Independent auditor's report
on the consolidated financial statements of the
International Investment Bank
and its subsidiary
for 2017

February 2018

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Contents

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Independent auditor's report

To the Council of the International Investment Bank

Opinion

We have audited the consolidated financial statements of International Investment Bank (the "Bank") and its subsidiary (the "Group"), which comprise the consolidated statement of financial position as at 31 December 2017, and the consolidated income statement, consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for 2017, and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of the Group as at 31 December 2017 and its financial performance and its cash flows for 2017 in accordance with International Financial Reporting Standards (IFRSs).

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the consolidated financial statements* section of our report. We are independent of the Group in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) together with the ethical requirements that are relevant to our audit of the consolidated financial statements in the Russian Federation, and we have fulfilled our other ethical responsibilities in accordance with these requirements and the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Key audit matters

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

We have fulfilled the responsibilities described in the *Auditor's responsibilities for the audit of the consolidated financial statements* section of our report, including in relation to these matters. Accordingly, our audit included the performance of procedures designed to respond to our assessment of the risks of material misstatement of the consolidated financial statements. The results of our audit procedures, including the procedures performed to address the matters below, provide the basis for our audit opinion on the accompanying consolidated financial statements.

Key audit matter	How the relevant key audit matter was considered during our audit
Provisions for impairment of loans to banks and loans to customers	
The assessment of provisions for impairment of loans to banks and loans to customers is a key area of judgement for management of the Group. The identification of impairment and the determination of the recoverable amount are processes involving significant use of judgements, various assumptions and factors including the financial standing of borrowers and expected future cash flows. Information on the impairment of loans to banks and customers is included in Note 9, Loans to banks, Note 10, Loans to customers and Note 23, Risk management, to the consolidated financial statements. The use of different models and assumptions could produce significantly different estimates of impairment of loans to banks and customers. Due to materiality of the loans to banks and customers represented 61% of the total assets and significant use of professional judgement the assessment of provisions for impairment was the key audit matter.	Our audit strategy for the impairment of loans to banks and loans to customers was founded on substantive procedures. Our audit procedures included an evaluation of the methodology of the assessment of provisions, testing of inputs, evaluation of the assumptions used by the Group in the calculation of the impairment and the assessment of the adequacy of provisions for loans to banks and customers with individual signs of impairment. We analyzed expected future cash flows in respect of significant individually impaired loans to banks and customers. We have also fulfilled the procedures for information on provisions for impairment of loans to banks and customers disclosed in Notes 9, 10 and 23 to the Group's consolidated financial statements.

Other information included in the Group's Annual Report for 2017

Other information consists of the information included in the Annual Report of International Investment Bank for 2017 other than the consolidated financial statements and our auditor's report thereon. Management is responsible for the other information. The Annual Report of International Investment Bank for 2017 is expected to be made available to us after the date of this auditor's report.

Our opinion on the consolidated financial statements does not cover the other information and we will not express any form of assurance conclusion thereon.

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

Responsibilities of management and Council of the International Investment Bank for the consolidated financial statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with IFRSs, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

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

Council of the International Investment Bank are responsible for overseeing the Group's financial reporting process.

Auditor's responsibilities for the audit of the consolidated financial statements

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

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

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

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- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

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

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

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

The partner in charge of the audit resulting in this independent auditor's report is O.V. Youshenkov.

O.V. Youshenkov
Partner
Ernst & Young Vneshaudit LLC

15 February 2018

Details of the audited entity

Name: International Investment Bank
Bank operates on the basis of the Agreement on the Establishment of the International Investment Bank dated 10 July 1970, registered in the UN Secretariat on 1 December 1971 under No. 11417.
Address: Russia 107078, Moscow, Mashi Poryvaevoy str., 7.

Details of the auditor

Name: Ernst & Young Vneshaudit LLC
Record made in the State Register of Legal Entities on 4 February 2016, State Registration Number 1167746123478.
Address: Russia 115035, Moscow, Sadovnicheskaya naberezhnaya, 77, building 1.
Ernst & Young Vneshaudit LLC is a member of Self-regulated organization of auditors "Russian Union of auditors" (Association) ("SRO RUA"). Ernst & Young Vneshaudit LLC is included in the control copy of the register of auditors and audit organizations, main registration number 11603050953.

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

As at 31 December 2017

(Thousands of euros)

	Note	31 December 2017	31 December 2016
Assets			
Cash and cash equivalents	5	66,097	93,031
Deposits with banks and other financial institutions	6	45,889	45,337
Derivative financial assets	7	7,761	14,362
Available-for-sale investment securities	8	138,704	170,849
Available-for-sale investment securities pledged under repurchase agreements	8	76,723	98,458
Loans to banks	9	201,635	94,367
Loans to customers	10	462,514	269,036
Investment property	11	21,853	21,840
Property, equipment and intangible assets	12	72,388	71,844
Other assets	13	2,476	2,319
Total assets		**1,096,040**	**881,443**
Liabilities			
Due to banks and other financial institutions	14	65,511	118,925
Derivative financial liabilities	7	15,073	11,623
Current customer accounts		8,593	9,218
Long-term loans of banks	15	95,592	73,349
Debt securities issued	16	509,213	272,528
Other liabilities	13	6,396	5,582
Total liabilities		**700,378**	**491,225**
Equity	17		
Subscribed capital		1,300,000	1,300,000
Callable capital		(985,038)	(986,947)
Paid-in capital		**314,962**	**313,053**
Revaluation reserve for available-for-sale investment securities		240	(1,506)
Revaluation reserve for property and equipment		13,748	12,945
Foreign currency translation reserve		(76)	(57)
Retained earnings less net income for the year		65,783	64,981
Net income for the year		1,005	802
Total equity		**395,662**	**390,218**
Total equity and liabilities		**1,096,040**	**881,443**

Signed and authorized for release on behalf of the Board of the Bank

Nikolay Kosov Chairman of the Board

Elena Minduksheva Acting Deputy Director of the Finance Department

14 February 2018

CONSOLIDATED INCOME STATEMENT

Year ended 31 December 2017

(Thousands of euros)

	Note	*2017*	*2016*
Interest income	20	35,963	32,455
Interest expenses	20	(32,566)	(27,651)
Net interest income		**3,397**	**4,804**
Allowance for loan impairment	10, 11	(12,165)	(7,557)
Net interest expense after allowance for loan impairment		**(8,768)**	**(2,753)**
Fee and commission income		1,763	843
Fee and commission expense		(133)	(138)
Net fee and commission income		**1,630**	**705**
Net gains from operations in foreign currencies and with derivatives	21	15,949	9,979
Net gains from available-for-sale investment securities		7,399	10,515
Dividend income		123	–
Income from lease of investment property	19	4,034	3,442
Losses from revaluation of investment property	11	(26)	(2,174)
Other income		543	447
Net non-interest income		**28,022**	**22,209**
Operating income		**20,884**	**20,161**
Reversal of allowance for impairment of other assets	13	29	67
General and administrative expenses	22	(18,872)	(18,939)
Other operating expenses on banking operations		(1,036)	(487)
Operating expenses		**(19,879)**	**(19,359)**
Net income for the year		**1,005**	**802**

The accompanying notes 1-30 are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

Year ended 31 December 2017

(Thousands of euros)

	Note	*2017*	*2016*
Net income for the year		**1,005**	**802**
Other comprehensive income			
Other comprehensive income/(loss) to be reclassified to profit or loss in subsequent periods			
Change in unrealized revaluation of available-for-sale investment securities	17	1,746	158
Translation differences		(19)	63
Net other comprehensive income to be reclassified to profit or loss in subsequent periods		**1,727**	**221**
Other comprehensive income/(loss), not to be reclassified to profit or loss in subsequent periods			
Revaluation of property and equipment	12	803	(18,508)
Net other comprehensive income/(loss) not to be reclassified to profit or loss in subsequent periods		**803**	**(18,508)**
Other comprehensive income/(loss)		**2,530**	**(18,287)**
Total income/(loss) for the year		**3,535**	**(17,485)**

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

Year ended 31 December 2017

(Thousands of euros)

	Subscribed capital	*Callable capital*	*Revaluation reserve for available-for-sale investment securities*	*Revaluation reserve for property and equipment*	*Foreign currency translation reserve*	*Retained earnings*	*Total equity*
At 31 December 2015	**1,300,000**	**(996,947)**	**(1,664)**	**31,453**	**(120)**	**64,981**	**397,703**
Profit for the year	–	–	–	–	–	802	**802**
Other comprehensive income/(loss) for the year	–	–	158	(18,508)	63	–	**(18,287)**
Total comprehensive income/(loss)	**–**	**–**	**158**	**(18,508)**	**63**	**802**	**(17,485)**
Contributions to capital (Note 18)	–	10,000	–	–	–	–	**10,000**
At 31 December 2016	**1,300,000**	**(986,947)**	**(1,506)**	**12,945**	**(57)**	**65,783**	**390,218**
Profit for the year	–	–	–	–	–	1,005	**1,005**
Other comprehensive income/(loss) for the year	–	–	1,746	803	(19)	–	**2,530**
Total comprehensive income/(loss)	**–**	**–**	**1,746**	**803**	**(19)**	**1,005**	**3,535**
Contributions to capital (Note 18)	–	1,909	–	–	–	–	**1,909**
At 31 December 2017	**1,300,000**	**(985,038)**	**240**	**13,748**	**(76)**	**66,788**	**395,662**

CONSOLIDATED STATEMENT OF CASH FLOWS

Year ended 31 December 2017

(Thousands of euros)

	Note	*2017*	*2016*
Cash flows from operating activities			
Interest, fees and commissions received		28,578	24,092
Interest, fees and commissions paid		(3,327)	(3,364)
Realized gains less losses from dealing in foreign currencies and operations with derivatives		31,228	9,079
Cash flows from lease of investment property		4,034	3,442
General and administrative expenses		(15,638)	(16,094)
Other operating income/(expenses) on banking operations		36	(78)
Cash flows from operating activities before changes in operating assets and liabilities		**44,911**	**17,077**
Net (increase)/decrease in operating assets			
Deposits with banks and other financial institutions		(5,776)	54,498
Loans to banks		(118,882)	47,598
Loans to customers		(210,605)	(118,231)
Other assets		(15)	(5)
Net increase/(decrease) in operating liabilities			
Due to banks and other financial institutions		(47,426)	1,589
Current customer accounts		(1,227)	1,481
Other liabilities		1,016	68
Net cash flows from operating activities		**(338,004)**	**4,075**
Cash flows from investing activities			
Interest received		6,491	11,458
Purchase of available-for-sale investment securities		(426,482)	(668,584)
Proceeds from sale and redemption of available-for-sale investment securities		478,424	618,419
Proceeds from sale and redemption of held-to-maturity investment securities		–	30,373
Investments in investment property		(39)	(50)
Acquisition of property, equipment and intangible assets		(1,673)	(1,754)
Net cash flows from investing activities		**56,721**	**(10,138)**
Cash flows from financing activities			
Interest paid		(26,212)	(26,324)
Long-term interbank financing raised	29	36,185	60,000
Long-term interbank financing repaid	29	(13,451)	(29,569)
Placement of bonds	29	348,661	67,398
Redemption of bonds	29	(88,290)	(43,910)
Contributions to capital		1,909	10,000
Net cash flows from financing activities		**258,802**	**37,595**
Effect of exchange rate changes on cash and cash equivalents		(4,453)	1,980
Net increase/(decrease) in cash and cash equivalents		**(26,934)**	**33,512**
Cash and cash equivalents, beginning		93,031	59,519
Cash and cash equivalents, ending	5	**66,097**	**93,031**

(Thousands of euros)

1. Principal activities

These consolidated financial statements include the financial statements of the International Investment Bank (the “Bank”, or “IIB”) and CJSC IIB Capital, the subsidiary of the Bank. The Bank and its subsidiary are hereinafter collectively referred to as the “Group”. The International Investment Bank is the parent company of the Group. Information on the subsidiary of the Bank is presented in Note 2.

The International Investment Bank was founded in 1970 and has operated since 1 January 1971.

The Bank is an international institution operating on the basis of the Intergovernmental Agreement on the Establishment of the International Investment Bank (the “Agreement”) and the Statute. The Agreement was ratified by the member countries of the Bank and registered with the Secretariat of the United Nations in December 1971. The Bank is primarily engaged in commercial lending for the benefit of national investment projects in the member countries of the Bank and for other purposes defined by the Council of the Bank. The Group also performs transactions with securities and foreign currency. The Group operates from its office at 7 Mashi Poryvaevoy St., Moscow, Russia, and the European regional office in Bratislava (Eurovea Central 1, Pribinova 4, Bratislava, 81109, Slovak Republic).

The Group had an average of 220 staff employees during 2017 (2016: 230).

On 31 July 2014, the EU Council imposed sectoral sanctions against Russia. The preamble of the Decision of the EU Council of 31 July 2014 (paragraph 9) and Council Regulation (EU) No. 833/2014 of 31 July 2014 (paragraph 5), which was developed based on the Decision, emphasize that the sanctions do not cover Russia-based institutions with international status established by intergovernmental agreements in which Russia is one of the parties. Therefore, the IIB is directly excluded from the list of financial institutions to which restrictions apply.

The Group continues to expand its operations in accordance with its mandate and strategic objectives established by the member countries

- The Banks winds up the introduction of changes to its constituent documents and implementation of the three-level corporate governance structure. The Protocol on Introducing Changes to the Agreement on the Establishment of the International Investment Bank and the Statutes (hereinafter, the “Protocol”) signed at the end of 2015 is at the stage of ratification (internal state procedures) by member countries of the Bank. The Protocol will enter into force upon completion of those ratification procedures. As at the end of 2017, the Protocol was ratified by Hungary, the Socialist Republic of Vietnam, Romania, the Republic of Bulgaria, the Russian Federation, the Republic of Cuba, the Czech Republic and Mongolia (8 member countries out of 9).
- In March 2017, IIB granted observer status to the Republic of Belarus, a sovereign state, for the first time.
- At the 107th meeting of the Bank’s Council (Bucharest, Romania, June 2017), member countries unanimously approved the Group’s mid-term development strategy for 2018-2022.
- Taking into account the Group’s new development strategy for 2018-2022 approved by the member countries of the IIB, the Government of Mongolia decided to increase its interest in the paid-in portion of the share capital of the Bank to 1.077%. On 27 December 2017, Mongolia made an additional contribution exceeding EUR 1.9 million.
- In December 2017, the international rating agency Fitch Ratings upgraded its outlook on the Bank’s credit rating from stable to positive and confirmed its issuer credit rating and debt rating at BBB. Previously, in May 2017, Moody’s Investors Service also upgraded its outlook on the Bank’s credit rating from stable to positive and confirmed its issuer credit rating and debt rating at Baa1. Also, the Bank is assigned the following investment grade ratings: BBB (stable outlook) by Standard&Poor’s and A (stable outlook) by Dagong Global Credit Rating.
- In April 2017, the Group entered capital markets in Western Europe for the first time, with a debut issue of SSD debentures (Schuldscheindarlehen) − a traditional loan instrument of the German market.
- In September 2017, the Bank placed EUR- and RON-denominated bonds totaling EUR 125 million on the Romanian stock market. This became the first issue of debt instruments denominated in euro on the Romanian market. As a result, the Romanian Stockbrokers’ Association awarded the International Investment Bank for its support of the development of the national stock market in the *Contribution to the Development of the Romanian Corporate Bonds Market* category.
- In 2017, the Bank’s trade financing program was recognized the best among other international financial institutions’ programs by the Association of Development Financing Institutions in Asia and the Pacific (ADFIAP), and the Bank was the winner of ADFIAP Awards 2017 in the *Trade Development* category.

  At the 107th meeting of the Bank’s Council (Bucharest, Romania), the Bank and the chambers of commerce and industry (the “CCIs”) of the member countries signed a multilateral Memorandum on Cooperation.

(Thousands of euros)

1. Principal activities (continued)

Member countries of the Bank

The member countries of the Bank include (share in the paid-in capital of the Bank, %):

Member countries	*2017, %*	*2016, %*
Russian Federation	47.633	47.923
Republic of Bulgaria	13.399	13.481
Hungary	12.700	12.777
Czech Republic	9.644	9.703
Slovak Republic	6.820	6.862
Romania	5.859	5.895
Republic of Cuba	1.702	1.713
Socialist Republic of Vietnam	1.165	1.172
Mongolia	1.077	0.474
	100.000	**100.000**

Conditions of the Group's financial and business operations in the member countries

In its member countries, the Bank is not subject to taxation and enjoys all privileges available to diplomatic representations.

The Group is not subject to regulation by the Central Banks of the member countries, including the country of residence.

Business environment in the member countries

Economic and political development of the Bank's member countries affects the activities of enterprises operating in these countries. Considering this fact, the Group performs its operations with reference to the regional features of its member countries to ensure overall assessment and control of credit and operational risks.

The accompanying consolidated financial statements reflect the management's assessment of the impact of the member countries' business environment on the results of operations and financial position of the Group. Future evolution of the conditions in which the Group operates may differ from the assessment made by the management for the purposes of these consolidated financial statements.

2. Basis of preparation

General

These consolidated financial statements of the Group have been prepared in accordance with International Financial Reporting Standards ("IFRS") approved by the International Accounting Standards Board.

Subsidiary

As at 31 December 2017, the Bank is a parent company of the Group, which owns CJSC IIB Capital (the Bank's 100% subsidiary) established in 2012 to deal with issues related to IIB activities in Russia including provision of trustee services to the Bank. As at 31 December 2017, the authorized capital of the subsidiary is RUB 44.5 thousand (31 December 2016: RUB 44.5 thousand), which is equivalent to EUR 1.1 thousand at the historical exchange rate at the date of establishment.

Basis of measurement

These consolidated financial statements have been prepared under the historical cost convention with the exception of the financial instruments under fair value convention, the changes of which are translated through profit or loss account for the period, available-for-sale financial instruments also stated at fair value, and buildings in the property, equipment and investment property stated at revalued amounts.

(Thousands of euros)

2. Basis of preparation (continued)

Preparation and presentation of financial statements

The financial year of the Group begins on 1 January and ends on 31 December.

Functional and presentation currency

Euro ("EUR") is the Group's functional and presentation currency as it reflects the economic substance of the underlying operations conducted by the Group and circumstances affecting its operations, because most financial assets and financial liabilities as well as income and expenses of the Group are denominated in EUR.

These consolidated financial statements are presented in thousands of euros ("thousands of euros" or "EUR thousand"), unless otherwise indicated.

3. Summary of accounting policies

Changes in accounting policies

The Group has adopted the following amended IFRS which are effective for annual periods beginning on or after 1 January 2017. The Group has not early adopted standards, interpretations or amendments that have been issued but are not yet effective. The nature and the impact of each new amendment are described below:

Amendments to IAS 7 Statement of Cash Flows − Disclosure Initiative

The amendments require entities to provide disclosures about changes in their liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes (such as foreign exchange gains or losses). The Group disclosed relevant information for both the current period and the comparative period in Note 29.

