 | 87,193 | 48,759 | 52,120 | 2,602 | 108,353 | - | 327,056 |
| -Other | 1,796 | 31,926 | 223,335 | 23,667 | 71,137 | 152,593 | - | 504,454 |
| 4. Financial assets held for trading | 5,936 | 1,697 | 115 | 1,226 | - | 10,723 | - | 19,697 |
| 5. Financial assets held to maturity and available-for--sale financial assets | 113,243 | - | - | - | 3,881 | 11,078 | - | 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** | **-** | **115,487** |
| 1. Financial guarantees | 15 | 5,771 | 1,624 | 10,706 | 12 | 13,426 | - | 31,553 |
| 3.Undrawn loans | 1,812 | 27,460 | 17,273 | 5,490 | 1,232 | 30,667 | - | 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** |

| 31.12.2010 | Financial institutions | Manufacturing | Real estate | Wholesale and retail trade | Public sector | Other indu-stries | Individuals | Total |
|---|---|---|---|---|---|---|---|---|
| **I. Balance sheet items** | **294,753** | **304,585** | **339,210** | **190,348** | **67,347** | **542,435** | **560,401** | **2,299,080** |
| 1. Cash and balances with Central Bank | 55,507 | - | - | - | - | - | - | 55,507 |
| **2. Loans to banks** | **14,191** | **-** | **-** | **-** | **-** | **-** | **-** | **14,191** |
| **3. Loans to clients** | **67,792** | **301,368** | **338,670** | **189,345** | **67,347** | **532,347** | **560,401** | **2,057,271** |
| **3a. Loans to individuals** | **-** | **-** | **-** | **-** | **-** | **-** | **560,401** | **560,401** |
| -Housing loans | - | - | - | - | - | - | 405,974 | 405,974 |
| -Consumer credits | - | - | - | - | - | - | 144,191 | 144,191 |
| -Other | - | - | - | - | - | - | 10,236 | 10,236 |
| **3b. Corporate loans** | **67,792** | **301,368** | **338,670** | **189,345** | **67,347** | **532,347** | **-** | **1,496,870** |
| -Large enterprises | 29,510 | 180,210 | 54,176 | 115,337 | - | 158,604 | - | 537,837 |
| -Small and medium enter-prises | 30,340 | 91,462 | 67,119 | 50,702 | 2,792 | 103,596 | - | 346,010 |
| -Other | 7,942 | 29,695 | 217,375 | 23,307 | 64,555 | 270,147 | - | 613,022 |
| 4. Financial assets held for trading | 3,771 | 3,217 | 540 | 1,003 | - | 10,088 | - | 18,619 |
| 5. Financial assets held to maturity and available-for--sale financial assets | 133,596 | - | - | - | - | - | - | 133,596 |
| 6. Other financial assets | 19,897 | - | - | - | - | - | - | 19,897 |
| **II. Off-balance-sheet items** | **5,891** | **30,293** | **39,349** | **22,777** | **504** | **56,198** | **-** | **155,012** |
| 1. Financial guarantees | 466 | 5,495 | 2,255 | 8,312 | 17 | 14,359 | - | 30,903 |
| 2. Undrawn loans | 5,425 | 24,798 | 37,094 | 14,464 | 488 | 41,839 | - | 124,109 |
| **Total maximum exposure to credit risk** | **300,645** | **334,878** | **378,560** | **213,125** | **67,852** | **598,633** | **560,401** | **2,454,092** |

As at 31 December 2011, the total Bank exposure to credit risk amounted to EUR 2,137,406 thousand. The credit risks exposure towards clients amounts to EUR 1,799,727 thousand. The biggest share in the loans to individuals segment belongs to housing loans (75.6 per cent); in the corporate segment, the biggest share belongs to the other industry sectors (41.7 per cent). The biggest share of receivables relates to enterprises located in the Republic of Slovenia and accounts for 99.4 per cent of the total exposure.

The Bank continuously monitors the movement of the Bank's 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 in industries with identified increased credit risk. Thorough analyses are prepared on a quarterly basis and are a part of regular reporting and discussion at the risk management committee.