Amendments to IAS 12 Income Taxes − Recognition of Deferred Tax Assets for Unrealized Losses

The amendments clarify that an entity needs to consider whether tax law restricts the sources of taxable profits against which it may make deductions on the reversal of that deductible temporary difference related to unrealized losses. Furthermore, the amendments provide guidance on how an entity should determine future taxable profits and explain the circumstances in which taxable profit may include the recovery of some assets for more than their carrying amount. These amendments had no effect on the Group's financial position and performance, since the Group has no deductible temporary differences or assets that are in the scope of the amendments.

Amendments to IFRS 12 Disclosure of Interests in Other Entities − Clarification of the scope of the disclosure requirements in IFRS 12

The amendments clarify that the disclosure requirements in IFRS 12 are applicable to an entity's interest in a subsidiary, a joint venture or an associate (or a portion of its interest in a joint venture or an associate) that is classified (or included in a disposal group that is classified) as held for sale. These amendments had no impact on the Group's financial position or performance.

Foreign currency transactions

The consolidated financial statements are presented in euro, which is the Group's functional and presentation currency. Every currency except euro is considered foreign currency. Transactions in foreign currencies are initially translated in the functional currency, converted at the rate of exchange ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the reporting date. Gains and losses resulting from the translation of foreign currency transactions are recognized in the consolidated income statement as "Net gains from operations in foreign currencies and with derivatives". Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary assets and liabilities measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

Differences between the contractual exchange rate of a transaction in a foreign currency and the Group's exchange rate on the date of the transaction are included in "Net gains from operations in foreign currencies and with derivatives".

(Thousands of euros)

3. Summary of accounting policies (continued)

Basis of consolidation

Subsidiaries, which are those entities in which the Group has an interest of more than one half of the voting rights, or otherwise has power to exercise control over their operations, are consolidated. Subsidiaries are consolidated from the date on which control is transferred to the Group and are no longer consolidated from the date that control ceases. All intra-group transactions, balances and unrealized gains on transactions between group companies are eliminated in full; unrealized losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Where necessary, accounting policies for subsidiaries have been changed to ensure consistency with the policies adopted by the Group.

A change in the ownership interest of a subsidiary, without a change of control, is accounted for as an equity transaction. Losses of the subsidiary are attributed to the non-controlling interests even if that results in a deficit balance.

If the Group loses control over a subsidiary, it derecognizes the assets (including goodwill) and liabilities of the subsidiary, the carrying amount of any non-controlling interests, the cumulative translation differences, recorded in equity; recognizes the fair value of the consideration received, the fair value of any investment retained and any surplus or deficit in profit or loss and reclassifies the parent’s share of components previously recognized in other comprehensive income to profit or loss.

Investments in associates

Associates are entities in which the Group generally has between 20% and 50% of the voting rights (interest), or is otherwise able to exercise significant influence, but which it does not control or jointly control. Investments in associates are accounted for under the equity method and are initially recognized at cost, including goodwill. Subsequent changes in the carrying amount reflect the post-acquisition changes in the net assets of the associate attributable to the Group. The Group’s share of its associates’ profits or losses is recognized in the consolidated income statement, and its share of movements in reserves is recognized in other comprehensive income. However, when the Group’s share of losses in an associate equals or exceeds its interest in the associate, the Group does not recognize further losses, unless the Group is obliged to make further payments to, or on behalf of, the associate.

Unrealized gains on transactions between Group and its associates are eliminated to the extent of the Group’s interest in the associates; unrealized losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred.

Cash and cash equivalents

Cash and cash equivalents include cash on hand and amounts due from banks and other financial institutions, including reverse repurchase agreements, which mature within ninety days from the origination date and are free from contractual encumbrances.

Fair value measurement

The Group measures financial instruments, such as trading and available-for-sale securities, derivatives and non-financial assets such as investment property, at fair value at each reporting date. Also, fair values of financial instruments measured at amortized cost are disclosed in Note 24.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either:

- In the principal market for the asset or liability; or
- In the absence of a principal market, in the most advantageous market for the asset or liability.

The principal or the most advantageous market must be accessible by the Group. The fair value of an asset or a liability is measured using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest. A fair value measurement of a non-financial asset takes into account a market participant’s ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use.

(Thousands of euros)

3. Summary of accounting policies (continued)

Fair value measurement (continued)

The Group uses valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximizing the use of relevant observable inputs and minimizing the use of unobservable inputs.

All assets and liabilities for which fair value is measured or disclosed in the consolidated financial statements are categorized within the fair value hierarchy, described as follows, based on the lowest level input that is significant to the fair value measurement as a whole:

- Level 1 − quoted (unadjusted) market prices in active markets for identical assets or liabilities.
- Level 2 − valuation techniques for which the lowest level input that is significant to the fair value measurement is directly or indirectly observable.
- Level 3 − valuation techniques for which the lowest level input that is significant to the fair value measurement is unobservable.

For assets and liabilities that are recognized in the consolidated financial statements on a recurring basis, the Group determines whether transfers have occurred between Levels in the hierarchy by re-assessing categorization (based on the lowest level input that is significant to the fair value measurement as a whole) at the end of each reporting period.

Financial assets

Initial recognition

Financial assets in the scope of IAS 39 are classified as either financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments, or available-for-sale financial assets, as appropriate. The Group determines the classification of its financial assets upon initial recognition, and subsequently can reclassify financial assets in certain cases as described below.

Date of recognition

All regular way purchases and sales of financial assets are recognized on the trade date i.e. the date that the Group commits to purchase the asset. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the period generally established by regulation or convention in the marketplace.

Financial assets at fair value through profit or loss

Financial assets classified as held for trading are included in the category “financial assets at fair value through profit or loss”. Financial assets are classified as held for trading if they are acquired for the purpose of selling in the near term. Derivatives are also classified as held for trading unless they are designated and effective hedging instruments. Gains or losses on financial assets held for trading are recognized in profit or loss.

Held-to-maturity investments

Non-derivative financial assets with fixed or determinable payments and fixed maturity are classified as held-to-maturity when the Group has the positive intention and ability to hold them to maturity. Investments intended to be held for an undefined period are not included in this classification. Held-to-maturity investments are subsequently measured at amortized cost. Gains and losses are recognized in profit or loss when the investments are impaired, as well as through the amortization process.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are not entered into with the intention of immediate or short-term resale and are not classified as trading securities or designated as investment securities available for sale. Such assets are carried at amortized cost using the effective interest method. Gains and losses are recognized in profit or loss when the loans and receivables are derecognized or impaired, as well as through the amortization process.

(Thousands of euros)

3. Summary of accounting policies (continued)

Financial assets (continued)

Available-for-sale financial assets

Available-for-sale financial assets are those non-derivative financial assets that are designated as available for sale or are not classified in any of the three preceding categories. After initial recognition available-for sale financial assets are measured at fair value with gains or losses from change in fair value being recognized in other comprehensive income until the investment is derecognized or until the investment is determined to be impaired at which time the cumulative gain or loss previously reported in other comprehensive income is reclassified to the consolidated income statement. However, interest calculated using the effective interest method is recognized in profit or loss.

Reclassification of financial assets

If a non-derivative financial asset classified as held for trading is no longer held for the purpose of selling in the near term, it may be reclassified out of the fair value through profit or loss category in one of the following cases:

- A financial asset that would have met the definition of loans and receivables above may be reclassified to loans and receivables category if the Group has the intention and ability to hold it for the foreseeable future or until maturity.
- Other financial assets may be reclassified to available for sale or held to maturity categories only in rare circumstances.

A financial asset classified as available for sale that would have met the definition of loans and receivables may be reclassified to loans and receivables category if the Group has the intention and ability to hold it for the foreseeable future or until maturity.

Financial assets are reclassified at their fair value on the date of reclassification. Any gains or losses already recognized in profit or loss are not reversed. The fair value of the financial asset on the date of reclassification becomes its new cost or amortized cost, as applicable.

Repurchase and reverse repurchase agreements and securities lending

Sale and repurchase agreements ("repo") are treated as secured financing transactions. Securities sold under sale and repurchase agreements are retained in the consolidated statement of financial position and in case the transferee has the right by contract or custom to sell or repledge them, reclassified as investment securities pledged under sale and repurchase agreements.

The corresponding liabilities are presented within amounts due to credit institutions or customers. Securities purchased under agreements to resell ("reverse repo") are recorded as cash equivalents, deposits with banks and other financial institutions as appropriate. The difference between sale and repurchase price is treated as interest and accrued over the life of repo agreements using the effective interest rate method.

Securities lent to counterparties are retained in the consolidated statement of financial position. Securities borrowed are not recorded in the consolidated statement of financial position, unless these are sold to third parties, in which case the purchase and sale are recorded within gains less losses from trading securities in the consolidated income statement. The obligation to return them is recorded at fair value as a trading liability.

Derivative financial instruments

In the normal course of business, the Group enters into various derivative financial instruments including forwards and swaps in the foreign exchange market. Such financial instruments are held for trading and are initially recorded at fair value. The fair values are estimated based on quoted market prices or pricing models that take into account the current market and contractual prices of the underlying instruments and other factors. Derivatives are carried as assets when their fair value is positive and as liabilities when it is negative. Gains and losses resulting from these instruments are included in the consolidated income statement as "Net gains from operations in foreign currencies and with derivatives".

Derivatives embedded in other financial instruments are treated as separate derivatives and recorded at fair value if their economic characteristics and risks are not closely related to those of the host contract, and the host contract is not itself held for trading or designated at fair value through profit or loss. The embedded derivatives separated from the host are carried at fair value on the trading portfolio with changes in fair value recognized in profit or loss.

(Thousands of euros)

3. Summary of accounting policies (continued)

Hedge accounting

To manage the risks associated with fluctuations in cash flows from receipt and payment of interest, as well as with fluctuations in the fair value of certain items, the Group uses derivative financial instruments. As a result, the Group applies hedge accounting for transactions that meet specified criteria.

At the inception of the hedge relationship, the Group documents the relationship between the hedged item and the hedging instrument, including the nature of the risk, the risk management objective and strategy for undertaking the hedge and the method that will be used to assess the effectiveness of the hedging relationship at the inception and on an ongoing basis.

At each hedge effectiveness assessment date, a hedge relationship must be expected to be highly effective on a prospective basis and demonstrate that it was highly effective (retrospective effectiveness) for the designated period in order to qualify for hedge accounting. A formal assessment is undertaken both at inception and at each month end on an ongoing basis. A hedge is expected to be highly effective if the changes in fair value or cash flows attributable to the hedged risk during the period for which the hedge is designated will be offset by the hedging instrument in a range of 80% to 125%.

Fair value hedges

For designated and qualifying fair value hedges, the change in the fair value of a hedging derivative is recognized in the consolidated income statement in “Net gains from operations in foreign currencies and with derivatives”.

Meanwhile, the cumulative change in the fair value of the hedged item attributable to the risk hedged is recorded as an adjustment of the carrying value of the hedged item in the consolidated income statement in “Net gains from operations in foreign currencies and with derivatives”.

If the hedging instrument expires or is sold, terminated or exercised, or where the hedge no longer meets the criteria for hedge accounting, the hedge relationship is discontinued prospectively. For hedged items recorded at amortized cost, using the effective interest rate method, when the hedge ceases, the adjustment of the carrying amount of the hedged financial instrument is amortized over the remaining period until date of maturity of the hedged financial instrument. If the hedged item is derecognized, the unamortized fair value adjustment is recognized in profit or loss.

Cash flow hedges

For designated and qualifying cash flow hedges, the effective portion of the cumulative gain or loss on the hedging instrument is initially recognized in consolidated other comprehensive income and is recorded through other comprehensive income. An ineffective portion of the gain or loss on the hedging instrument is recognized in the consolidated income statement.

When a hedging instrument expires, is sold, terminated, exercised, or when a hedge no longer meets the criteria for hedge accounting, the total amount of income or expense accumulated at that time in equity is transferred from equity and recognized in the consolidated income statement in the same period or periods during which hedged projected cash flows affect profit or loss.

When a forecast transaction is no longer expected, the cumulative gain or loss recognized in equity is immediately transferred to the consolidated income statement.

Borrowings

Issued financial instruments or their components are classified as liabilities, where the substance of the contractual arrangement results in the Group having an obligation either to deliver cash or another financial asset to the holder, or to satisfy the obligation other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of own equity instruments. Such instruments include amounts due to banks and other financial institutions, long-term loans of banks and debt securities issued. After initial recognition, borrowings are subsequently measured at amortized cost using the effective interest method. Gains and losses are recognized in profit or loss when the borrowings are derecognized as well as through the amortization process.

(Thousands of euros)

3. Summary of accounting policies (continued)

Leases

Operating − Group as lessee

Leases of assets under which the risks and rewards of ownership are effectively retained by the lessor are classified as operating leases. Lease payments under an operating lease are recognized as expenses on a straight-line basis over the lease term and included into general and administrative expenses.

Operating − Group as lessor

The Group presents assets subject to operating leases in the consolidated statement of financial position according to the nature of the asset.

Lease income from operating leases is recognized in the consolidated income statement over the lease term within net non-interest income on "Income from lease of investment property". The aggregate cost of incentives provided to lessees is recognized as a reduction of rental income over the lease term on a straight-line basis. Initial direct costs incurred specifically to earn revenues from an operating lease are added to the carrying amount of the leased asset.

Measurement of financial instruments at initial recognition

When financial instruments are recognized initially, they are measured at fair value, adjusted, in the case of instruments not at fair value through profit or loss, for directly attributable fees and costs.

The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price. If the Group determines that the fair value at initial recognition differs from the transaction price, then:

- If the fair value is evidenced by a quoted price in an active market for an identical asset or liability (i.e., a Level 1 input) or based on a valuation technique that uses only data from observable markets, the Group recognizes the difference between the fair value at initial recognition and the transaction price as a gain or loss.
- In all other cases, the initial measurement of the financial instrument is adjusted to defer the difference between the fair value at initial recognition and the transaction price. After initial recognition, the Group recognizes that deferred difference as a gain or loss only when the inputs become observable, or when the instrument is derecognized.

Offsetting of financial instruments

Financial assets and liabilities are offset and the net amount is reported in the consolidated statement of financial position when there is a legally enforceable right to set off the recognized amounts and there is an intention to settle on a net basis, or to realize the asset and settle the liability simultaneously. This is not generally the case with master netting agreements, and the related assets and liabilities are presented gross in the consolidated statement of financial position.

Impairment of financial assets

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

Evidence of impairment may include indications that the borrower or a group of borrowers is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they will enter bankruptcy or other financial reorganization and where observable data indicate that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that may be related to defaults.

(Thousands of euros)

3. Summary of accounting policies (continued)

Impairment of financial assets (continued)

Deposits with banks and other financial institutions, long-term loans to banks, trade financing loans, and loans to customers

For deposits with banks and other financial institutions, long-term loans to banks, trade financing loans, and loans to customers carried at amortized cost, the Group first assesses individually whether objective evidence of impairment exists individually for financial assets that are individually significant, or collectively for financial assets that are not individually significant. If the Group determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risks characteristics and collectively assesses them for impairment.

Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be, recognized are not included in a collective assessment of impairment.

If there is an objective evidence that an impairment loss exists, the amount of the loss is measured as the difference between the assets' value in the consolidated statement of financial position and the present value of estimated future cash flows (excluding future expected credit losses that have not yet been incurred). The value of the asset in the consolidated statement of financial position is reduced through the use of an allowance account and the amount of the loss is recognized in the consolidated income statement. Interest income continues to be accrued on the reduced carrying amount of asset based on the original effective interest rate of the asset. Loans together with the associated allowance are written off when there is no realistic prospect of future recovery and all collateral has been realized or has been transferred to the Group. If, in a subsequent year, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognized, the previously recognized impairment loss is increased or reduced by adjusting the allowance account. If amounts previously written off are later recovered, the recovery is credited to the consolidated income statement.

The present value of the estimated future cash flows is discounted at the financial asset's original effective interest rate. If a financial asset is provided at a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate. The calculation of the present value of the estimated future cash flows of a collateralized financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

Future cash flows on a group of financial assets that are collectively evaluated for impairment are estimated on the basis of historical loss experience for assets with credit risk characteristics similar to those in the group. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the years on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently. Estimates of changes in future cash flows reflect, and are directionally consistent with, changes in related observable data from year to year (such as changes in unemployment rates, property prices, commodity prices, payment status, or other factors that are indicative of incurred losses incurred by the Group and their magnitude).

The methodology and assumptions used for estimating future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

Held-to-maturity financial investments

For held-to-maturity investments the Group assesses individually whether there is objective evidence of impairment. If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the asset's carrying value and the present value of estimated future cash flows.

The carrying amount of the asset is reduced and the amount of the loss is recognized in profit or loss.

If, in a subsequent year, the amount of the estimated impairment loss decreases because of an event occurring after the impairment was recognized, any amounts formerly charged are credited to the consolidated income statement.

(Thousands of euros)

3. Summary of accounting policies (continued)

Impairment of financial assets (continued)

Available-for-sale financial instruments

For available-for-sale financial instruments, the Group determines at each reporting date whether there is objective evidence that an instrument or a group of instruments is impaired.

In the case of equity investments classified as available for sale, objective evidence would include a significant or prolonged decline in the fair value of the investment below its acquisition cost. Where there is evidence of impairment, the cumulative loss − measured as the difference between the acquisition coast and the current fair value, less any impairment loss on that investment previously recognized in the consolidated income statement − is reclassified from other comprehensive income to the consolidated income statement. Impairment losses on equity investments are not reversed through the consolidated income statement; increases in their fair value after impairment are recognized in other comprehensive income.

In the case of debt instruments classified as available for sale, impairment is assessed based on the same criteria as financial assets carried at amortized cost. Future interest income is based on the reduced carrying amount and is accrued using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss. The interest income is recorded in the consolidated income statement. If, in a subsequent year, the fair value of a debt instrument increases and the increase can be objectively related to an event occurring after the impairment loss was recognized in the consolidated income statement, the impairment loss is reversed through the consolidated income statements.

Renegotiated loans

Where possible, the Group seeks to restructure loans rather than to take possession of collateral. This may involve extending the payment arrangements and the agreement of new loan conditions. The accounting treatment of such restructuring is as follows:

- If the currency of the loan has been changed, the old loan is derecognized and the new loan is recognized in the consolidated statement of financial position.
- If the loan restructuring is not caused by the financial difficulties of the borrower, the Group uses the same approach as for financial liabilities described below.
- If the loan restructuring is due to the financial difficulties of the borrower and the loan is impaired after restructuring, the Group recognizes the difference between the present value of the new cash flows discounted using the original effective interest rate and the carrying amount before restructuring in the provision charges for the period.

Once the terms have been renegotiated, the loan is no longer considered past due. The Group's management continuously reviews renegotiated loans to ensure that all criteria are met and that future payments are likely to occur. The loans continue to be subject to an individual or collective impairment assessment, calculated using the loan's original or current effective interest rate.

Derecognition of financial assets and liabilities

Financial assets

A financial asset (or, where applicable a part of a financial asset or part of a group of similar financial assets) is derecognized in the consolidated statement of financial position where:

- The rights to receive cash flows from the asset have expired.
- The Group has transferred its rights to receive cash flows from the asset, or retained the right to receive cash flows from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a 'pass-through' arrangement.
- The Group either (a) has transferred substantially all the risks and rewards of the asset, or (b) has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

(Thousands of euros)

3. Summary of accounting policies (continued)

Derecognition of financial assets and liabilities (continued)

Where the Group has transferred its rights to receive cash flows from an asset and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognized to the extent of the Group's continuing involvement in the asset. Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Group could be required to repay.

Where continuing involvement takes the form of a written and/or purchased option (including a cash-settled option or similar provision) on the transferred asset, the extent of the Group's continuing involvement is the amount of the transferred asset that the Group may repurchase, except that in the case of a written put option (including a cash-settled option or similar provision) on an asset measured at fair value, the extent of the Group's continuing involvement is limited to the lower of the fair value of the transferred asset and the option exercise price.

Financial liabilities

A financial liability is derecognized when the obligation under the liability is discharged or cancelled or expires.

Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognized in the consolidated income statement.

Financial guarantees

In the ordinary course of business, the Group gives financial guarantees, consisting of letters of credit, guarantees and acceptances. Financial guarantees are initially recognized in the consolidated financial statements at fair value, in "Other liabilities", being the premium received. Subsequent to initial recognition, the Group's liability under each guarantee is measured at the higher of the amortized premium and the best estimate of expenditure required to settle any financial obligation arising as a result of the guarantee.

Any increase in the liability relating to financial guarantees is taken to the consolidated statement of profit or loss. The premium received is recognized in profit or loss on a straight-line basis over the life of the guarantee.

Property and equipment

Property and equipment are carried in the consolidated financial statements at cost, excluding the costs of day-to-day servicing, less accumulated depreciation and any accumulated impairment, excluding buildings carried at revalued cost, as described below. Such cost includes the cost of replacing part of equipment when that cost is incurred if the recognition criteria are met.

The carrying amount of property and equipment is reviewed for impairment when events or changes in circumstances indicate that the carrying amount may not be recoverable.

Where an item of property and equipment comprises major components having different useful lives, they are accounted for as separate items of property and equipment.

Following initial recognition at cost, buildings are carried at a revalued amount, which is the fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses. Valuations of buildings are performed frequently enough to ensure that the fair value of a revalued asset does not differ materially from its carrying amount.

Accumulated depreciation as at the revaluation date is eliminated against the gross carrying amount of the asset and the net amount is restated to the revalued amount of the asset. Any revaluation surplus is carried in other comprehensive income, except to the extent that it reverses a revaluation decrease of the same asset previously recognized in the consolidated income statement, in which case the increase is recognized in profit or loss. A revaluation deficit is recognized in the consolidated income statement, except that a deficit directly offsetting a previous surplus on the same asset is directly offset against the surplus in the revaluation reserve for property and equipment.

(Thousands of euros)

3. Summary of accounting policies (continued)

Property and equipment (continued)

Upon disposal, any revaluation reserve relating to the particular asset being sold is transferred to retained earnings.

Depreciation of property and equipment (including self-constructed property and equipment) begins when it is available for use and is recognized in the consolidated income statement. Depreciation is calculated on a straight-line basis over the following estimated useful lives:

	Years
Buildings	85
Equipment	3-7
Computers	3-6
Office furniture	5-10
Motor vehicles	4

The asset's residual values, useful lives and depreciation methods are reviewed, and adjusted as appropriate, at each financial year-end.

Costs related to repairs and renewals are charged when incurred and included in general and administrative expenses, unless they qualify for capitalization.

Investment property

Investment property includes a part of buildings held to earn rental income or for capital appreciation and which are not used by the Group or held for the sale in the ordinary course of business. Property that is being constructed or developed or redeveloped for future use as investment property is also classified as investment property.

Investment property is initially recognized at cost, including transaction costs, and subsequently remeasured at fair value reflecting market conditions at the end of the reporting period. Fair value of the Group's investment property is determined on the basis of various sources including reports of independent appraisers, who hold a recognized and relevant professional qualification and who have recent experience in valuation of property of similar location and category.

Investment property that is being redeveloped for continuing use as investment property or for which the market has become less active continues to be measured at fair value. Earned rental income is recorded in the consolidated income statement within "Income from lease of investment property". Gains and losses resulting from changes in the fair value of investment property are recorded in the consolidated income statement and presented within gains/(losses) from revaluation of investment property.

Subsequent expenditure is subject to capitalization only when it is probable that future economic benefits associated with an asset will flow to the Group and it can be measured reliably. All other repairs and maintenance costs are expensed when incurred. If an investment property becomes owner-occupied, it is reclassified to buildings, and its carrying amount at the date of reclassification becomes its deemed cost to be subsequently depreciated.

Intangible assets

The useful lives of intangible assets are assessed to be finite and include capitalized computer software. Intangible assets that have been acquired and recorded are capitalized based on costs incurred to acquire and bring to use these intangible assets. Following initial recognition, intangible assets are carried at acquisition cost less any accumulated amortization and any accumulated impairment losses. Intangible assets are amortized using the straight-line method and assessed for impairment whenever there is an indication that the intangible asset may be impaired. Depreciation is calculated on a straight-line basis over the following estimated useful lives:

	Years
Automated banking system	20
Other computer software	1-5

(Thousands of euros)

3. Summary of accounting policies (continued)

Assets classified as held for sale

The Group classifies a non-current asset as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use. For this to be the case, the non-current asset must be available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets and its sale must be highly probable.

The sale qualifies as highly probable if the Group's management is committed to a plan to sell the non-current asset and an active program to locate a buyer and complete the plan must have been initiated. Further, the non-current asset must have been actively marketed for a sale at price that is reasonable in relation to its current fair value and in addition the sale should be expected to qualify for recognition as a completed sale within one year from the date of classification of the non-current asset as held for sale.

The Group measures an asset classified as held for sale at the lower of its carrying amount and fair value less costs to sell.

The Group recognizes an impairment loss for any initial or subsequent write-down of the asset to fair value less costs to sell if events or changes in circumstance indicate that their carrying amount may be impaired.

Provisions

Provisions are recognized when the Group has a present legal or constructive obligation as a result of past events, and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate of the amount of obligation can be made.

Equity

In accordance with amendments to IAS 32, *Financial Instruments: Presentation*, and IAS 1, *Presentation of Financial Statements − Puttable Financial Instruments and Obligations Arising on Liquidation*, that were issued in February 2008, participants' shares are recognized in equity and not in liabilities.

Contingencies

Contingent liabilities are not recognized in the consolidated statement of financial position but are disclosed unless the possibility of any outflow in settlement is remote. A contingent asset is not recognized in the consolidated statement of financial position but disclosed in the consolidated financial statements when an inflow of economic benefits is probable.

Recognition of income and expenses

Revenue is recognized to the extent that it is probable that the economic benefits will flow to the Group and the revenue can be reliably measured. The following specific recognition criteria must also be met before revenue is recognized in the consolidated financial statements.

Interest and similar income and expense

For all financial instruments measured at amortized cost and interest bearing securities classified as trading or available for sale, interest income or expense is recorded at the effective interest rate, which is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or a shorter period, where appropriate, to the net carrying amount of the financial asset or financial liability. The calculation takes into account all contractual terms of the financial instrument (for example, prepayment options) and includes any fees or incremental costs that are directly attributable to the instrument and are an integral part of the effective interest rate, but not future credit losses. The carrying amount of the financial asset or financial liability is adjusted if the Group revises its estimates of payments or receipts. The adjusted carrying amount is calculated based on the original effective interest rate and the change in carrying amount is recorded as interest income or expense.

Once the recorded value of a financial asset or a group of similar financial assets has been reduced due to an impairment loss, interest income continues to be recognized using the original effective interest rate applied to the new carrying amount.

(Thousands of euros)

3. Summary of accounting policies (continued)

Recognition of income and expenses (continued)

Fee and commission income

The Group earns fee and commission income from a diverse range of services it provides to its customers. Fee income can be divided into the following two categories:

Fee income earned from services that are provided over a certain period of time

Fees earned for the provision of services over a period of time are accrued over that period. Loan commitment fees for loans that are likely to be drawn down and other credit-related fees are deferred (together with any incremental costs) and recognized as an adjustment to the effective interest rate on the loan.

Other fee and commission income

Fees earned for the provision of transaction services are recognized on completion of the underlying transaction. Fees or components of fees that are linked to a certain performance are recognized after fulfilling the corresponding criteria.

Fee and commission expense

Fee and commission expenses comprise commissions on securities transactions and commissions on cash settlement transactions. Commissions paid on purchase of securities classified as financial instruments at fair value through profit or loss are recognized in the consolidated income statement at the purchase date. Commissions paid on all other purchases of securities are recognized as an adjustment to the carrying amount of the instrument with corresponding adjustment to its effective yield.

Dividend income

Dividend income is recognized when the Group's right to receive the payment is established.

Fiduciary assets

Fiduciary assets are not reported in the consolidated financial statements, as they are not owned by the Group.

Segment reporting

The reportable segments of the Group comprise the following operating segments: Credit and investment activity, Treasury, Other operations.

Standards issued but not yet effective

The standards and interpretations issued, but not yet effective, up to the date of issuance of the Group's consolidated financial statements are disclosed below. The Group intends to adopt these standards when they become effective.

Standards issued but not yet effective

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IFRS 9 Financial Instruments

In July 2014, the IASB issued the final version of IFRS 9 *Financial Instruments* which supersedes IAS 39 *Financial Instruments: Recognition and Measurement*. The standard introduces new requirements for classification and measurement, impairment, and hedge accounting. IFRS 9 is effective for annual periods beginning on or after 1 January 2018. Except for hedge accounting, retrospective application is required, but recalculation of comparative information is not compulsory, except for hedge accounting.

(Thousands of euros)

3. Summary of accounting policies (continued)

Standards issued but not yet effective (continued)

The Group plans to adopt the new standard and recognize the cumulative effect of transition in retained earnings as at 1 January 2018. The comparative information will not be restated. Based on data as at 31 December 2017 and the current adoption status, the Group is currently assessing, in quantitative terms, the impact of IFRS 9 adoption; however, the assessment has not been finalized yet.

The Group has developed a plan for the phase-by-phase transition to IFRS 9. The working group for the transition to the new standard comprises experts on methodology, data search and modeling, information technology and financial statements. The group was engaged in the assessment of financial instruments affected by classification and measurements requirements of IFRS 9, as well as in the development of the methodology to provide for expected credit losses.

(a) Classification and measurement

Pursuant to IFRS 9, all debt financial assets that do not meet the Solely Payments of Principal and Interest (SPPI) criterion are classified at initial recognition as financial assets at fair value through profit or loss (FVPL). According to this criterion, debt instruments that do not meet the definition of basic credit agreement (such as instruments with embedded conversion options or non-recourse loans) are measured at FVPL. Those debt financial instruments that meet the SPPI criterion are classified at initial recognition based on a business model for managing these instruments:

- Instruments held to receive the contractual cash flows are at amortized cost.
- Instruments held to receive the contractual cash flows and for sale are classified as at fair value through other comprehensive income (FVOCI).
- Instruments held for other purposes are classified as at FVPL.

Equity financial assets are to be classified at initial recognition as at FVPL, except when the entity decided to irrevocably designate such assets as at FVOCI. For equity financial instruments classified as at FVOCI, all realized and unrealized gains or losses (except for dividend income) are recognized in other comprehensive income, with no subsequent reclassification to profit or loss.

The classification and measurement of financial liabilities remain almost unchanged from the existing requirements of IAS 39. Derivative financial instruments continue to be measured at FVPL.

The Group does not expect any significant changes in classification and measurement of financial instruments recorded on its consolidated statement of financial position.

(b) Impairment

IFRS 9 sets requirements for assessing expected credit losses and providing for financial assets measured at amortized cost and at fair value through other comprehensive income, including loans, trade and lease receivables, debt securities, contractual assets per IFRS 15, as well as off-balance credit-related commitments (hereinafter, the "financial instruments").

Key changes in the approach to assessing provisions for expected credit losses in IFRS 9:

- Expected credit losses are assessed for all financial instruments, including assets without any indications of impairment and/or deterioration of credit quality; provision is required from the date of acquisition of a financial instruments exposed to credit risk, which result in higher provisions.
- A more complex provisioning methodology was introduced. A provisioning model is to be developed using the following parameters: probability of default (PD) within 12 months and for the whole term of the financial instrument, loss given default (LGD), macroeconomic indicators.

The assessment of impairment losses is based on expected losses (IFRS 9) rather than on incurred losses (IAS 39). According to the new assessment model, an allowance should be created at initial recognition of a financial instrument (or at the date when the Group becomes a party to a loan agreement or a financial guarantee) based on expected potential credit losses.

(Thousands of euros)

3. Summary of accounting policies (continued)

Standards issued but not yet effective (continued)

Pursuant to IFRS 9, for financial instruments, either occurred or acquired, the Group will recognize an allowance for impairment in the amount of expected credit losses for 12 months, if there has been no significant increase in credit risk since origination (phase 1). This amount represents expected credit losses as a result of a default that may take place within the next 12 months. Interest income is calculated based on the gross carrying amount of a financial instrument at phase 1.

According to IFRS 9, credit losses shall be recognized over the remaining useful lives of financial instruments (“expected losses over the useful life”) that are considered to have a significantly increased credit risk exposure (phase 2), as well as for financial assets impaired at the reporting date (phase 3).

Expected losses for financial instruments are all possible events of default that may occur over the expected useful life of a financial instrument. The Group uses current risk management measures, changes in credit rating and relevant reasonable information to determine whether there is a significant increase in credit risk of a financial instrument. This includes considering prospective information, including macroeconomic factors. In addition, financial instruments will be transferred at phase 2, if they are 30 days overdue. Interest income is calculated based on the gross carrying amount of a financial instruments at phase 2.

IFRS 9 does not require separating individually significant financial instruments / borrowers in assessing expected credit losses and using a separate approach to such instruments/borrowers. Interest income is calculated only based on net carrying amount of these financial instruments at phase 3.

The Group decided to assess the provision for credit losses on an individual basis at phase 3. There is a number of criteria the Group analyses at transitions between phases 1, 2 and 3. At the same time, it analyses, on an individual basis, all factors that may provide evidences of changes in credit risk or impairment.

In order to assess expected credit losses, the Bank uses three basic components: the probability of default (PD) (point in time and lifetime), loss given default (LGD), macroeconomic indicators.

For the purpose of IFRS 9, provisions for credit losses are affected by such key characteristics as exposure at default (EAD), expected useful life of a financial asset, etc. As a result, the provision for credit losses for phase 2 financial instruments will be increased along with the expected useful life of a financial instrument.

According to estimates, IFRS 9 will result in higher provisions to cover credit losses, as mentioned above. This increase is a result of the requirement to fix a provision in the amount of expected credit losses for 12 months for instruments with no significant increase in credit risk since origination, and a larger number of financial instruments to which expected losses are applied over their useful lives.

(c) Changes in hedge accounting

IFRS 9 sets new hedge accounting rules that will align hedge accounting with risk management approach. The standard eliminated certain restrictions, so more instruments can qualify as hedging instruments for hedge accounting purposes.

Key changes: Modified approach to hedge effectiveness testing, risk component designated as the hedged item, hedging cannot be derecognized when the hedging purpose remains unchanged.

IFRS 9 provides possibility to postpone implementation of the standard in relation to hedge accounting and continue to apply IAS 39 requirements. The Group decided not to implement IFRS 9 in relation to hedge accounting at the date of IFRS 9 became effective.

(Thousands of euros)

3. Summary of accounting policies (continued)

Standards issued but not yet effective (continued)

IFRS 15 Revenue from Contracts with Customers

IFRS 15 was issued in May 2014 and amended in April 2016. The new standard will supersede all existing revenue recognition requirements under IFRS. Either a full retrospective application or a modified retrospective application will be required for annual periods beginning on or after 1 January 2018. The Group plans to adopt the new standard using the modified retrospective approach and recognize the cumulative effect of transition in retained earnings as at 1 January 2018. The comparative information will not be restated.

IFRS 15 establishes a new five-step model that will apply to revenue arising from contracts with customers. Under IFRS 15, revenue is recognized at an amount that reflects the consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer. However, interest and fee income integral to financial instruments and leases will continue to fall outside the scope of IFRS 15 and will be regulated by the other applicable standards (e.g., IFRS 9 and IFRS 16 *Leases*). As a result, this standard will have no impact on a significant portion of the Group's revenue.

The Group does not expect a significant impact of IFRS 15.

Amendments to IFRS 10 and IAS 28 − Sale or Contribution of Assets between an Investor and its Associate or Joint Venture

The amendments address the inconsistency between the requirements in IFRS 10 and IAS 28 in dealing with the loss of control of a subsidiary that is sold or contributed to an associate or a joint venture. The amendments clarify that gains or losses arising as a result of the sale or contribution of assets that constitute a business, as defined in IFRS 3, in a transaction between an investor and its associate or joint venture are recognized in full. However, gains or losses arising as a result of the sale or contribution of assets that do not constitute a business are recognized only to the extent of interests of investors, other than the entity, in an associate or a joint venture. The IASB has deferred the effective date of these amendments for an indefinite term, but an entity that early adopts the amendments must apply them prospectively. The Group does not expect any significant effect from these amendments.

Amendments to IFRS 2 − Classification and Measurement of Share-based Payments

The IASB issued amendments to IFRS 2 *Share-based Payments*, which cover the following three aspects: the effects of vesting conditions on the measurement of a cash-settled share-based payment; classification of share-based payments with settlement of the tax at source on a net basis; accounting for amended terms of share-based payments resulting in cease of classification as a cash-settled transaction and start of classification as equity-settled transaction.

When adopting the amendments, entities do not have to restate data for the prior periods, however retrospective application is possible if the entity applies all three aspects and if other criteria are met. The amendments are effective for annual periods beginning on or after 1 January 2018, with early adoption permitted. The Group does not expect any significant effect from these amendments.

IFRS 16 Leases

IFRS 16 was issued in January 2016 and replaces IAS 17 *Leases*, IFRIC 4 *Determining Whether an Arrangement Contains a Lease*, SIC 15 *Operating Leases − Incentives* and SIC 27 *Evaluating the Substance of Transactions Involving the Legal Form of a Lease*. IFRS 16 sets out the principles for the recognition, measurement, presentation and disclosure of leases, and requires that lessees account for all lease agreements using a single lessee accounting model, i.e. similarly to the accounting for finance leases in IAS 17. The standard provides for two types of disclosure exemptions for lessees: for leases of 'low-value' assets and 'short-term' leases (e.g. leases expiring in 12 months or less). At the inception of the lease, the lessee will recognize a liability to make lease payments (i.e. a lease liability) and an asset granting the right to use an underlying asset over the lease term (i.e. a right-of-use asset). The lessees will recognize the interest expense related to the lease liability separately from the amortization expense related to the right-of-use asset.