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

| | 2011 | | 2010 | |
|---|---|---|---|---|
| Izpostavljenost | Loans to banks | Loans to clients | Loans to banks | Loans to clients |
| Exposure that is neither past due nor impaired | 3,796 | 407,682 | 14,648 | 436,055 |
| Exposure that is past due but is not individually impaired | - | 73,545 | - | 54,663 |
| Exposure that is not past due and is grouply impaired | - | 1,295,571 | - | 1,302,734 |
| Exposure that is individually impaired | - | 138,384 | - | 418,374 |
| **Total** | **3,796** | **1,915,182** | **14,648** | **2,211,827** |
| **Value of adjustments (impairments)** | **-** | **53,482** | **-** | **120,530** |
| **Net** | **3,796** | **1,861,699** | **14,648** | **2,091,297** |
| Individual impairments | - | 23,404 | - | 95,221 |
| Group impairments | - | 30,079 | - | 25,309 |
| **Total** | **-** | **53,482** | **-** | **120,530** |

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

## f) Loans and advances neither past due nor impaired

| 31.12.2011 | Loans to clients | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 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 | 5,026 | 24,761 | 496 | 3,531 | 43,758 | 2,893 | 80,466 | - |
| Standard grade | 144,017 | 74,685 | 19,734 | 6,785 | 38,844 | 34,447 | 318,511 | 3,796 |
| Special monitoring | 2,106 | 462 | 238 | - | 1,865 | 3,217 | 7,889 | - |
| Default class | 500 | 193 | 124 | - | - | - | 816 | - |
| **Total** | **151,649** | **100,101** | **20,592** | **10,316** | **84,466** | **40,557** | **407,682** | **3,796** |

| 31.12.2010 | Loans to clients | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 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 | - | - | - | - | 20,087 | - | 20,087 | 779 |
| Standard grade | 165,406 | 100,015 | 14,729 | 21,955 | 61,532 | 41,865 | 405,502 | 13,857 |
| Special monitoring | 805 | 331 | 104 | - | - | 333 | 1,573 | 12 |
| Default class | 293 | 304 | 75 | 5,036 | 1,118 | 2,066 | 8,893 | - |
| **Total** | **166,504** | **100,650** | **14,909** | **26,992** | **82,737** | **44,264** | **436,055** | **14,648** |

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

### g) Loans and advances past due but not impaired

| 31.12.2011 | Loans to individuals | | |
|---|---|---|---|
| | Housing loans | Consumer credit | 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 | - | 869 | 4,207 |
| Delay from 31 to 60 days | - | 68 | 2,811 |
| Delay from 61 to 90 days | - | - | 1,146 |
| **Total** | **-** | **938** | **8,164** |
| Internal collateral value | - | 739 | 8,062 |
| Unsecured part of the exposure | - | 199 | 102 |

| 31.12.2010 | Loans to individuals | | |
|---|---|---|---|
| | Housing loans | Consumer credit | Other |
| Delay up to 30 days | 835 | 155 | 2.381 |
| Delay from 31 to 60 days | 5.289 | 2.972 | 58 |
| Delay from 61 to 90 days | 62 | 15 | 49 |
| **Total** | **6.187** | **3.141** | **2.488** |
| Internal collateral value | 5.951 | 2.992 | 2.062 |
| Unsecured part of the exposure | 236 | 149 | 426 |

| 31.12.2010 | Corporate loans | | |
|---|---|---|---|
| | Large enterprises | Small and medium enterprises | Other |
| Delay up to 30 days | 2.520 | 5.797 | 1.940 |
| Delay from 31 to 60 days | - | 1.638 | 4.033 |
| Delay from 61 to 90 days | 636 | - | 248 |
| **Total** | **3.156** | **7.435** | **6.221** |
| Internal collateral value | 3.155 | 7.100 | 6.108 |
| Unsecured part of the exposure | 1 | 335 | 113 |

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

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

### 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.

| 31.12.2011 | Loans to individuals: Housing loans | Loans to individuals: Consumer credit | Loans to individuals: Other | Corporate loans: Large enterprises | Corporate loans: Small and medium enterprises | Corporate loans: Other | Total |
|---|---|---|---|---|---|---|---|
| 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** |

| 31.12.2010 | Loans to individuals: Housing loans | Loans to individuals: Consumer credit | Loans to individuals: Other | Corporate loans: Large enterprises | Corporate loans: Small and medium enterprises | Corporate loans: Other | Total |
|---|---|---|---|---|---|---|---|
| Individually impaired exposure | 1,034 | 14,021 | 157 | 179,892 | 42,858 | 180,412 | **418,374** |
| Individual impairments | 263 | 7,382 | 148 | 36,477 | 9,231 | 41,719 | **95,221** |
| Internal collateral value | 784 | 4,481 | - | 58,193 | 17,763 | 77,019 | **158,240** |

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 21.20 per cent of the total exposure of "Loans to clients". Exposures that are past due but are not impaired represent 2.66 per cent of the total exposure of "Loans to clients".