The lessees will also remeasure the lease liability on occurrence of a certain event (e.g. a change in lease terms or future lease payments resulting from a change in the index or rate used to determine those payments). In most cases, a lessee will account for the amount of the remeasured lease liability as an adjustment to the right-of-use asset.

(Thousands of euros)

3. Summary of accounting policies (continued)

Standards issued but not yet effective (continued)

The accounting treatment for the lessor under IFRS 16 remains almost unchanged from the existing requirements of IAS 17. Lessors will continue to classify leases as operating or finance leases using the same classification principles as in IAS 17.

In addition, IFRS 16 requires that lessors and lessees provide a more detailed disclosures as compared with IAS 17.

IFRS 16 is effective for annual periods beginning on or after 1 January 2019. Early application is permitted but not before the date on which the entity begins to apply IFRS 15. A lessee may apply this standard using either a full or modified retrospective approach. The transitional provisions of the standard contain certain exemptions. In 2018, the Group will continue to assess the potential impact of IFRS 16 on its consolidated financial statements.

IFRS 17 Insurance Contracts

In May 2017, the IASB issued IFRS 17 *Insurance Contracts*, a new comprehensive financial reporting standard related to insurance contracts, which addresses the issues of recognition, measurement, information presentation and disclosures.

When IFRS 17 is effective, it will replace IFRS 4 *Insurance Contracts*, which was issued in 2005. IFRS 17 applies to all insurance contracts (i.e., life insurance and insurance other than life insurance, direct insurance and reinsurance) regardless of the type of entity that issues them, as well as to certain guarantees and financial instruments with discretionary participation conditions.

There are several scope exceptions. The main objective of IFRS 17 is to provide a recognition model for insurance contracts, which is more effective and consistent for insurers. Unlike requirements of IFRS 4, which are based mostly on previous local accounting policies, IFRS 17 provides a comprehensive recognition model for insurance contracts covering all the relevant accounting considerations.

IFRS 17 is effective for reporting periods beginning on or after 1 January 2021. In addition, comparative information shall be provided. Earlier application is permitted on condition that the entity also applies IFRS 9 and IFRS 15. The Group does not expect that IFRS 15 will have a significant effect on the consolidated financial statements.

Amendments to IAS 40 − Transfers of Investment Property

Amendments clarify the cases when an entity is required to transfer real estate, including real estate under construction or development, into or from the category of investment property. The amendments state that a change in use occurs when property begins or ceases to comply with the definition of investment property and there is evidence of a change in use. Any change in management’s intentions regarding the use of the property itself does not indicate a change in its use. Entities should apply these amendments prospectively with respect to changes in use, which occurred on or after the beginning of the annual reporting period, in which the entity applies these amendments for the first time, or after that date. The entity shall re-assess the classification of real estate held at that date and, if necessary, transfer real estate to reflect conditions that exist at that date. Retrospective application is permitted according to IAS 8 only if it is possible without more recent information. The amendments are effective for annual periods beginning on or after 1 January 2018. The Group does not expect any significant effect from these amendments.

Annual improvements 2014-2016 cycle (issued in December 2016)

They include:

IFRS 1 First-time Adoption of International Financial Reporting Standards − Elimination of Short-Term Exemptions for First-Time Adopters

Short-term exemptions stipulated by paragraphs E3-E7 of IFRS 1 were deleted since they had served their purpose. These amendments are effective from 1 January 2018. These amendments are not applicable to the Group.

(Thousands of euros)

3. Summary of accounting policies (continued)

Standards issued but not yet effective (continued)

IAS 28 Investments in Associates and Joint Ventures − Clarification that the Decision to Measure Investees at Fair Value through Profit or Loss Should Be Made Individually for Each Investment

The amendments clarify:

An entity that is a venture capital organization, or other similar entity may decide to measure investments in associates and joint ventures at fair value through profit or loss. This decision is made individually for each investment.

If the entity that is not an investment entity itself has an interest in an associate or joint venture that are investment entities, when applying the equity method, such entity can retain the fair value measurement applied by its investment associate or joint venture to its interests in subsidiaries. This decision is made individually for each investment associate or joint venture at the later of: (a) the date of initial recognition of an investment associate or joint venture; (b) the date when an associate or joint venture becomes an investment entity and (c) the date when an investment associate or joint venture first becomes a parent.

These amendments are applied retrospectively and are effective from 1 January 2018. The Group does not expect any significant effect from these amendments.

Amendments to IFRS 4 − Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts

These amendments eliminate concerns arising from implementing the new standard related to financial instruments, IFRS 9, before implementing IFRS 17 *Insurance Contracts*, which replaces IFRS 4. The amendments grant two options for entities issuing insurance contracts: a temporary exemption from applying IFRS 9 and an overlay approach. The temporary exemption is first applied for reporting periods beginning on or after 1 January 2018. An entity may elect the overlay approach when it first applies IFRS 9 and apply that approach retrospectively to financial assets designated at the entity's discretion on transition to IFRS 9. In addition, the entity restates comparative information to reflect the overlay application approach if, and only if, it restates comparative data while applying IFRS 9. These amendments are not applicable to the Group.

IFRIC 22 − Foreign Currency Transactions and Prepayment

It clarifies that for the purpose of determining exchange rate to be applied at initial recognition of the respective assets, expenses or revenues (or their part) at derecognition of a non-monetary asset or non-monetary liability related to making or receiving prepayment, the date of transaction should be considered the date when an entity initially recognizes non-monetary asset or non-monetary liability related to making or receiving prepayment. The clarification become effective for annual reporting periods beginning on or after 1 January 2018. However, since the current activities of the Group comply with the requirements of the clarification, the Group does not expect that it will have any impact on its consolidated financial statements.

IFRIC 23 − Uncertainty over Income Tax Treatments

The clarification addresses the treatment of income tax when there is uncertainty over tax interpretations, which affects the application of IAS 12. The clarification does not apply to taxes or fees that are not within the scope of IAS 12, nor does it contain specific requirements for interest and penalties related to uncertain tax interpretations.

The entity should decide whether to consider each uncertain tax interpretation separately or together with one or several other uncertain tax interpretations. It is necessary to use an approach that will allow predicting results of resolving uncertainty more accurately. The clarification also covers assumptions made to review interpretations of tax authorities and changes in facts and circumstances.

The clarification become effective for annual reporting periods beginning on or after 1 January 2019. The Bank is not subject to taxation, therefore application of these amendments has no effect on the Group's financial position and performance.

(Thousands of euros)

3. Summary of accounting policies (continued)

Standards issued but not yet effective (continued)

Annual improvements 2015-2017 cycle (issued in December 2017)

These improvements are applied for annual reporting periods beginning on or after 1 January 2019 and include:

IFRS 3 Business Combinations and IFRS 11 Joint Arrangements − previously held interest in a joint operation

- These amendments clarify whether the previously held interest in a joint operation (that is a business as defined in IFRS 3) should be remeasured to fair value, when:A party to a joint operation obtains control over the joint operation (IFRS 3);
- A party that participates in (but does not have joint control over a joint operation) obtains joint control over the joint operation (IFRS 11).

The Group does not expect any effect on its consolidated financial statements.

IAS 12 Income Taxes − income tax consequences of payments on financial instruments classified as equity

These amendments clarify that an entity must recognise all income tax consequences of dividends in profit or loss, other comprehensive income or equity, depending on where the entity recognised the originating transaction or event that generated the distributable profits giving rise to the dividend. Earlier application is permitted and must be disclosed. The amendments must first be applied to income tax consequences of dividends recognised on or after the beginning of the earliest comparative period. Since the Group's current practice is in line with the amendments, the Group does not expect any effect on its consolidated financial statements.

IAS 23 Borrowing Costs − borrowing costs eligible for capitalization

These amendments clarify that, when a qualifying asset is ready for its intended use or sale, and some of the specific borrowing related to that qualifying asset remains outstanding at that point, that borrowing is to be included in the funds that an entity borrows generally. Earlier application is permitted and should be disclosed. The Group does not expect any effect on its consolidated financial statements.

4. Significant accounting judgments and estimates

Assumptions and estimation uncertainty

In the process of applying the Group's accounting policies, management has made its professional judgments, used several assumptions and estimates on determining the amounts of assets and liabilities recognized in the consolidated financial statements, which have the most significant effect on the amounts recognized in the consolidated financial statements and the carrying amount of assets and liabilities in the following financial year. Estimates and assumptions are continuously assessed and are based on the management experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. The most significant uses of judgments and estimates are as follows:

Allowance for impairment of loans and other financial assets carried at amortized cost

Financial assets are recorded in the Group's consolidated statement of financial position less allowances for impairment. The Group regularly reviews its financial assets to assess impairment. When assessing impairment losses, the Group uses its professional judgment in relation to objective evidences that future contractual cash flows on financial asset shall decrease. These evidences may include information on financial difficulties of the borrower or other observable data on adverse changes in the payment status of borrowers, or national or local economic conditions that correlate with defaults on assets. The Group uses its professional judgment to adjust observable data for financial assets to reflect current circumstances. Impairment loss may be reversed only if a subsequent increase of estimated contractual cash flows can be objectively related to an event occurring after the impairment loss was recognized.

(Thousands of euros)

4. Significant accounting judgments and estimates (continued)

Assumptions and estimation uncertainty (continued)

Fair value of financial instruments

Where the fair values of financial assets and financial liabilities recorded in the consolidated statement of financial position cannot be derived from active markets, they are determined using a variety of valuation techniques that include the use of mathematical models. The input to these models is taken from observable markets where possible, but where this is not feasible, a degree of judgment is required in establishing fair values. Additional details are provided in Note 24.

Impairment of available-for-sale equity securities

The Group determines that available-for-sale equity investment securities are impaired when there has been a significant or prolonged decline in the fair value below their cost. The determination of what is significant or prolonged requires judgment. In making this judgment, the Group evaluates, among other factors, the volatility of share prices. In addition, impairment may take place when there is evidence of a deterioration in the financial health of the investee, industry and sector performance, changes in technology, and operating or financing cash flows.

Fair value of the buildings classified to "property and equipment" and "investment property"

As disclosed in Note 3, the Group applies the fair value model with regard to investment property. Buildings included in fixed assets are stated at revalued amount.

As for buildings within property and equipment, the Group monitors the compliance of the present value of buildings with their fair value and performs revaluation to ensure that there are no significant differences. Changes in the fair value are recognized in other comprehensive income. The most recent revaluation of the Group's building were carried out as at 31 October 2017 by an independent companies of professional appraisers applying an appropriate valuation methodology and information on transactions with similar real estate objects on the local market. However, valuation results based on the above valuation technique may differ from the prices of actual transactions in the real estate market.

Management believes that during the period from the valuation date to the date of consolidated financial statements there were no significant changes in economy and technical parameters of the building that could affect its revalued cost. Starting from 31 October 2017, the revalued building is depreciated in accordance with the remaining useful life.

As for investment property, the Group monitors changes in its fair value at each reporting date to ensure that the present value of investment property does not differ materially from its fair value. Changes in the fair value of investment property are recognized in the consolidated income statement. The most recent revaluation of the Group's investment properties were carried out as at 31 October 2017 by an independent company of professional appraisers applying an appropriate valuation methodology and information on transactions with similar real estate objects on the local market. However, valuation results based on the above valuation technique may differ from the prices of actual transactions in the real estate market. Management believes that during the period from the valuation date to the date of consolidated financial statements there were no significant changes in economy and technical parameters of the investment properties that could affect its revalued cost.

In particular, information on significant areas of estimation uncertainty and critical judgments in applying accounting policies is presented in the following notes:

- Note 7 − Derivative financial instruments;
- Note 8 − Available-for-sale investment securities;
- Note 9 − Loans to banks;
- Note 10 − Loans to customers;
- Note 11 − Investment property;
- Note 12 − Property, equipment and intangible assets;
- Note 18 − Commitments and contingencies.

(Thousands of euros)

4. Significant accounting judgments and estimates (continued)

Reclassification of comparative information

The Group changed the presentation of line items in the consolidated income statement for the year ended 31 December 2016. The following adjustments were made to the data for 2016 to conform to the presentation of data for 2017:

	In accordance with the previously issued report	*Reclassification amount*	*After reclassification*
Article of the consolidated income statement			
Net gains from revaluation of derivative financial instruments	32,330	(32,330)	–
Net losses from fair value hedge operations	(246)	246	–
Net gains from dealing in foreign currencies and operations with derivatives	9,068	(9,068)	–
Net losses from revaluation of assets and liabilities in foreign currencies	(31,173)	31,173	–
Net gains from operations in foreign currencies and with derivatives	–	9,979	9,979

5. Cash and cash equivalents

Cash and cash equivalents comprise:

	2017	*2016*
Cash on hand	**85**	**104**
Nostro accounts with banks and other financial institutions		
Credit rating from A- to A+	49,120	62,548
Credit rating from BBB- to BBB+	4,167	4,526
Credit rating from BB- to BB+	274	551
Total nostro accounts with banks and other financial institutions	**53,561**	**67,625**
Short-term deposits with banks		
Term deposits with banks		
Credit rating BBB-	68	–
Credit rating from BB- to BB+	12,383	25,302
Total short-term deposits with banks	**12,451**	**25,302**
Cash and cash equivalents	**66,097**	**93,031**

Cash and cash equivalents are neither impaired, nor past due.

6. Deposits with banks and other financial institutions

Deposits with banks and other financial institutions are presented based on contractual terms and include the following items:

	2017	*2016*
Term deposits up to 1 year		
Credit rating from B- to B+	37,157	37,126
Total term deposits up to 1 year	**37,157**	**37,126**
Term deposits over 1 year		
Credit rating from A- to A+	5,650	5,821
Credit rating from BB- to BB+	3,082	2,390
Total term deposits over 1 year	**8,732**	**8,211**
Total deposits with banks and other financial institutions	**45,889**	**45,337**

(Thousands of euros)

6. Deposits with banks and other financial institutions (continued)

Amounts due from the Central Bank of Cuba

	2017	*2016*
Term deposits with the Central Bank of Cuba without credit rating	34,967	34,967
Less: allowance for impairment	(34,967)	(34,967)
Term deposits with the Central Bank of Cuba	**–**	**–**

Concentration of deposits with banks and other financial institutions

As at 31 December 2017, besides deposits with the Central Bank of Cuba, the Group had three counterparties (31 December 2016: three counterparties) accounting for over 10% of the Group's total deposits with banks and other financial institutions. As at 31 December 2017, deposits with these counterparties amounted to EUR 25,724 thousand (31 December 2016: EUR 37,125 thousand).

7. Derivative financial instruments

The Group performs the operations with currency and other derivative financial instruments which are generally traded in an over-the-counter market with professional market counterparties on standardized contractual terms and conditions. Derivative financial instruments have either potentially favorable terms (and are assets) or potentially unfavorable conditions (and are liabilities) as a result of fluctuations in exchange rates or other variable factors associated with these instruments. The fair value of derivative financial instruments can vary significantly depending on the potentially favorable and unfavorable conditions.

The table below shows the fair value of derivative financial instruments as at 31 December 2017 and 31 December 2016 and notional amounts of term contracts for the purchase and sale of foreign currency specifying contractual exchange rates.

	31 December 2017				
	Notional amount		*Weighted average*	*Fair value*	
	Purchase	*Sale*	*exchange rate*	*Assets*	*Liabilities*
Derivative financial assets and liabilities at fair value through profit or loss					
Swaps	EUR 180,000 thousand	USD 209,572 thousand	1.16	5,203	89
	EUR 10,270 thousand	HUF 3,160,000 thousand	307.69	54	–
	RUB 9,997,998 thousand	EUR 158,232 thousand	63.20	–	8,603
	RUB 3,000,000 thousand	USD 52,910 thousand	56.70	638	–
	RON 319,800 thousand	EUR 70,544 thousand	4.53	931	1,212
Forwards	EUR 34,000 thousand	USD 39,527 thousand	1.16	935	–
Total derivative financial assets and liabilities at fair value through profit or loss				**7,761**	**9,904**
Derivative financial assets and liabilities designated as hedging instruments					
Swaps	RON 298,300 thousand	EUR 67,068 thousand	4.45	–	5,169
Total derivative financial assets and liabilities designated as hedging instruments				**–**	**5,169**
Derivative financial instruments				**7,761**	**15,073**

(Thousands of euros)

7. Derivative financial instruments (continued)

	31 December 2016				
	Notional amount		*Weighted average*	*Fair value*	
	Purchase	*Sale*	*exchange rate*	*Assets*	*Liabilities*
Derivative financial assets and liabilities at fair value through profit or loss					
Swaps	RUB 9,136,720 thousand	EUR 132,150 thousand	69.42	14,246	883
	RON 110,300 thousand	EUR 24,971 thousand	4.44	–	632
	EUR 117,000 thousand	USD 128,825 thousand	1.10	116	5,704
	EUR 8,000 thousand	RUB 572,280 thousand	71.54	–	788
Forwards	EUR 34,000 thousand	USD 37,896 thousand	1.11	–	2,080
Total derivative financial assets and liabilities at fair value through profit or loss				**14,362**	**10,087**
Derivative financial assets and liabilities designated as hedging instruments					
Swaps	RON 298,300 thousand	EUR 67,068 thousand	4.45	–	1,536
Total derivative financial assets and liabilities designated as hedging instruments				**–**	**1,536**
Derivative financial instruments				**14,362**	**11,623**

Due to issue off bonds denominated in currencies other than the Group's functional currency (Note 16), the Group concluded cross currency interest rate swaps and currency forwards on an arm's length basis with large international and Russian credit institutions. These swaps are used to manage long-term currency risks of the Group. Payment netting is not applied to the parties' obligations in respect of interest and principal payments.

The Group applies hedge accounting for the fair value of the bond issue in Romanian lei placed on September 27, 2016 (Note 16).

The notional amount, recorded gross, is the amount of a derivative's underlying asset and liability and is the basis upon which changes in the value of derivatives are measured. The notional amounts indicate the volume of transactions outstanding at the end of the reporting period and are not indicative of the credit risk.

As at 31 December 2017 and 31 December 2016, the Group has positions in the following types of derivatives:

Forwards: Forward contracts are contractual agreements to buy or sell a specified financial instrument at a specific price and date in the future. Forwards are customized contracts transacted in the over-the-counter market.

Swaps: Swaps are contractual agreements between two parties to exchange movements in interest and foreign currency rates and equity indices, and (in the case of credit default swaps) to make payments with respect to defined credit events based on specified notional amounts.

Fair value measurement is based on the corresponding forward curves that depend on exchange rates, interest rates and swap contract maturity. For the fair value of swaps, the discount rate was calculated on the basis of zero coupon yield curve and credit risk. Changes in the fair value of swaps were mainly due to the increase in the forward EUR to RUB exchange rates.