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

### i) Loans and advances renegotiated

EUR '000

| | 2011 | 2010 |
|---|---|---|
| Renegotiated loans and advances to clients | 36,477 | 281,581 |
| - Continuing to be individually impaired after restructuring | 25,682 | 242,361 |

### j) Debt securities

The tables below present an analysis of bank book and trading book securities by rating grades.

| 31.12.2010 | Available-for-sale financial assets | Financial investments classified as held to maturity |
|---|---|---|
| Investment grade | 57,000 | 42,315 |
| Standard monitoring | 8,091 | - |
| **Total** | **65,091** | **42,315** |

| 31.12.2011 | Available-for-sale financial assets | Financial investments classified as held to maturity |
|---|---|---|
| Investment grade | 64,179 | 36,462 |
| Standard monitoring | 10,694 | |
| **Total** | **74,873** | **36,462** |

### k) Repossessed collateral

EUR '000

| | 31.12.2011 | 31.12.2010 |
|---|---|---|
| Nature of assets | Carrying amount | Carrying amount |
| Quoted shares (Ljubljana Stock Exchange) | 24,557 | 26,662 |

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

### l) Fair value of collateral

| | 2011 | | 2010 | |
|---|---|---|---|---|
| Izpostavljenost | Individuals | Corporates | Individuals | Corporates |
| **Collateral for individually impaired exposures** | **1.433.083** | **75.946.040** | **5.280.448** | **83.518.594** |
| Real estate | 1.424.083 | 70.796.301 | 3.348.995 | 33.603.609 |
| Securities (shares, bonds and mutual fund points) | - | 2.883.000 | 1.854.000 | 9.807.000 |
| Other (guarantees, pledges and insurance) | 9.000 | 2.266.739 | 77.453 | 40.107.985 |
| **Collateral for group impairment of exposures** | **346.256.182** | **653.303.696** | **408.262.791** | **688.325.841** |
| Real estate | 257.748.915 | 527.121.136 | 156.023.169 | 395.222.598 |
| Securities (shares, bonds and imutual funds points) | 5.090.016 | 38.649.858 | 806.671 | 22.056.187 |
| Other (guarantees, pledges and insurance) | 83.417.250 | 87.532.703 | 251.432.950 | 271.047.056 |
| **Total** | **347.689.256** | **729.249.736** | **413.543.239** | **771.844.435** |

* 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 liabilities. The importance of effective controlling and managing of the liquidity risk has increased at the time of the financial crisis.

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 considering the requirements of liquidity reserves, the new system support "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.

The Bank's liquidity is managed in the department of the Asset Liability Management where all known liability flows are recorded.

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

- višini in izpolnjevanju obvezne rezerve,
- doseženih količnikih likvidnosti,
- stanju refinanciranja s strani matične banke in
- dostopu do primarne likvidnosti centralne banke.

The table below presents the cash flows of financial assets and financial liabilities by residual maturities at the balance sheet date. 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 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** | **1,908,222** |
| **Financial guarantees** | **–** | **–** | **617** | **19,167** | **7,088** | **4,681** | **31,555** |
| **Loan commitments** | **53,864** | **4,485** | **2,757** | **16,894** | **7,047** | **3,754** | **88,801** |

Bilančne postavke glede na rokovno neusklajenost na dan 31.december 2010

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** | **335,378** | **4,450** | **192,174** | **869,053** | **685,182** | **478,290** | **2,564,527** |
| | | | | | | | |
| **Financial liabilities** | | | | | | | |
| Financial liabilities to Central Bank | - | - | 40,010 | - | - | - | 40,010 |
| Financial liabilities held for trading | 2,450, | - | - | - | - | - | 2,450 |
| Financial liabilities measured at amortized cost | 145,021 | 209,914 | 218,943 | 248,827 | 886,512 | 321,636 | 2,030,853 |
| Other financial liabilities | 14 | 5,279 | - | 200 | - | - | 5,493 |
| **Total financial liabilities** | **147,485** | **215,193** | **258,953** | **249,027** | **886,512** | **321,636** | **2,078,806** |
| **Financial guarantees** | **-** | **-** | **3,880** | **6,999** | **14,439** | **5,585** | **30,903** |
| **Loan commitments** | **33,896** | **-** | **32,914** | **35,437** | **17,671** | **4,189** | **124,107** |

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.

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 |

The joint liquidity ratios as per 31 December 2010 are as follows:

| | |
|---|---|
| First class investments/assets (0–30 days) | 1.15 |
| Second class investments/assets (0–180 days) | 0.86 |

## 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 minimize 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 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 it manages them through periodical reporting on utilization of limits and achieved operations' 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 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 implemented derivatives, which, in line with confirmed limits for market risk, it closes immediately and thus minimizes 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 standardized approach. The Bank conducts foreign currency purchase/sale transactions in order to serve its clients and to balance its overall foreign currency position. Equity securities are mainly forward sold, while a minor net position is represented only by the Hypo funds. The Bank maintains the latter in the trading book for the purpose of selling them 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), for whose development and improvement is responsible the department of Information technology and Market Risk Controlling of the parent bank. In order to determine the risk parameters, the Bank uses its own, 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 2011 (trading and bank book)

in €

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

Movement of VaR value in 2010

in €

| | Maximum | Minimum | Average |
|---|---|---|---|
| Equity securities | 762 | 196 | 411 |
| Derivatives | 616 | 329 | 445 |

Besides the value at risk limits, the entire system of position risks is supplemented by volume limits, limits of the maximum permitted loss and sensitivity 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 percent 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 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 2.63 per cent of the Bank's equity at the end of 2011 (2010: 5.95 per cent).

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

EUR '000

| | Effect of yield curve shift |
|---|---|
| + 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 |

**Effect of yield curve shift by different scenarios (excluding non-interest bearing items at 31 December 2010)**

EUR '000

| | Effect of yield curve shift |
|---|---|
| + 10 bps parallel shift | -774 |
| - 10 bps parallel shift | 774 |
| + 1 bp parallel shift | -77 |
| - 1 bp parallel shift | 77 |
| Rotation (ON-3M -> +60BP, 3M-5Y -> -20 BP, 5Y -> -50 BP) | 698 |
| Rotation (ON-3M -> -60BP, 3M-5Y -> +20 BP, 5Y -> +50 BP) | -772 |

### c) Currency risk

Currency risk is a risk of a loss arising from mismatch of the currency sub-balance and inconsistencies 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 domestic currency. Group of volume limits is rounded up by the VaR limit on total open position. 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 position in foreign currencies does not exceed 2 % of its capital.

**Movement of VaR value for total open FX position for 2011**

EUR '000

| | Maximum | Minimum | Average |
|---|---|---|---|
| Odvisno od VaR | 70.008 | 655 | 8.665 |

**Movement of VaR value for total open FX position for 2010**

EUR '000

| | Maximum | Minimum | Average |
|---|---|---|---|
| Odvisno od VaR | 40.067 | 1.002 | 6.595 |

### 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 | 100 |
| Financial liabilities held for trading | - | - | - | - | - | - |
| Financial liabilities measured at amortized 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** |

### Exposure to currency risk on 31 December 2010

EUR '000

| | USD | CHF | GBP | Other currencies | EUR | Total |
|---|---|---|---|---|---|---|
| **Financial assets** | | | | | | |
| Cash on hand and balances with Central Bank | 179 | 381 | 46 | 96 | 54,805 | 55,507 |
| Financial assets held for trading | - | 22 | - | - | 24,070 | 24,092 |
| Available-for-sale financial assets | - | - | - | - | 91,280 | 91,280 |
| Loans | 5,155 | 373,695 | 808 | 185 | 1,574,909 | 1,954,752 |
| Financial assets held to maturity | - | - | - | - | 42,315 | 42,315 |
| Other financial assets | - | - | - | - | 783 | 783 |
| **Total financial assets** | **5,334** | **374,098** | **854** | **281** | **1,788,162** | **2,168,729** |
| | | | | | | |
| **Financial liabilities** | | | | | | |
| Financial liabilities to Central Bank | - | - | - | - | 40,010 | 40,010 |
| Financial liabilities held for trading | - | 21 | - | - | 2,429 | 2,450 |
| Financial liabilities measured at amortized cost | 5,890 | 370,168 | 761 | 63 | 1,588,587 | 1,965,469 |
| Other financial liabilities | - | 2 | - | - | 3,870 | 3,872 |
| **Total financial liabilities** | **5,890** | **370,191** | **761** | **63** | **1,634,896** | **2,011,801** |

Net open balance sheet position in CHF is closed with a forward leg of FX swap.