(Thousands of euros)

8. Available-for-sale investment securities

Available-for-sale investment securities comprise:

	2017	*2016*
Owned by the Group		
Quoted debt securities		
Government bonds		
Government bonds of member countries		
Credit rating from BBB- to BBB+	–	39,923
Credit rating from BB- to BB+	–	12,755
Government bonds of non-member countries		
Credit rating AAA	4,066	–
Credit rating AA+	5,396	–
Credit rating B-	18,552	–
Government bonds	**28,014**	**52,678**
Corporate bonds		
Credit rating from A- to A+	12,292	21,152
Credit rating from BBB- to BBB+	20,370	21,861
Credit rating from BB- to BB+	62,496	57,579
Credit rating from B- to B+	13,817	17,575
Corporate bonds	**108,975**	**118,167**
Total quoted debt securities	**136,989**	**170,845**
Quoted equity instruments		
Credit rating A-	633	–
Credit rating BBB	1,077	–
No credit rating	5	4
Total quoted equity instruments	**1,715**	**4**
Available-for-sale investment securities	**138,704**	**170,849**
Pledged under repurchase agreements		
Quoted debt securities		
Government bonds of member countries		
Credit rating A+	10,010	10,286
Government bonds of non-member countries		
Credit rating A+	7,867	7,597
Government bonds	**17,877**	**17,883**
Corporate bonds		
Credit rating AAA	19,991	22,486
Credit rating from AA- to AA+	7,466	4,688
Credit rating from A- to A+	18,544	32,521
Credit rating from BBB- to BBB+	5,995	4,994
Credit rating from BB- to BB+	6,850	15,886
Corporate bonds	**58,846**	**80,575**
Total quoted available-for-sale debt securities pledged under repurchase agreements	**76,723**	**98,458**

Government bonds represent EUR-denominated and USD-denominated securities issued and guaranteed by the Ministries of Finance of these countries, maturing in 2020-2027 (31 December 2016: maturing in 2018-2027). The annual coupon rate for these bonds varies from 0.4% to 7.6% (31 December 2016: from 0.4% to 7.9%).

Corporate bonds are represented by the bonds issued by large companies and banks of member countries of the Bank, as well as corporate international companies and development banks that have similar goals and missions with the Group, maturing in 2020-2026 (31 December 2016: maturing in 2018-2031). The annual coupon rate for these bonds varies from 0.4% to 7.9% (31 December 2016: from 0.6% to 10.3%).

Equity securities are represented by shares and depositary receipts issued by major international companies.

(Thousands of euros)

9. Loans to banks

During 2017, the Group continued its lending activities, being guided by the key priorities of the Development Strategy of the IIB. The principal lending activity is to facilitate the development of small and medium-sized businesses in the member countries and participate in financing of socially important infrastructure projects in these countries. The Group considers national development institutes, export and import banks and agencies, international financial organizations and development banks as its key counterparties.

In 2017 and 2016, the Group provided trade financing loans and long-term loans to borrowers operating in the following countries:

	2017	*2016*
Trade financing loans		
Russian Federation	23,298	953
Republic of Belarus	3,239	–
Trade financing loans	**26,537**	**953**
Long-term loans to banks		
Russian Federation	75,401	26,425
Republic of Cuba	49,863	–
Mongolia	33,735	47,970
Socialist Republic of Vietnam	25,252	19,019
Long-term loans to banks	**184,251**	**93,414**
Less: allowance for impairment of loans to banks	(9,153)	–
Total loans to banks	**201,635**	**94,367**

The information on overdue loans as at 31 December 2017 and 31 December 2016 is provided below:

	2017	*2016*
Total loans with overdue principal and/or interest	15,254	–
Less: allowance for impairment of loans to banks	(9,153)	–
Overdue loans to banks	**6,101**	**–**

For the purposes of these consolidated financial statements, a loan to a bank is considered overdue if at least one of the loan-related payments is past due at the reporting date. In this case, the amount of the overdue loan is the total amount due from the borrower, including the accrued interest income.

Allowance for impairment of loans to banks

A reconciliation of the allowance for impairment of loans to banks by country is as follows:

	Russian Federation	*Total*
At 1 January 2017	**–**	**–**
Net charge for the period	9,153	**9,153**
At 31 December 2017	**9,153**	**9,153**
Individual impairment	**9,153**	**9,153**
Gross amount of loans to banks individually determined to be impaired, before deducting any individually assessed impairment allowance	**15,254**	**15,254**

During 2016 and as at 31 December 2016, there were no impaired loans, and no allowance for impairment was accrued.

(Thousands of euros)

9. Loans to banks (continued)

Analysis of collateral for loans to banks

The following table provides an analysis of the portfolio of trade financing loans and long-term loans to banks by type of collateral as at 31 December 2017 and 31 December 2016:

	2017		*2016*	
	Loans to banks	***Share in the total loans, %***	***Loans to banks***	***Share in the total loans, %***
State guarantees	49,863	24.7	–	–
Pledge of real property (mortgage) and title	–	–	7,247	7.7
Uncollateralized part of the loans	151,772	75.3	87,120	92.3
	201,635	**100.0**	**94,367**	**100.0**

The amounts shown in the table above represent the carrying amount of the portfolio of long-term loans to banks and do not necessarily represent the fair value of the collateral.

Concentration of long-term loans to banks

As at 31 December 2017, long-term loans and trade financing loans to two banks (31 December 2016: five banks) with a total amount of loans to each of them exceeding 10% of total loans to banks were recorded on the Group’s balance sheet. As at 31 December 2017, the total amount of such major loans was EUR 70,100 thousand (31 December 2016: EUR 74,787 thousand) and no impairment allowances (31 December 2016: no allowances) were made for them.

10. Loans to customers

The Group issued loans to customers operating in the following countries:

	2017	*2016*
Russian Federation	81,817	61,213
Romania	78,440	40,235
Slovak Republic	60,464	8,411
Republic of Bulgaria	57,995	65,922
Czech Republic	49,967	22,930
Hungary	42,910	–
Republic of Ecuador	34,763	39,570
Republic of Panama	29,775	36,276
Mongolia	24,425	5,683
Kingdom of the Netherlands	5,847	–
USA	1,666	6,108
Gross loans to customers	**468,069**	**286,348**
Less: allowance for impairment of loans to customers	(5,555)	(17,312)
Loans to customers	**462,514**	**269,036**

The information on overdue loans as at 31 December 2017 and 31 December 2016 is provided below:

	2017	*2016*
Total loans with overdue principal and/or interest	15,151	14,769
Less: allowance for impairment of loans to customers	(5,255)	(14,769)
Overdue loans to customers	**9,896**	**–**

For the purposes of these consolidated financial statements, a loan to a customer is considered overdue if at least one of the loan-related payments is past due at the reporting date. In this case, the amount of the overdue loan is the total amount due from the borrower, including the accrued interest income.

(Thousands of euros)

10. Loans to customers (continued)

Allowance for impairment of loans to customers

A reconciliation of the allowance for loan impairment by country is as follows:

	Slovak Republic	*Republic of Bulgaria*	*Romania*	*Total*
At 1 January 2017	**8,103**	**6,955**	**2,254**	**17,312**
Net charge for the period	–	11	3,001	**3,012**
Write off against previously accrued allowance	(8,103)	(6,666)	–	**(14,769)**
At 31 December 2017	**–**	**300**	**5,255**	**5,555**
Individual impairment	**–**	**–**	**5,255**	**5,255**
Gross amount of loans to customers, individually determined to be impaired, before deducting any individually assessed impairment allowance	**–**	**–**	**15,151**	**15,151**

	Slovak Republic	*Republic of Bulgaria*	*Romania*	*Total*
At 1 January 2016	**3,000**	**6,755**	**–**	**9,755**
Net charge for the period	5,103	200	2,254	**7,557**
At 31 December 2016	**8,103**	**6,955**	**2,254**	**17,312**
Individual impairment	**8,103**	**6,666**	**–**	**14,769**
Gross amount of loans to customers, individually determined to be impaired, before deducting any individually assessed impairment allowance	**8,103**	**6,666**	**–**	**14,769**

The following table provides an analysis of the customer loan portfolio, net of allowance for impairment, by types of collateral as at 31 December 2017 and 31 December 2016:

	2017		*2016*	
	Loans net of allowance for impairment	*Share in the total loans, %*	*Loans net of allowance for impairment*	*Share in the total loans, %*
Pledge of real property (mortgage) and title	86,728	18.8	25,811	9.6
State guarantees	74,476	16.1	75,845	28.2
Corporate guarantees	70,599	15.3	22,930	8.5
Pledge of shares	42,504	9.2	21,579	8.0
Pledge of equipment and goods in turnover	15,292	3.3	22,641	8.4
Pledge of rights of claim	6,150	1.3	22,970	8.5
Pledge of vehicles	1,476	0.3	2,756	1.0
Uncollateralized part of the loans	165,289	35.7	74,504	27.8
Total loans to customers	**462,514**	**100.0**	**269,036**	**100.0**

Analysis of collateral for loans to customers

The amounts shown in the table above represent the carrying amount of the customer loan portfolio, and do not necessarily represent the fair value of the collateral.

(Thousands of euros)

10. Loans to customers (continued)

Concentration of loans to customers

As at 31 December 2017, loans to three borrowers (2016: three borrowers) with the total amount of loans to each of the three borrowers exceeding 10% of total loans to customers were recorded on the Group's balance sheet. As at 31 December 2017, these loans comprised EUR 181,256 thousand (31 December 2016: EUR 107,191 thousand) in total and no impairment allowances (31 December 2016: no allowances) were made for them.

Analysis of loans to customers by industry

The Group issued loans to borrowers operating in the following industries:

	2017	*2016*
Leasing	116,910	85,897
Production and transmission of electricity	104,847	39,570
Metal working industry	49,967	22,930
Crude oil refining	30,099	10,002
Food and beverage	25,662	27,504
Communications	22,815	−
Manufacturing of electrical equipment	21,159	20,809
Mining	20,632	−
Real estate	19,722	308
Advisory services	19,543	−
Agriculture	13,408	14,295
Production of pharmaceutical products	11,319	6,645
Transport	11,248	13,752
Trading	738	6,036
Chemical production	−	23,831
Construction	−	14,769
	468,069	**286,348**
Less: allowance for impairment of loans to customers	(5,555)	(17,312)
Loans to customers	**462,514**	**269,036**

11. Investment property

In 2017 and 2016, the following changes occurred in the cost of property under operating lease:

	2017	*2016*
At 1 January	**21,840**	**33,819**
Additions	−	14,324
Inseparable improvements	39	50
Transfers to property and equipment	−	(24,179)
Effect of revaluation	(26)	(2,174)
Carrying amount at 31 December	**21,853**	**21,840**

The Group leases out investment properties under operating lease agreements. In 2017, the Group's income from lease of investment property amounted to EUR 4,034 thousand (2016: EUR 3,442 thousand).

As at 31 December 2017, the fair value of investment properties are determined based on the results of the valuation performed by independent companies of professional appraisers which have acknowledged qualification and relevant professional experience in appraising real property of a similar category and in a similar location.

The fair value is determined by reference to market-based evidence and ability to generate income. For further details on the fair value of investment property, refer to Note 24.

(Thousands of euros)

11. Investment property (continued)

If the investment property was measured using the cost method, the carrying amounts as at 31 December 2017 and 31 December 2016 would be as follows:

	2017	*2016*
Cost	20,141	20,091
Additions	49	50
Accumulated depreciation	(2,611)	(2,370)
Net book value	**17,579**	**17,771**

The Group has neither restrictions on the sale of its investment property nor contractual obligations to purchase, construct or develop investment properties, or to repair, maintain and enhance them.

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(Thousands of euros)

12. Property, equipment and intangible assets

The movements in property, equipment and intangible assets for the years 2017 and 2016 were as follows:

	Buildings	*Equipment*	*Computers and software*	*Office furniture*	*Vehicles*	*Intangible assets*	*Other*	*Capital expenditure*	*Total*
Cost or revalued amount									
At 1 January 2017	**67,644**	**7,500**	**3,361**	**307**	**808**	**2,472**	**183**	**427**	**82,702**
Additions	–	–	–	–	–	–	–	1,749	**1,749**
Transfers	350	364	150	14	–	590	2	(1,470)	**–**
Disposals	–	(283)	(1,588)	(20)	(119)	(11)	(7)	–	**(2,028)**
Recovery of accumulated depreciation and amortization upon revaluation	(1,039)	–	–	–	–	–	–	–	**(1,039)**
Effect of revaluation	803	–	–	–	–	–	–	–	**803**
At 31 December 2017	**67,758**	**7,581**	**1,923**	**301**	**689**	**3,051**	**178**	**706**	**82,187**
Accumulated depreciation and amortization									
At 1 January 2017	**(117)**	**(6,747)**	**(2,730)**	**(236)**	**(580)**	**(343)**	**(105)**	–	**(10,858)**
Charge for the period	(1,108)	(250)	(284)	(21)	(102)	(237)	(6)	–	**(2,008)**
Disposals	–	283	1,587	18	119	14	7	–	**2,028**
Recovery of accumulated depreciation and amortization upon revaluation	1,039	–	–	–	–	–	–	–	**1,039**
At 31 December 2017	**(186)**	**(6,714)**	**(1,427)**	**(239)**	**(563)**	**(566)**	**(104)**	**–**	**(9,799)**
Net book value									
At 31 December 2016	**67,527**	**753**	**631**	**71**	**228**	**2,129**	**78**	**427**	**71,844**
At 31 December 2017	**67,572**	**867**	**496**	**62**	**126**	**2,485**	**74**	**706**	**72,388**

(Thousands of euros)

12. Property, equipment and intangible assets (continued)

	Buildings	*Equipment*	*Computers and software*	*Office furniture*	*Vehicles*	*Intangible assets*	*Other*	*Capital expenditure*	*Total*
Cost or revalued amount									
At 1 January 2016	**62,807**	**7,073**	**3,278**	**296**	**808**	**325**	**176**	**1,591**	**76,354**
Additions	–	–	–	–	–	–	–	1,754	**1,754**
Transfers from investment property	24,179	–	–	–	–	–	–	–	**24,179**
Transfers	223	436	83	22	–	2,147	7	(2,918)	**–**
Disposals	–	(9)	–	(11)	–	–	–	–	**(20)**
Recovery of accumulated depreciation and amortization upon revaluation	(1,057)	–	–	–	–	–	–	–	**(1,057)**
Effect of revaluation	(18,508)	–	–	–	–	–	–	–	**(18,508)**
At 31 December 2016	**67,644**	**7,500**	**3,361**	**307**	**808**	**2,472**	**183**	**427**	**82,702**
Accumulated depreciation and amortization									
At 1 January 2016	**–**	**(6,547)**	**(2,445)**	**(228)**	**(477)**	**(165)**	**(99)**	–	**(9,961)**
Charge for the period	(1,174)	(209)	(285)	(19)	(103)	(178)	(6)	–	**(1,974)**
Disposals	–	9	–	11	–	–	–	–	**20**
Recovery of accumulated depreciation and amortization upon revaluation	1,057	–	–	–	–	–	–	–	**1,057**
At 31 December 2016	**(117)**	**(6,747)**	**(2,730)**	**(236)**	**(580)**	**(343)**	**(105)**	**–**	**(10,858)**
Net book value									
At 31 December 2015	**62,807**	**526**	**833**	**68**	**331**	**160**	**77**	**1,591**	**66,393**
At 31 December 2016	**67,527**	**753**	**631**	**71**	**228**	**2,129**	**78**	**427**	**71,844**

As at 31 December 2017, the cost of fully depreciated property and equipment still used by the Group was EUR 5,217 thousand (31 December 2016: EUR 7,982 thousand).

(Thousands of euros)

12. Property, equipment and intangible assets (continued)

As at 31 December 2017, the fair value of buildings owned by the Group is determined based on the results of the valuation performed by an independent company of professional appraisers which have acknowledged qualification and relevant professional experience in appraising real property of a similar category and in a similar location.

The fair value is determined by reference to market-based evidence and ability to generate income. For further details on the fair value of property and equipment, refer to Note 24.

If the buildings were measured using the cost method, the carrying amounts as at 31 December 2017 and 31 December 2016 would be as follows:

	2017	*2016*
Cost	52,355	52,132
Additions	350	223
Accumulated depreciation and amortization	(21,298)	(20,871)
Net book value	**31,407**	**31,484**

13. Other assets and liabilities

Other assets comprise:

	2017	*2016*
Financial assets		
Settlements on bank transactions	2,007	1,814
Accounts receivable on business operations	73	1,352
Guarantee payments	26	42
Other financial assets	363	136
	2,469	**3,344**
Less: allowance for impairment	(1,741)	(1,924)
Total financial assets	**728**	**1,420**
Non-financial assets		
Advances issued	990	−
Assets held for sale − real estate	89	89
Inventories − real estate	50	55
Other non-financial assets	619	755
Total non-financial assets	**1,748**	**899**
Total other assets	**2,476**	**2,319**

The movements in other impairment allowance are as follows:

	2017	*2016*
Allowance at 1 January	**1,924**	**1,633**
Reversal charge for the year	(29)	(67)
Change in allowance resulting from changes in exchange rates	(154)	358
Allowance at 31 December	**1,741**	**1,924**

(Thousands of euros)

13. Other assets and liabilities (continued)

Other liabilities comprise:

	2017	*2016*
Financial liabilities		
Other accounts payable on bank transactions	1,125	662
Other accounts payable on business operations	1,015	1,182
Other financial liabilities	8	19
Total financial liabilities	**2,148**	**1,863**
Non-financial liabilities		
Settlements with employees	4,070	3,647
Other non-financial liabilities	178	72
Total non-financial liabilities	**4,248**	**3,719**
Total other liabilities	**6,396**	**5,582**

14. Due to banks and other financial institutions

Due to banks and other financial institutions are presented based on contractual terms and include the following items:

	2017	*2016*
Due to banks up to 1 year		
Term deposits of banks and other financial institutions	3,496	52,856
Total due to banks up to 1 year	**3,496**	**52,856**
Due to banks over 1 year		
Repurchase agreements	62,015	66,069
Total due to banks over 1 year	**62,015**	**66,069**
Total due to banks	**65,511**	**118,925**

The Group performs daily monitoring of repurchase agreements and the value of collateral when placing/returning additional collateral, if necessary.

Concentration of deposits from banks and other financial institutions

As at 31 December 2017, the Group has two counterparties (31 December 2016: two counterparties) accounting for over 10% of the Group's total deposits from banks and other financial institutions. As at 31 December 2017, deposits from these counterparties amounted to EUR 62,015 thousand (31 December 2016: EUR 111,418 thousand).

15. Long-term loans of banks

Long-term loans of banks comprise:

	2017	*2016*
Syndicated loans	59,755	59,039
SSD	22,939	–
Loans of banks	12,898	14,310
Total long-term loans of banks	**95,592**	**73,349**

In 2017, the Group issued SSD debentures (Schuldscheindarlehen) in the Western European market in the total amount of EUR 23,000 thousand.

On 3 August 2017, the Group raised bilateral financing in the Hungarian financial market in the amount of HUF 4.0 billion (EUR 13,185 thousand).

(Thousands of euros)

16. Debt securities issued

Debt securities issued comprise:

	Interest rate, % p.a.	*Maturity*	*2017*	*2016*
RUB-denominated bonds	0.01-9.5	2024-2027	267,112	151,516
RON-denominated bonds	3.4-4.1	2018-2020	152,084	90,885
EUR-denominated bonds	1.59-3.5	2019-2020	90,017	30,127
Total bonds			**509,213**	**272,528**

On 27 April 2017, the Group made a secondary placement of RUB-denominated bonds, series 02, in the amount of RUB 2,998.0 million (EUR 48,615 thousand) that had been repurchased in 2016 under the offer. A new coupon rate of 9.5% p.a. was set, with an offer planned for April 2019.

The Group redeemed RUB-denominated bonds, series 03, worth a total of RUB 3.99 billion (EUR 62,858 thousand) on 2 June 2017, as scheduled under the offer. A new coupon rate of 0.01% was set for the remaining bonds of this issue.

On 14 June 2017, the Group placed an issue of exchange-traded bonds at the Moscow Exchange under the Program to issue exchange-traded bonds registered in 2016. The issue totaled RUB 10 billion (EUR 156,579 thousand) and provides for an offer in March 2020. The coupon rate on the bonds was set at 8.75% payable on a quarterly basis with the first coupon payment to be made on 11 September 2017.

The Group placed a third issue of bonds in the Romanian stock market on 25 September 2017. The issue comprises two tranches of EUR 60 million and RON 300 million (EUR 65,199 thousand) maturing in three years. EUR-denominated bonds and RON-denominated bonds bear interest rates of 1.593% p.a. and 3m Robor + 1.50%, respectively.

The Group partially redeemed RUB-denominated bonds, series 01, worth a total of RUB 489,432 thousand (EUR 7,259 thousand) on 27 October 2017, as scheduled under the offer. A new coupon rate of 0.01% was set for the remaining bonds of this issue.

The Group redeemed and made a secondary placement of bonds, series 04, worth RUB 1.2 billion (EUR 18,271 thousand) on 21 November 2017, as scheduled under the offer. A new coupon rate of 8.15% was set.

On 27 September 2016, the Group issued bonds denominated in Romanian lei in the amount of RON 300.0 million (EUR 67,398 thousand) maturing in three years. The coupon rate on the bonds was set at 3.4% payable annually with the first coupon payment to be made on 27 September 2017.

On 31 October 2016, the Group offered to repurchase RUB-denominated bonds, series 02, and repurchased almost the total amount of those bonds (RUB 2,998.0 million, or EUR 43,327 thousand) from investors. A new coupon rate of 0.1% p.a. was set for the remaining bonds.

At the dates of placement of the RUB-denominated bonds, the Group entered into cross-currency interest rate swaps for the purpose of managing currency risks (Note 7) and exchanging interest expense from debt securities issued, denominated in RUB, RON, to the currency required by the Group (EUR, USD) to Finance credit projects in the required currency. The Group applies hedge accounting for the fair value of the bond issue in Romanian lei placed on 27 September 2016 (Note 16). The effects of using cross-currency interest rate swaps and fair value hedge operations are disclosed in Note 21.

Among other things, the Group used the proceeds from issuance of debt instruments and placement of bonds to expand its loan portfolio.

(Thousands of euros)

17. Equity

Subscribed and paid-in capital

The Bank's subscribed capital amounts to EUR 1,300,000 thousand, which represents the Bank's equity stated in the Agreement on the Establishment of the International Investment Bank. The Bank's member countries make contributions to the Bank's equity pursuant to their shares stipulated in the Agreement.

As at 31 December 2017, the unpaid portion of the Bank's subscribed capital in the amount of EUR 985,038 thousand (31 December 2016: EUR 986,947 thousand) is the amount of contributions that have not been made yet by the Bank's member countries and the amount of unallocated equity contributions totaling EUR 175,500 thousand (31 December 2016: EUR 175,500 thousand).

The Government of Mongolia made an additional contribution of EUR 1,909 thousand to the Bank's equity on 27 December 2017.

On 9 March 2016, in accordance with the Memorandum of Understanding singed at the 102nd meeting of the IIB's Council (20-21 November 2014), the Government of Hungary contributed EUR 10,000 thousand to the Bank's equity.

As a result, the paid-in capital of the International Investment Bank totaled EUR 314,962 thousand (31 December 2016: EUR 313,053 thousand).

Revaluation reserve for available-for-sale investment securities and revaluation reserve for property and equipment

The movements in the revaluation reserve for available-for-sale investment securities and revaluation reserve for property and equipment were as follows:

	Revaluation reserve for available-for-sale investment securities	*Revaluation reserve for property and equipment*
At 1 January 2016	**(1,664)**	**31,453**
Net unrealized gains on available-for-sale investment securities	10,673	−
Realized gains on available-for-sale investment securities reclassified to the income statement	(10,515)	−
Revaluation of buildings	−	(18,508)
At 31 December 2016	**(1,506)**	**12,945**
Net unrealized gains on available-for-sale investment securities	9,145	−
Realized gains on available-for-sale investment securities reclassified to the income statement	(7,399)	−
Revaluation of buildings	−	803
At 31 December 2017	**240**	**13,748**

Revaluation reserve for available-for-sale investment securities

The revaluation reserve for available-for-sale investment securities records fair value changes of available-for-sale investments.

Revaluation reserve for property and equipment

The revaluation reserve for property and equipment is used to record increases in the fair value of buildings and decreases to the extent that such decrease relates to an increase on the same asset previously recognized in equity.

(Thousands of euros)

18. Commitments and contingencies

Legal

In the ordinary course of business, the Group is subject to legal actions and complaints. Management believes that the ultimate liability, if any, arising from such actions or complaints will not have a material adverse effect on the financial position or the results of future operations of the Group. In accordance with the Agreement on the Establishment of the Bank, its assets (irrespective of their location) enjoy immunities from any administrative and legal claims.

The Group takes all necessary legal and other actions to collect the bad debt and to realize respective repossession rights. When the estimated amount of costs resulting from the Group's further actions to collect bad debt and/or realize respective repossession rights is higher than the amount collected and also when the Group holds necessary and sufficient documents and/or regulations issued by the governmental authorities, it decides to write off such bad debt against the respective provision.

Insurance

The Group obtained insurance coverage for a group of buildings, equipment and car park as well as liability insurance against damages caused by operating assets of a hazardous nature. However, the Group did not obtain insurance coverage related to temporarily discontinued operations or the Group's obligations to third parties.

Taxation

The IIB is an international institution operating on the basis of the Intergovernmental Agreement on the Establishment of the International Investment Bank (the "Agreement") and the Statute that constitutes an integral part of the Agreement. Pursuant to the Agreement, the Bank is exempt from any national or local direct taxes or duties effective in the territories of its member states. For taxation purposes, its subsidiaries are subject to the provisions of the effective Russian tax, currency and customs legislation.

Credit-related commitments

At any time, the Group may have outstanding commitments to extend loans. These commitments take the form of approved loan agreements.

As at 31 December 2017, credit-related commitments of the Group comprised off-balance credit-related commitments, in particular undrawn loan facilities, guarantees and reimbursement obligations.

The primary purpose of credit-related commitments is to ensure that funds are available to customers as required. Guarantees issued, which represent irrevocable assurances that the Group will make payments in the event that a customer cannot meet its obligations to third parties, carry the same credit risk as loans. Reimbursement obligations, which are irrevocable reimbursement obligations of the Group issued on behalf of banks issuing documentary letters of credit that are accepted and paid by foreign partner banks up to a stipulated amount under specific terms and conditions, are collateralized by the underlying shipments of goods to which they relate and therefore carry less risk than a direct borrowing. Undrawn loan facilities represent unused portions of funds to be issued as loans.

Off-balance credit-related commitments are presented in the table below as at 31 December 2017 and 31 December 2016.

	2017	***2016***
Undrawn loan facilities	116,161	33,103
Reimbursement obligations	32,812	9,898
Guarantees issued	15,425	4,934
Total credit-related commitments	**164,398**	**47,935**

19. Leases

Group as lessor

The Group provides its investment property for operating leases. As at 31 December 2017, the Group's non-cancelable operating lease rentals amount to EUR 6,819 thousand (31 December 2016: EUR 4,752 thousand) and will be settled within 1-5 years.

(Thousands of euros)

20. Interest income and interest expenses

Net interest income comprises:

	2017	*2016*
Loans to customers	19,754	13,886
Loans to banks	6,908	6,462
Available-for-sale investment securities	6,006	5,091
Deposits with banks and other financial institutions, including cash and cash equivalents	3,252	4,041
Held-to-maturity investment securities	–	2,975
Other	43	–
Interest income	**35,963**	**32,455**
Debt securities issued	(27,851)	(22,511)
Long-term loans of banks	(2,377)	(1,798)
Funds raised under repurchase agreements	(1,940)	(1,839)
Current customer accounts	(237)	(305)
Due to banks and other financial institutions	(161)	(1,198)
Interest expenses	**(32,566)**	**(27,651)**
Net interest income	**3,397**	**4,804**

In 2017, interest income accrued on impaired loans issued amounted to EUR 122 thousand (2016: EUR 185 thousand).

21. Net gains from operations in foreign currencies and with derivatives

Gains less losses from operations in foreign currencies and with derivatives comprised:

	2017	*2016*
Derivative financial instruments and operations with foreign currencies		
Net gains from dealing in foreign currencies and operations with derivatives	29,915	9,068
Net (losses)/gains from revaluation of derivative financial instruments	(6,419)	32,330
Total derivative financial instruments and operations with foreign currencies	**23,496**	**41,398**
Fair value hedge operations		
Net gains from fair value hedge operations	1,016	–
Net losses from revaluation of fair value hedge operations	(3,633)	(1,536)
Net gains from revaluation of the hedged object	2,553	1,290
Total fair value hedge operations	**(64)**	**(246)**
Translation differences		
Net losses from revaluation of assets and liabilities in foreign currencies	(7,483)	(31,173)
Net gains from operations in foreign currencies and with derivatives	**15,949**	**9,979**

(Thousands of euros)

22. General and administrative expenses

General and administrative expenses comprise:

	2017	*2016*
Employee compensations and employment taxes	13,105	13,001
Depreciation of property, equipment and intangible assets (Note 12)	2,008	1,974
IT-expenses, inventory and occupancy expenses	1,842	1,715
Expenses related to business travel, representative and accommodation expenses	805	682
Professional services	559	1,019
Other	553	548
General and administrative expenses	**18,872**	**18,939**

23. Risk management

Risk management framework

The Group's risk management policy is based on the conservative assessment approach and is mainly aimed at mitigation of adverse impact of risks on the Group's results, i.e. on the safety and reliability of fund allocation while maintaining the reasonable level of profitability. The conservative assessment approach assumes that the Group does not enter into potential transactions with high or undeterminable risk level, regardless of profitability.

The Group's risk management activities are intended to:

- Identify, analyze and manage risks faced by the Group.
- Establish ratios and limits that restrict level of the appropriate types of risks.
- Monitor the level of the risk and its compliance with established limits.
- Develop and implement regulative and methodological documents as well as software applications that ensure professional risk management for the bank transactions.

Risk management policies and procedures are reviewed regularly to reflect changing situation on the financial markets.

Risk management system

Integrated into the whole vertical organizational structure of the Group and all areas of the Group's activities, the risk management system makes it possible to identify in a timely manner and effectively manage different types of risks.

Risk management involves all of the Group's divisions in the evaluating, assuming, and controlling risks ("Three lines of defense"):

- Risk-taking (1st line of defense): the Group's divisions directly preparing and conducting transactions, are involved in the identification, assessment, and monitoring of risks and comply with internal regulations on risk management, as well as give due consideration to the risk level in the preparation of transactions.
- Risk management (2nd line of defense): the division responsible for risk management develops risk management tools and methodology, assesses and monitors the risk level, prepares reports on risks, carries out risk aggregation, and calculates the amount of total capital requirements.
- Internal audit (3rd line of defense): independent quality assessment for existing risk management processes, identification of violations, and proposals for the improvement of the risk management system.

The Group's operations are managed taking into account the level of the risk appetite approved by the Council and its integration into a system of limits and restrictions insuring the acceptable level of risk for aggregated positions, transparent distribution of total risk limit among the activities of the Group.

The Bank's Council, the Board, the Finance Committee, the Credit Committee and the Risk Management Department are responsible for managing the Group's risks.

(Thousands of euros)

23. Risk management (continued)

Risk management system (continued)

The Bank's Council is responsible for the general control over the risk management system, determines its development strategy and sets strategic limits and risk appetite.

The Board is the executive body of the Bank, which is responsible for compliance with risk management policies and procedures and exercises control over ratios, limits and risk appetite set by the Council. The Board ensures co-operation among all divisions and committees of the Bank.

The Finance Committee determines approaches to forming the optimal structure of the balance sheet, taking into account information of current and expected level of risks associated with assets and liabilities management within the established limits and other restrictions. It also ensures management and control over the credit risk, market risk, operational risk, reputational risk, legal risk and liquidity risk and reviews the limit-setting offers.

The Credit Committee manages the Group's loan portfolio in accordance with its effective lending policy, aligns operation of the Bank's divisions in terms of the credit risk management and reviews the offers for setting credit risk limits in respect of the certain counterparties.

Committees meet on a regular basis and provide to the Board their recommendations on how to perform transactions and improve risk management policies and procedures.

The Risk Management Department collects and analyzes information related to all types of bank risks, develops and implements risk management methodology, performs their qualitative and quantitative assessment, prepares recommendations for the Board and committees of the Bank to mitigate risk impact on the Group's performance.

During 2017, further development of the risk management system started in 2013 was aimed at implementation of Basel standards and best practices of development banks within the Group.

In compliance with the existing procedures, twice a year the Group sets and reviews limits for counterparties for the purpose of performing financial transactions and assessing their creditworthiness. As part of the lending activity analysis, the Group continuously monitored the level of its loan assets risk. During the reporting period, the Group sent its specialists to certain borrowers in order to monitor the implementation of the projects and identify potential primary evidence of impairment of loan assets.

To control and monitor the compliance with limits, the Group performs daily monitoring of compliance with restrictions set in the list of the Bank's limits applied to transactions on money, currency and equity markets, as well as structural limits and stop-loss limits. In addition, the Group's management receives regular reports on the status of risks within the Group.

Risk appetite

The risk appetite is the aggregate amount of risk taken by the Group to achieve its strategic goals and objectives. By approving the level of risk appetite, the Bank's Council determines the willingness to accept a risk or the amount of equity and liquidity that the Bank is willing to risk in the implementation of this strategy.

Risk appetite consists of 4 main components:

- ► The allocation of capital and liquidity (if necessary).
- ► Target allocation of capital across the main types of risk.
- ► The level of risk and target risk appetite in the context of the main performance indicators of the Group and risks significant for the Group.
- ► Determining levels of tolerance.

The procedure for determining the Group's risk appetite shall be defined by the Risk Management Department and submitted for review by the Board and approval by the Council of the Bank.

The risk appetite shall be approved by the Council of the Bank on an annual basis for the next year and shall be a major factor of the Group's strategic limits determining the thresholds for the Group's key performance indicators and the Group's significant risks.

(Thousands of euros)

23. Risk management (continued)

Risk management system (continued)

In determining the risk appetite, the Group assesses whether the specified risk appetite is acceptable in the current time period and whether it will be acceptable in the future, taking into account:

- Expectations of the founders concerning the level of profitability.
- International regulatory standards.
- Current and expected future volume of transactions.
- Current and expected future structure of significant risks.
- Current and expected future level of aggregate capital.

Based on the risk appetite determined by the Council, the Board annually approves the Group's limits, sublimits, and risk indicators, which should not exceed the target values of the risk appetite.

Risk identification

The Group identifies and manages both external and internal risk factors throughout its organizational structure. As a result of regular analysis of the Group's exposure to different types of risks performed by the Risk Management Department, the Group identifies factors leading to the increase of the risk level and determines the level of assurance over the current risk mitigation procedures. Apart from the standard credit and market risk analysis, the Risk Management Department monitors financial and non-financial risks influencing the results of banking transactions. Current risks exposures and their projected changes are discussed during the meetings of the Finance Committee and, if necessary, also communicated to the Board along with the recommendations on possible risk mitigation measures.

Risk assessment, management and control

The Group's risk exposure is primarily reduced by means of collective decision-making. Strict allocation of responsibilities between divisions and officers of the Group, precise description of instructions and procedures and assignment of competencies and powers to departments and their heads are also important risk mitigation factors. Appropriate methodologies are used to assess the risks. Instructions, procedures and methodologies are regularly reviewed and, if necessary, updated by the Group in order to reflect changed market conditions and improve the risk management methodology.

The risk monitoring system comprises:

- Establishing limits to assume risks based on the respective risk assessment.
- Exercising control over the Group's exposure by means of compliance with the established limits, regular assessment of the Group's risk exposure, and internal audit of risk management systems.

The Group identifies the following major risks inherent in its various activities:

- Credit risk;
- Liquidity risk;
- Market risk;
- Operational risk.

Credit risk

Credit risk is the risk that the Group will incur a loss because its counterparty fails to discharge its contractual financial obligations to the Group, or discharged them in an untimely fashion or not in full. Credit risk arises principally from loans and advances to customers and banks and other on and off-balance sheet credit exposures. For risk reporting purposes, the Group considers and consolidates all elements of potential credit risk exposures such as consolidated borrower or counterparty default risk.

(Thousands of euros)

23. Risk management (continued)

Credit risk (continued)

System of credit risk management

The Group's regulatory documents establish the following:

- Procedures to review and approve loan/credit applications.
- Methodology for the credit assessment of borrowers, counterparties, issuers and insurance companies.
- Requirements to the credit documentation.
- Procedures for the ongoing monitoring of loans and other credit exposures.

Pursuant to the established procedure, the Credit Committee establishes the limits per borrower/group of related borrowers. The Credit Committee structures the transaction to minimize credit risk. The Loan Operations Analysis Department, together with the Risk Management Department, is responsible for ongoing control over the quality of the Group's loan portfolio.

Upon preparation of a transaction by the initiating unit it is reviewed by the Credit Committee, and then it is approved by the Board. The Board is responsible for all direct credit risk exposures in the amount of up to 15% of the Group's share capital and for the period of up to 7 years. Direct credit risks exposures exceeding the specified amount or the period of 7 years should be approved by the Bank's Council.

The corporate loan/credit application and appropriate project documents are reviewed by the Customer Relations Department. Based on the background information on the deal, the Customer Relations Department takes a decision whether to continue work with the client or not. In case of a positive decision, the Loan Operations Analysis Department makes full examination of the deal and sends the full set of required documents for reviewing the loan/credit application to the Legal Department, Risk Management Department, Security Department, Strategic Development and Analysis Department, Internal Control Department, Compliance Control Department, Operational Department, Financial Department, and Structured and Debt Financing Department. These departments prepare expert opinions in the framework of their competence. The loan/credit application is subject to review by the Credit Committee based on the Loan Operations Analysis Department's materials and expert opinions received from the departments. The procedure of making lending decisions comprises the following steps: Step 1 includes reviewing the application and making a decision by the Credit Committee (if such issue falls within its competence); Step 2 includes making a decision by the Board of the Group (if such issue falls within its competence); Step 3 includes sending a set of respective documents approved by the Board of the Bank to the member country in order to obtain the final approval from the country of origin of the borrower or making a decision by the Council of the Bank (if such issue falls within its competence).