## Fair values of assets and liabilities

### a) Financial instruments not measured at fair value

The table below summarizes 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

| | 2011 | | 2010 | |
|---|---|---|---|---|
| | Carrying amount | Fair value | Carrying amount | Fair value |
| **Financial assets** | | | | |
| 1. Cash and balances with Central Bank | 39,753 | 39,753 | 55,507 | 55,507 |
| 2. Loans to banks | 20,107 | 20,107 | 14,191 | 14,191 |
| 3. Loans to clients | 1,752,964 | 1,760,148 | 1,940,561 | 1,929,810 |
| 4. Financial assets held to maturity | 36,462 | 32,572 | 42,315 | 42,594 |
| 5. Other financial assets | 3,986 | 3,986 | 783 | 783 |
| **Financial liabilities** | | | | |
| 1. Financial liabilities to Central Bank | 120,147 | 120,147 | 40,010 | 40,010 |
| 2. Financial liabilities to banks measured at amortized cost | 953,482 | 953,482 | 1,440,334 | 1,440,334 |
| 3. Financial liabilities to clients measured at amortized cost | 713,631 | 721,403 | 525,135 | 524,958 |
| 4. Other financial liabilities | 16,117 | 16,117 | 3,872 | 3,872 |

- 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 amortized 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 (for example Nasdaq, S&P 500).
- 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 required the use of observable market data when they are available. The Bank considers significant and observable market prices in its valuations whenever possible.

There were no transfers between Level 1 and Level 2 of the fair value hierarchy.

### 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 expected future cash flows, mark to market (comparative entities listed on the stock exchange – direct comparison with entities quoted in an organized 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 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 |

EUR '000

| 31 December 2010 | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| **Financial assets** | | | | |
| 1. Financial assets held for trading | 6,136 | 8,079 | 9,877 | 24,092 |
| 2. AFS financial assets | 80,356 | 9,292 | 1,632 | 91,280 |
| **Financial liabilities** | | | | |
| 1. Financial assets held for trading | 2,450 | – | – | 2,450 |

### d) Fair value changes analysis (level 3)

**Movements in Level 3 hierarchy in 2011**

EUR '000

| | 1.1.2011 | Gains/losses recognized in profit or loss | Change in valuation | Additions | Disposals | 31.12. 2010 |
|---|---|---|---|---|---|---|
| **Financial assets held for trading** | | | | | | |
| Shares and securities with no fixed return | 9,877 | - | (9,877) | - | - | - |
| **Total financial assets held for trading** | **9,877** | **-** | **(9,877)** | **-** | **-** | **-** |
| | | | | | | |
| **Available-for-sale financial assets** | | | | | | |
| Shares and securities with no fixed return | 1,632 | - | (7,049) | 7,021 | - | 1,604 |
| Bonds and other securities with fixed return | - | - | - | - | - | - |
| **Total available-for-sale financial assets** | **1,632** | **-** | **(7,049)** | **7,021** | **-** | **1,604** |

**Movements in Level 3 hierarchy in 2010**

EUR '000

| | 1.1.2010 | Gains/losses recognized in profit or loss | Change in valuation | Additions | Disposals | 31.12. 2010 |
|---|---|---|---|---|---|---|
| **Financial assets held for trading** | | | | | | |
| Shares and securities with no fixed return | 11,014 | - | 3,484 | 20,203 | 24,824 | 9,877 |
| **Total financial assets held for trading** | **11,014** | **-** | **3,484** | **20,203** | **24,824** | **9.877** |
| | | | | | | |
| **Available-for-sale financial assets** | | | | | | |
| Shares and securities with no fixed return | 2,408 | - | (776) | - | - | 1,632 |
| Bonds and other securities with fixed return | 9,923 | - | (9,923) | - | - | - |
| **Total available-for-sale financial assets** | **12,331** | **-** | **(10,699)** | **-** | **-** | **1,632** |

The table below shows gains and losses from investments, classified at level 3.