Apart from individual customer analysis, the Risk Management Department assesses the whole loan portfolio with regard to credit concentration by industry.

To mitigate credit risk, the Group limits concentrations of exposure by individual customers, counterparties and issuers, groups of related customers, counterparties and issuers as well as by industry and credit rating (for securities). Credit risk management process is based on regular analysis of the creditworthiness of the borrowers and their ability to repay interest and principal, and on correspondent limits modification (if necessary).

The Group continuously monitors the quality of individual credit exposures and regularly reassesses the creditworthiness of its customers. The revaluation is based on the customer's most recent financial statements, past-due status, performance of its business plan and other information submitted by the borrower, or otherwise obtained by the Group. Based on this information, the borrower's internal credit rating (class of the loan) may be revised and, accordingly, the appropriate loan impairment provision may be created or changed.

(Thousands of euros)

23. Risk management (continued)

Credit risk (continued)

Collateral and other credit enhancements

Credit risk is also managed by obtaining pledge of real estate, assets and securities, and other collateral, including corporate and personal guarantees, as well as monitoring availability and value of collateral.

As availability of collateral is important to mitigate credit risk, this factor is a priority for the Group when reviewing loan/credit applications if their terms and conditions are similar. To ensure recovery of its resources associated with conducting lending and project-financing transactions, the Group applies the following types of collateral for recovery of loans and fulfillment of obligations:

- Pledge of equipment and goods in turnover;
- Pledge of real estate (mortgage) and title;
- Pledge of construction investment agreements.

Quality of the collateral provided is assessed by the following criteria: safety, adequacy and liquidity. Collateral is not generally held over interbank loans and deposits, except where securities are held as collateral in reverse repurchase agreements.

The Group assumes that the fair value of the collateral is its value estimate recognized by the Group to calculate the discounted impairment allowance based on its liquidity and possibility of selling such property in the event of borrower's default considering the time needed for such sale, litigation and other costs. Current market value of the collateral, if necessary, is assessed by accredited appraisers or based on the Group's internal expert estimate, or carrying amount of the collateral including adjustment coefficient (discount). Where the market value of the collateral is assessed as impaired, the borrowers are usually required to provide additional collateral.

Portfolio of loans to banks and customers (less allowance for impairment) by type of collateral is analyzed in Notes 9 and 10.

Maximum exposure to credit risk

The maximum exposure to credit risk for the components of the consolidated statement of financial position, including derivatives, before the effect of mitigation through the use of master netting and collateral agreements, is best represented by their carrying amounts.

Where the financial instruments are recorded at fair value, their carrying amounts represent the current credit risk exposure but not the maximum credit risk exposure that could arise in the future as a result of changes in values.

Analysis of credit risk concentration by customers' industry is presented in Note 10.

Maximum credit risk exposure by credit-related commitments represents the whole amount of these commitments (Note 18).

Derivative financial instruments

Credit risk arising from derivative financial instruments is, at any time, limited to those with positive fair values, as recorded in the consolidated statement of financial position.

Credit quality per class of financial assets

The assessment of credit quality of assets is based on the qualitative and quantitative assessment of credit risk.

Deposit contracts with banks and other financial institutions are concluded with counterparties with acceptable credit ratings assigned by such internationally recognized rating agencies as Standard & Poor's, Fitch and Moody's.

(Thousands of euros)

23. Risk management (continued)

Credit risk (continued)

Assessment of credit quality of loans is based on a 5-grade system of risk factor categories: standard, sub-standard, doubtful, impaired and uncollectible. The risk factor category is assigned on the basis of the assessment of the customer's financial position, payment discipline, credit history, compliance with business plan and production discipline, additional characteristics such as management quality, compliance with other terms and conditions of the loan agreement, strength of positions in the market, competitive potential, administrative resources, industry specifics and country rating.

The following table provides information on the credit quality of long-term loans to banks and trade financing loans (Note 9) and loans to customers (Note 10) as at 31 December 2017 and 31 December 2016:

2017	*Loan amount*	*Allowance for impairment*	*Loan amount, including allowance for impairment*	*Impairment to loan amount ratio, %*
Trade financing loans without any signs of impairment identified				
Standard loans				
- *Russian Federation*	23,298	–	23,298	–
- *Republic of Belarus*	3,239	–	3,239	
Long-term loans to banks without any signs of impairment identified				
Standard loans				
- *Russian Federation*	60,147	–	60,147	–
- *Republic of Cuba*	49,863	–	49,863	–
- *Mongolia*	33,735	–	33,735	–
- *Socialist Republic of Vietnam*	25,252	–	25,252	–
Impaired loans				
- *Russian Federation*	15,254	(9,153)	6,101	60
	210,788	**(9,153)**	**201,635**	**4.3**
Loans to customers without any signs of impairment identified				
Standard loans				
- *Russian Federation*	81,817	–	81,817	–
- *Romania*	63,289	–	63,289	–
- *Slovak Republic*	60,464	–	60,464	–
- *Republic of Bulgaria*	51,987	–	51,987	–
- *Czech Republic*	49,967	–	49,967	–
- *Hungary*	42,910	–	42,910	–
- *Republic of Ecuador*	34,763	–	34,763	–
- *Republic of Panama*	29,775	–	29,775	–
- *Mongolia*	24,425	–	24,425	–
- *Kingdom of the Netherlands*	5,847	–	5,847	–
- *USA*	1,666	–	1,666	–
Restructured loans				
- *Republic of Bulgaria*	6,008	(300)	5,708	5.0
Impaired loans				
- *Romania*	15,151	(5,255)	9,896	34.7
	468,069	**(5,555)**	**462,514**	**1.2**
Total loans	**678,857**	**(14,708)**	**664,149**	**2.2**

(Thousands of euros)

23. Risk management (continued)

Credit risk (continued)

2016	*Loan amount*	*Allowance for impairment*	*Loan amount, including allowance for impairment*	*Impairment to loan amount ratio, %*
Trade financing loans without any signs of impairment identified				
Standard loans				
- *Russian Federation*	953	–	953	–
Long-term loans to banks without any signs of impairment identified				
Standard loans				
- *Mongolia*	47,970	–	47,970	–
- *Russian Federation*	26,425	–	26,425	–
- *Socialist Republic of Vietnam*	19,019	–	19,019	–
	94,367	**–**	**94,367**	**–**
Loans to customers without any signs of impairment identified				
Standard loans				
- *Russian Federation*	61,213	–	61,213	–
- *Republic of Bulgaria*	53,477	–	53,477	–
- *Republic of Ecuador*	39,570	–	39,570	–
- *Republic of Panama*	36,276	–	36,276	–
- *Romania*	25,205	–	25,205	–
- *Czech Republic*	22,930	–	22,930	–
- *USA*	6,108	–	6,108	–
- *Mongolia*	5,683	–	5,683	–
- *Slovak Republic*	308	–	308	–
Watch loans to customers				
- *Romania*	15,030	(2,254)	12,776	15.0
Restructured loans				
- *Republic of Bulgaria*	5,779	(289)	5,490	5.0
Impaired loans				
- *Slovak Republic*	8,103	(8,103)	–	100
- *Republic of Bulgaria*	6,666	(6,666)	–	100
	286,348	**(17,312)**	**269,036**	**6.0**
Total loans	**380,715**	**(17,312)**	**363,403**	**4.5**

Where possible, the Group seeks to restructure loans rather than to take possession of collateral. This may involve extending the payment arrangements and the agreement of new loan conditions. Once the terms have been renegotiated, the loan is no longer considered past due. Renegotiated loans are continuously reviewed to ensure that all criteria are met and that future payments are likely to occur. The loans continue to be subject to an individual impairment assessment, calculated using the loan's original effective interest rate.

(Thousands of euros)

23. Risk management (continued)

Credit risk (continued)

Impairment assessment

The Group creates allowance for impairment of loans that represents its estimate of losses incurred in its loan portfolio. The Group writes off a loan balance against related allowances for impairment of loans only subject to the approval of the Council and where the loan is determined as uncollectible and when all necessary steps to collect the loan are completed. Such decision is made after consideration of the information on significant changes in the borrower's financial position such as inability to repay the loan, and when proceedings from disposal of the collateral are insufficient to cover the debt amount in full.

Individually assessed allowances

The Group determines the allowances appropriate for each individually significant loan on an individual basis. Due to a limited number of borrowers, the Group considers each loan as individually significant. Items considered when determining allowance amounts include the sustainability of the counterparty's business plan, its ability to improve performance once a financial difficulty has arisen, projected receipts and the expected dividend payout should bankruptcy ensue, the availability of financial support, the realizable value of collateral, and the timing of the expected cash flows. The impairment losses are evaluated at each reporting date, or more frequently, unless unforeseen circumstances require more careful attention.

The total amount of impairment allowance is approved by the Credit Committee on a monthly basis.

Liquidity risk

Liquidity risk is the risk of loss resulting from the Group's inability to meet its payment obligations in full when they fall due under normal and stress circumstances. Liquidity risk results from improper balance between the Group's financial assets and financial liabilities by period and amount (including due to untimely discharge of its financial obligations by one or several counterparties of the Group) and/or an unforeseen need of immediate and simultaneous discharge of its financial obligations.

Liquidity management is an integral part of general policy for the Group's assets and liabilities management (ALM) and operates within the established limits and restrictions related to management of risks (liquidity, interest rate and currency risk) and the Group's balance sheet items, and in accordance with the documents of strategic, tactical and operating planning.

Procedures for the Group's liquidity position management, ensuring the Group's ability to meet its obligations in full and on a timely basis and efficient resources management, are stipulated in the Regulations for IIB's Liquidity Position Management that enables the development of the liquidity position management function provided for by the IIB's Assets and Liabilities Management Policy, as an integral part of general function of the Group's management.

Decision making matrix related to liquidity management includes a strategic level of liquidity management (the Council), tactical level (the Board and special-purpose committees) and operational level (responsible structural divisions). Asset and Liability Management Department (DUAP or ALM Unit) is responsible for organizing and aligning management of the Group's liquidity position. The Group manages its liquidity position in accordance with planning horizons (up to 6 months) and possible scenarios of movements in liquidity position (stable, stressed).

Main instrument of liquidity position management under the stable scenario is a Plan of Cash Flows defining the cash flow by balance sheet products/instruments and taking into account the plan of future financial operations. The Group determines the balance sheet gaps, payment schedule and need in financing of future operations based on the Plan of Cash Flows. As a result of application of these instruments, DUAP issues appropriate recommendations to responsible structural divisions.

The Group has implemented a liquidity buffer to manage the Group's liquidity under the stressed scenario. Application of the liquidity buffer enables the Group to promptly monitor the sustainability and stability of the Group's balance sheet structure in case of liquidity shortage that is critical to the Group's solvency.

(Thousands of euros)

23. Risk management (continued)

Liquidity risk (continued)

The liquidity buffer is formed primarily due to liquidity reserves, namely securities recognized in the Group's balance sheet and included in the Lombard lists of the European Central Bank and Bank of Russia, and nostro accounts with banks and other financial institutions. The Group calculates its liquidity reserves as at the reporting date and for the next six monthly reporting dates (forecast). Liquidity buffer may be used to close the negative net position. As at 31 December 2017, the liquidity buffer amounts to EUR 83.5 million (31 December 2016: EUR 75.9 million).

Off-balance sheet credit related commitments of the Group are stated in accordance with contractual maturities in the table presented below. In case of absence of contractual schedule of the credit related commitments, these obligations are included into the earliest date, at which the client can demand their execution.

	2017	***2016***
Less than 1 month	25,835	33,213
1 to 3 months	72,744	3,650
3 months to 1 year	41,489	6,138
1 to 5 years	24,330	4,934
Off-balance credit-related commitments	**164,398**	**47,935**

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(Thousands of euros)

23. Risk management (continued)

Liquidity risk (continued)

The following table provides an analysis of assets and liabilities on the basis of the remaining period from the reporting date to the contractual maturity date. Quoted available-for-sale debt securities and equity instruments were included in "Less than 1 month" category as they are highly liquid investment securities, shares and depositary receipts which the Group may sell in the short term on the arm-length basis. Available-for-sale investment securities pledged under repurchase agreements are presented on the basis of periods from the reporting date to the expiry date of respective contractual obligations of the Group.

	2017							*2016*						
	Less than 1 month	*1 to 3 months*	*3 months to 1 year*	*1 to 5 years*	*Over 5 years*	*Past due*	*Total*	*Less than 1 month*	*1 to 3 months*	*3 months to 1 year*	*1 to 5 years*	*Over 5 years*	*Past due*	*Total*
Assets														
Cash and cash equivalents	65,445	652	–	–	–	–	**66,097**	93,031	–	–	–	–	–	**93,031**
Deposits with banks and other financial institutions	5,026	7,097	25,034	8,732	–	–	**45,889**	14,254	–	27,472	3,611	–	–	**45,337**
Derivative financial instruments	935	–	5,072	1,754	–	–	**7,761**	–	116	14,246	–	–	–	**14,362**
Available-for-sale investment securities	138,737	54,783	21,907	–	–	–	**215,427**	170,849	379	502	97,577	–	–	**269,307**
Loans to banks	1,322	53,491	49,786	90,935	–	6,101	**201,635**	–	3,059	16,638	71,051	3,619	–	**94,367**
Loans to customers	8,965	8,719	77,334	147,277	210,323	9,896	**462,514**	2,066	10,139	59,833	133,047	63,951	–	**269,036**
Other financial assets	489	57	19	163	–	–	**728**	166	123	381	750	–	–	**1,420**
Total assets	**220,919**	**124,799**	**179,152**	**248,861**	**210,323**	**15,997**	**1,000,051**	**280,366**	**13,816**	**119,072**	**306,036**	**67,570**	**–**	**786,860**
Liabilities														
Due to banks and other financial institutions	–	(30,982)	(34,059)	(470)	–	–	**(65,511)**	(48,558)	–	–	(70,367)	–	–	**(118,925)**
Current customer accounts	(8,593)	–	–	–	–	–	**(8,593)**	(9,218)	–	–	–	–	–	**(9,218)**
Derivative financial instruments	–	(89)	(1,213)	(13,771)	–	–	**(15,073)**	(2,080)	–	(1,671)	(7,872)	–	–	**(11,623)**
Long-term loans of banks	–	(24)	(59,967)	(18,819)	(16,782)	–	**(95,592)**	–	–	(14,345)	(59,004)	–	–	**(73,349)**
Debt securities issued	–	(3,906)	(26,519)	(478,788)	–	–	**(509,213)**	–	–	(152,484)	(120,044)	–	–	**(272,528)**
Other financial liabilities	(762)	(953)	(396)	(37)	–	–	**(2,148)**	(348)	–	(933)	(582)	–	–	**(1,863)**
Total liabilities	**(9,355)**	**(35,954)**	**(122,154)**	**(511,885)**	**(16,782)**	**–**	**(696,130)**	**(60,204)**	**–**	**(169,433)**	**(257,869)**	**–**	**–**	**(487,506)**
Net position	**211,564**	**88,845**	**56,998**	**(263,024)**	**193,541**	**15,997**	**303,921**	**220,162**	**13,816**	**(50,361)**	**48,167**	**67,570**	**–**	**299,354**
Accumulated net position	**211,564**	**300,409**	**357,407**	**94,383**	**287,924**	**303,921**		**220,162**	**233,978**	**183,617**	**231,784**	**299,354**	**299,354**	

(Thousands of euros)

23. Risk management (continued)

Analysis of financial liabilities by remaining contractual maturities

The table below summarizes the maturity profile of the Group's financial liabilities at 31 December 2017 and 31 December 2016 based on contractual undiscounted repayment obligations except for gross settled derivatives that are shown by contractual maturity. Debt securities with put options (offers) are presented as if investors will exercise their options at the earliest possible date. The Group expects that it will have to make payment on current bond offers.

At 31 December 2017	*Less than 1 month*	*1 to 3 months*	*3 to 12 months*	*1 to 5 years*	*Over 5 years*	*Total*
Financial liabilities						
Due to banks and other financial institutions	−	31,331	34,783	470	−	**66,584**
Current customer accounts	8,593	−	−	−	−	**8,593**
Net settled derivative liabilities	(904)	−	−	−	−	**(904)**
Gross settled derivative financial instruments						
- Contractual amounts payable	−	37,664	155,912	348,158	−	**541,734**
- Contractual amounts receivable	−	(42,735)	(169,034)	(350,742)	−	**(562,511)**
Long-term loans of banks	−	60,496	230	19,498	19,624	**99,848**
Debt securities issued	−	6,935	46,200	523,383	−	**576,518**
Other liabilities	762	953	396	37	−	**2,148**
Total undiscounted financial liabilities	**8,451**	**94,644**	**68,487**	**540,804**	**19,624**	**732,010**

At 31 December 2016	*Less than 1 month*	*1 to 3 months*	*3 to 12 months*	*1 to 5 years*	*Over 5 years*	*Total*
Financial liabilities						
Due to banks and other financial institutions	48,590	−	−	73,120	−	**121,710**
Current customer accounts	9,218	−	−	−	−	**9,218**
Net settled derivative liabilities	2,080	−	−	−	−	**2,080**
Gross settled derivative financial instruments						
- Contractual amounts payable	−	47,000	147,836	166,726	−	**361,562**
- Contractual amounts receivable	−	(47,089)	(173,371)	(173,625)	−	**(394,085)**
Long-term loans of banks	−	−	15,078	60,989	−	**76,067**
Debt securities issued	−	−	168,367	128,406	−	**296,773**
Other liabilities	348	−	933	582	−	**1,863**
Total undiscounted financial liabilities	**60,236**	**(89)**	**158,843**	**256,198**	**−**	**475,188**

(Thousands of euros)

23. Risk management (continued)

Market risk

Market risk is the risk that the Group shall incur losses due to adverse fluctuations in market rate of financial instruments, interest rates, foreign exchanges, and securities' prices. Market risk includes equity risk on securities, interest rate risk and currency risk.

The Group is exposed to market risk due to open positions in currency. Equity risk on securities arises from open positions in debt and equity instruments, which are exposed to general and specific market changes.

The Board of the Bank performs overall management of market risk.

The Finance Committee coordinates the Group's market risk management policy and reviews and provides recommendations on management of market risks to the Management Board.

The Treasury Department performs strategic management of market risks. The Risk Management Department performs the assessment of equity and currency risks exposure. The Treasury Department manages open positions within the established limits in order to increase the Group's income on a daily basis.

Currency risk and price risk

Currency risk is the risk of loss resulting from adverse changes in exchange rates with respect to the Group's open positions in foreign currencies. Price risk is the risk that the fair values of securities decrease as the result of changes in the levels of indices and the value of individual securities.