EUR '000

| | Realized gains | Unrealized losses | Total |
|---|---|---|---|
| **31. December 2011** | | | |
| Total gains and losses included in income statement | (2,231) | 7,050 | 9,281 |
| | | | |
| **31. December 2010** | | | |
| Total gains and losses included in income statement | 605 | 6,284 | 6,889 |

During the year the Bank transferred a total book value of € 3,485 thousand (SAVA) from Level 3 to Level 1. The total unrealized gains (losses) relating to those assets were € 3,136 thousand on the day of transfer. The reason for the transfer from Level 3 to Level 1 was transition from model to market valuation.

The table below shows movement in Level 3 in 2011

EUR '000

| | 1.1.2011 | Purchases | Sales | Transfers between Level 3, Level 2 and Level 1 | 31.12.2011 |
|---|---|---|---|---|---|
| **Assets** | | | | | |
| Financial assets, available for sale | 1,632 | 7,696 | 675 | 348 | 1,604 |

For valuations of non-marketable equity securities the Bank uses methods in accordance with MSOV 2011. One of the methods is market comparison method, where the Bank does not perform other additional tests of assumptions and sensitivity analysis.

## Capital risk

The Bank is required to have adequate capital at any time, 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.

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

| Postavka | 31.12.2011 | 31.12.2010 |
|---|---|---|
| Subscribed paid-up capital | 174,037 | 174,037 |
| Capital surplus | 27,696 | 2,696 |
| Reserves and retained earnings or accumulated loss | (38,640) | (11,774) |
| - Intangible assets | (4,122) | (4,216) |
| Revaluation reserves | (280) | (109) |
| - Unrecorded impairments and provisions due to recording lag | (342) | (307) |
| **TIER 1 CAPITAL** | **158,349** | **160,327** |
| Subordinated debt | 69,000 | 73,000 |
| Adjustment of revaluation reserve associated with available-for-sale financial assets – equity instruments | - | 1,850 |
| **Tier II CAPITAL** | **69,000** | **74,850** |
| **TOTAL CAPITAL (for the capital adequacy purposes)** | **227,349** | **235,177** |
| Capital requirement for credit risk, counter party risk and settlement risk | 132,448 | 158,318 |
| Capital requirement for settlement risk | - | 3,109 |
| Capital requirement for position risk and currency risk | 1,213 | 406 |
| Capital requirement for operational risk | 8,290 | 7,276 |
| Capital requirement for exceeding the exposure from the trading activities | - | - |
| **TOTAL CAPITAL REQUIREMENTS** | **141,951** | **169,109** |
| **CAPITAL ADEQUACY RATIO (%)** | **12.81** | **11.13** |

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 2011, the Bank fully complied with the legal requirements regarding capital. As at the end of year 2011, the Bank's capital amounted to €227,349 thousand, tier 1 or core capital amounted to €158,349 thousand, the capital surplus amounted to €85,398 thousand, while the capital adequacy ratio was 12.81 per cent.

In 2011, 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 standardized 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, the capital adequacy ratio resulting from the process of assessing internal bank capital was 9.72 per cent as at 31 December 2011.

### 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 standardized approach.

As the Bank is aware of the importance of operational risk management, it 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 2011, the Bank recorded 48 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 €669 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 renewed management policy.

The Bank reports regularly on quarterly basis to the ICCO 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 2011, 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. This risk is managed by procedures described in the section Responsibility towards employees.

### Events after the balance sheet date

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

In February 2012, the Bank assumed investment banking transactions from the BPH Certius (brokers); however, financial effect of this on the financial result of the Bank is insignificant.

# 5 Useful Information

**Basic information Hypo Alpe-Adria-Bank, d.d.:**

Full name: Hypo Alpe-Adria-Bank d.d.
Headquarters: Dunajska cesta 117, SI - 1000 Ljubljana
Court register: nr. 1/31020/00, court or business register 99/01362
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VAT number: SI75482894
Transaction account number: SI56 0100 0000 3300 023
SWIFT: HAABSI22
Share capital:174.036.881,54 EUR
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