The Group applies a VaR methodology to assess currency and equity risks. VaR is a method used in measuring maximum risk of the Group, i.e. the level of losses on a certain position in relation to a financial instrument/currency/precious metals or a portfolio, which shall not be exceeded at a given confidence level and over a specified time horizon.

The Group uses an assumption that the accuracy of assessment of maximum value at risk (confidence level) is 99%, and the time horizon is 10 days. The assessment of value at risk in relation to currency position of the Group is carried out in major currencies and financial instruments of the Group attributable to a securities portfolio.

At estimating value at risk, the Group uses a parameter method, which allows assessing the volatility of yield on the basis of the most current market data.

The choice of a respective approach to value at risk estimation is made on the basis of data on statistical analysis of changes in fair values of financial instruments and exchange rates.

Selection period used by the Group for modeling purposes depends on types of instruments: 250 days for currency and securities. In order to monitor the accuracy of assessment of the above-mentioned risks, the Group carries out regular testing (back-testing) based on historical data, which allows evaluating the compliance of the risk assessment model with the actual market situation.

As at 31 December 2017 and 31 December 2016, final data on value at risk (VaR) assessment in relation to currency and price risks assumed by the Group are represented as follows:

	2017	***2016***
Fixed income securities price risk	1,005	2,325
Equity securities price risk	125	−
Currency risk	45	27

(Thousands of euros)

23. Risk management (continued)

Market risk (continued)

Despite the fact that measurement of value at risk is a standard industry method for risk assessment, this method has a number of limitations:

- Analysis based on value at risk assessment is correct in case current market conditions remain unchanged.
- Assessment of value at risk is sensitive to market liquidity in relation to a particular financial instrument, and the lack of liquidity may lead to biased volatility data.
- If a confidence level of 99% is used, losses exceeding the confidence range are not taken into account.
- 10-day time horizon implies the entire Group’s position over this period could have been closed or hedged. Results of value at risk assessment may be incorrect in case of market liquidity deterioration.

Fluctuations that may occur in the course of the day are not taken into account at calculating value at risk on the basis of the results of a business day.

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(Thousands of euros)

23. Risk management (continued)

Market risk (continued)

The Group has assets and liabilities denominated in several foreign currencies. The financial position and the cash flows are exposed to the effects of fluctuations in foreign currency exchange rates. Non-monetary financial instruments and financial instruments denominated in functional currency are not exposed to currency risk.

The Group's exposure to currency risk as at 31 December 2017 and 31 December 2016 is presented below:

	2017					*2016*				
	EUR	*USD*	*RUB*	*Other currencies*	*Total*	*EUR*	*USD*	*RUB*	*Other currencies*	*Total*
Non-derivative financial Assets										
Cash and cash equivalents	50,488	1,730	13,501	378	**66,097**	66,125	19,969	6,778	159	**93,031**
Deposits with banks and other financial institutions	28,936	16,953	–	–	**45,889**	40,568	4,769	–	–	**45,337**
Available-for-sale investment securities	111,516	102,202	–	1,709	**215,427**	208,628	53,070	7,609	–	**269,307**
Long-term loans to banks	147,253	54,382	–	–	**201,635**	53,574	40,793	–	–	**94,367**
Loans to customers	247,804	108,254	64,097	42,359	**462,514**	131,906	137,130	–	–	**269,036**
Other financial assets	186	323	214	5	**728**	225	14	927	254	**1,420**
Total non-derivative financial assets	**586,183**	**283,844**	**77,812**	**44,451**	**992,290**	**501,026**	**255,745**	**15,314**	**413**	**772,498**
Liabilities										
Due to banks and other financial institutions	(34,608)	(29,337)	–	(1,566)	**(65,511)**	(36,981)	(81,944)	–	–	**(118,925)**
Current customer accounts	(8,481)	(112)	–	–	**(8,593)**	(9,089)	(129)	–	–	**(9,218)**
Long-term loans of banks	(82,694)	–	–	(12,898)	**(95,592)**	(59,039)	(14,310)	–	–	**(73,349)**
Debt securities issued	(90,017)	–	(267,112)	(152,084)	**(509,213)**	(30,046)	–	(151,515)	(90,967)	**(272,528)**
Other financial liabilities	(546)	(175)	(1,427)	–	**(2,148)**	(529)	(49)	(1,106)	(179)	**(1,863)**
Total non-derivative financial liabilities	**(216,346)**	**(29,624)**	**(268,539)**	**(166,548)**	**(681,057)**	**(135,684)**	**(96,432)**	**(152,621)**	**(91,146)**	**(475,883)**
Net balance sheet position (excluding derivative financial instruments)	**369,837**	**254,220**	**(190,727)**	**(122,097)**	**311,233**	**365,342**	**159,313**	**(137,307)**	**(90,733)**	**296,615**
Derivative financial instruments										
Claims	190,457	–	197,443	132,639	**520,539**	125,117	–	145,832	90,318	**361,267**
Liabilities	(296,697)	(220,909)	–	(10,245)	**(527,851)**	(224,955)	(124,785)	(8,788)	–	**(358,528)**
Net balance sheet position including derivative financial instruments	**263,597**	**33,311**	**6,716**	**297**	**303,921**	**265,504**	**34,528**	**(263)**	**(415)**	**299,354**

(Thousands of euros)

23. Risk management (continued)

Market risk (continued)

Interest rate risk

The Group is exposed to the effects of fluctuations in the prevailing levels of market interest rates on its financial position and cash flows. Interest margins may increase as a result of such fluctuations but may also reduce or create losses in the event that unexpected movements arise.

The sensitivity of the consolidated income statement is the effect of the assumed changes in interest rates on net interest income for one year, based on financial assets and financial liabilities with floating rates. The sensitivity of equity is calculated by revaluing inactive traded available-for-sale securities with fixed rates as at 31 December 2017 for the effects of the assumed changes in interest rates based on the assumption that there are parallel shifts in the yield curve.

	Increase in basis points	*Sensitivity of the income statement*	*Sensitivity of equity*
	2017	***2017***	***2017***
RGBEY	0.75%	(719)	−
Libor EUR	0.25%	792	−
Libor USD	0.70%	(214)	−
3Y Swap-RON	6.74%	(15,479)	−
YTM 5Y USTreasuries	1.30%	1,761	−
YTM 5Y German Treasuries	0.50%	962	−

	Decrease in basis points	*Sensitivity of the income statement*	*Sensitivity of equity*
	2017	***2017***	***2017***
RGBEY	1.75%	1,677	−
Libor EUR	0.01%	(32)	−
Libor USD	0.08%	24	−
3Y Swap-RON	4.47%	10,266	−
YTM 5Y USTreasuries	0.50%	(677)	−
YTM 5Y German Treasuries	0.40%	(192)	−

	Increase in basis points	*Sensitivity of the income statement*	*Sensitivity of equity*
	2016	***2016***	***2016***
RGBEY	1.00%	(956)	(233)
Libor EUR	0.12%	128	−
Libor USD	0.60%	405	−
3Y Swap-RON	0.50%	(1,148)	−
YTM 5Y USTreasuries	0.70%	973	−
YTM 5Y German Treasuries	0.40%	770	−

	Decrease in basis points	*Sensitivity of the income statement*	*Sensitivity of equity*
	2016	***2016***	***2016***
RGBEY	3.00%	2,868	699
Libor EUR	0.08%	(86)	−
Libor USD	0.08%	(54)	−
3Y Swap-RON	0.50%	1,148	−
YTM 5Y USTreasuries	0.50%	695	−
YTM 5Y German Treasuries	0.40%	(770)	−

(Thousands of euros)

23. Risk management (continued)

Market risk (continued)

Indices listed in the tables above:

RGBEY − Russian Government Bonds Effective Yield until Redemption;

Libor EUR −London inter-bank EUR offer rate (3 and 6 months);

Libor USD − London inter-bank USD offer rate (1, 3 and 6 months);

3Y Swap-RON − three-year bid rate in Romanian leu on swap market;

YTM 5Y USTreasuries − yield-to-maturity of five-year US Treasuries;

YTM 5Y German Treasuries − yield-to-maturity of five-year Germany Treasuries.

Operational risk

Operational risk is a risk of loss arising from inadequate management and control procedures, fraud, inconsistent business solutions, system failures due to human errors and abuse of power, technical deficiencies, calculation errors, disasters and misuse of the Group's property.

Generally, the Board controls the risk management process as well as compliance with internal policies, approves internal regulations relating to risk management, establishes operational risks monitoring limits and allocates duties relating to operational risk management among various agencies.

The Risk Management Department controls and monitors operational risks and provides respective reporting to the Board. The current control enables to timely identify and eliminate deficiencies in policies and procedures aimed at operational risk management, as well as to cut the possibility and amount of related losses. The Group continuously seeks to enhance its business processes, operating structure and personnel incentives system in order to minimize the impact of operational risk.

24. Fair value measurements

Fair value is the amount at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced sale or liquidation, and is best evidenced by a quoted market price.

The estimated fair values of financial instruments have been determined by the Group using available market information, where it exists, and appropriate valuation methodologies. However, judgment is necessarily required to interpret market data to determine the fair value. While management has used available market information in estimating the fair value of financial instruments, the market information may not be fully reflective of the value that could be realized in the current circumstances.

Fair value hierarchy

The Group uses the following hierarchy for determining and disclosing the fair value of financial instruments by valuation technique:

- Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities;
- Level 2: techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly;
- Level 3: techniques that use inputs which have a significant effect on the recognized fair value that are not based on observable market data.

(Thousands of euros)

24. Fair value measurements (continued)

Fair value hierarchy (continued)

For the purpose of fair value disclosures, the Group has determined classes of assets and liabilities on the basis of the nature, characteristics and risks of the asset or liability, and the level of the fair value hierarchy. The following table shows an analysis of financial instruments recorded at fair value by level of the fair value hierarchy as at 31 December 2017:

	Level 1 2017	*Level 2 2017*	*Level 3 2017*	*Total 2017*
Assets measured at fair value				
Derivative financial assets	–	7,761	–	**7,761**
Government bonds of member countries	45,891	–	–	**45,891**
Corporate bonds	149,277	18,544	–	**167,821**
Quoted equity instruments	1,710	5	–	**1,715**
Investment property	–	–	21,853	**21,853**
Property and equipment – buildings	–	–	67,572	**67,572**
Liabilities measured at fair value				
Derivative financial liabilities	–	15,073	–	**15,073**
Assets for which fair values are disclosed				
Cash and cash equivalents	85	66,012	–	**66,097**
Deposits with banks and other financial institutions	–	–	45,889	**45,889**
Loans to banks	–	–	201,743	**201,743**
Loans to customers	–	–	465,973	**465,973**
Liabilities for which fair values are disclosed				
Due to banks and other financial institutions	–	–	65,511	**65,511**
Current customer accounts	–	–	8,593	**8,593**
Long-term loans of banks	–	–	95,592	**95,592**
Debt securities issued	–	514,893	–	**514,893**

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(Thousands of euros)

24. Fair value measurements (continued)

Fair value hierarchy (continued)

The following table shows an analysis of financial instruments recorded at fair value by level of the fair value hierarchy as at 31 December 2016:

	Level 1 2016	*Level 2 2016*	*Level 3 2016*	*Total 2016*
Assets measured at fair value				
Derivative financial assets	−	14,362	−	**14,362**
Government bonds of member countries	70,561	−	−	**70,561**
Corporate bonds	194,003	4,739	−	**198,742**
Quoted equity instruments	−	4	−	**4**
Investment property	−	−	21,840	**21,840**
Property and equipment − buildings	−	−	67,527	**67,527**
Liabilities measured at fair value				
Derivative financial liabilities	−	11,623	−	**11,623**
Assets for which fair values are disclosed				
Cash and cash equivalents	104	92,927	−	**93,031**
Deposits with banks and other financial institutions	−	−	45,337	**45,337**
Loans to banks	−	−	88,558	**88,558**
Loans to customers	−	−	270,243	**270,243**
Liabilities for which fair values are disclosed				
Due to banks and other financial institutions	−	−	118,925	**118,925**
Current customer accounts	−	−	9,218	**9,218**
Long-term loans of banks	−	−	73,349	**73,349**
Debt securities issued	−	279,181	−	**279,181**

Fair value of financial assets and liabilities not recorded at fair value

Set out below is a comparison of the carrying amounts and fair values of the Group's financial instruments that are recorded in the consolidated financial statements. The table does not include the fair values of non-financial assets and non-financial liabilities.

	Carrying amount 2017	*Fair value 2017*	*Unrecognized gain/(loss) 2017*	*Carrying amount 2016*	*Fair value 2016*	*Unrecognized gain/(loss) 2016*
Financial assets						
Cash and cash equivalents	66,097	66,097	−	93,031	93,031	−
Deposits with banks and other financial institutions	45,889	45,889	−	45,337	45,337	−
Loans to banks	201,635	201,743	108	94,367	88,558	(5,809)
Loans to customers	462,514	465,973	3,459	269,036	270,243	1,207
Financial liabilities						
Due to banks and other financial institutions	65,511	65,511	−	118,925	118,925	−
Current customer accounts	8,593	8,593	−	9,218	9,218	−
Long-term loans of banks	95,592	95,592	−	73,349	73,349	−
Debt securities issued	509,213	514,893	(5,680)	272,528	279,181	(6,653)
Total unrecognized change in unrealized fair value			**(2,113)**			**(11,255)**

(Thousands of euros)

24. Fair value measurements (continued)

Fair value measurements

The Group determines the policies and procedures for both recurring fair value measurement, such as unquoted derivatives, investment property and buildings, and for non-recurring measurement, such as inventories.

External appraisers are involved for valuation of significant assets, such as buildings and real estate. Involvement of external appraisers is decided upon by the Bank’s Finance Department. Unquoted derivatives are measured by the Finance Department.

Selection criteria include market knowledge, reputation, independence and compliance with professional standards.

Methodologies and assumptions

The following describes the methodologies and assumptions used to determine fair values of assets and liabilities recorded at fair value in the consolidated financial statements and of those items that are not measured at fair value in the consolidated statement of financial position, but their fair value is disclosed.

Assets for which fair value approximates their carrying amount

For financial assets and financial liabilities that are liquid or have a short-term maturity (less than three months) it is assumed that the carrying amounts approximate their fair values.

Cash and cash equivalents, deposits with banks and other financial institutions

Management has estimated that as at 31 December 2017 and 31 December 2016 the fair value of deposits with banks and other financial institutions, and cash and cash equivalents was not significantly different from their respective carrying amount. This is due to the existing practice of renegotiating interest rates to reflect current market conditions, and, therefore, a majority of balances carries interest at rates approximating market interest rates.

Financial instruments with fixed and floating rates

The fair value of instruments with floating interest rates is approximately equal to their carrying amount. In case of significant changes of the market situation the interest rates on loans to customers and banks, and long-term loans of banks at a fixed interest rate may be revised. Consequently, the interest rates on the financial instruments issued or received shortly before the balance sheet date are not significantly different from the current interest rates for new instruments with similar credit risk and a similar maturity. If the Group determines that the rates for loans issued or borrowings are significantly different from the current market rates, the Group determines the fair value of such loans issued and borrowings. The valuation is based on the discounted cash flow method using current market interest rates for new financial instruments with similar credit risk and similar maturity. The discount rates depend on the currency, the maturity of the instrument and the credit risk of the counterparty. Management determines that the fair value of amounts due to banks and other financial institutions and long-term loans of banks did not differ significantly from their carrying amounts as at 31 December 2017 and 31 December 2016.

Investment property

The Group engages an independent appraiser for the investment property fair value measurement. As at the valuation date (31 December 2017), the fair values of investment property were based on the results of valuation performed by an accredited independent appraiser and the prices of market transactions using the market, cost and income approaches to fair value measurement.

The duration of the cash flows and the specific timing of inflows and outflows are determined by events such as rent reviews, lease renewal and related re-letting, redevelopment, or refurbishment. The appropriate duration is typically driven by market behavior that is a characteristic of the class of real property. Periodic cash flow is typically estimated as gross income less vacancy, non-recoverable expenses, collection losses, lease incentives, maintenance cost, agent and commission costs and other operating and management expenses. The series of periodic net operating income, along with an estimate of the terminal value anticipated at the end of the projection period, is then discounted.

(Thousands of euros)

24. Fair value measurements (continued)

Methodologies and assumptions (continued)

Property and equipment − buildings

Fair value of the properties was determined using the market approach. This means that valuations performed by the appraiser are based on market transaction prices, significantly adjusted for difference in the nature, location or condition of the specific property. As at the valuation date (31 December 2017), the properties' fair values are based on valuations performed by an accredited independent appraiser and the prices of market transactions using the market, cost and income approaches to fair value measurement.

Significant unobservable inputs in determining the fair value of real estate properties

As at the valuation date (31 December 2017), the significant unobservable inputs used in determining the fair value of real estate properties included the average asking prices for sale of similar properties ranging from EUR 2,773 per. sq. m (range minimum) to EUR 3,982 per sq. m (range maximum), and lease rates ranging from EUR 360 per sq. m. a year (minimum) to EUR 504 per sq. m. a year (maximum).

There were no transfers of financial instruments between Level 1 and Level 2 in 2017 and 2016.

Movements in Level 3 assets and liabilities at fair value

The following table shows a reconciliation of the opening and closing amount of Level 3 assets and liabilities that are recorded at fair value:

	At 1 January 2017	*Gains/(losses) recorded in profit or loss*	*Gains/(losses) recorded in comprehensive income*	*Purchases*	*Transfer to property and equipment*	*At 31 December 2017*
Assets						
Property and equipment − buildings	67,527	(1,108)	803	350	−	67,572
Investment property	21,840	(26)	−	39	−	21,853
Total	**89,367**	**(1,134)**	**803**	**389**	**−**	**89,425**

	At 1 January 2016	*Gains/(losses) recorded in profit or loss*	*Gains/(losses) recorded in comprehensive income*	*Purchases*	*Transfer to property and equipment*	*At 31 December 2016*
Assets						
Property and equipment − buildings	62,807	(1,174)	(18,508)	223	24,179	67,527
Investment property	33,819	(2,174)	−	14,374	(24,179)	21,840
Total	**96,626**	**(3,348)**	**(18,508)**	**14,597**	**−**	**89,367**

(Thousands of euros)

25. Transferred financial assets that are not derecognized

The table below provides a summary of the financial assets transferred by the Group in such a way that all the transferred financial assets do not qualify for derecognition:

	Available-for-sale investment securities		
	Government bonds	***Corporate bonds***	***Total***
Transferred financial asset	***2017***	***2017***	***2017***
Carrying amount of assets	17,877	58,846	**76,723**
Carrying amount of associated liabilities	(14,768)	(47,247)	**(62,015)**
Net position	**3,109**	**11,599**	**14,708**

	Available-for-sale investment securities		
	Government bonds	***Corporate bonds***	***Total***
Transferred financial asset	***2016***	***2016***	***2016***
Carrying amount of assets	17,883	80,575	**98,458**
Carrying amount of associated liabilities	(13,485)	(52,584)	**(66,069)**
Net position	**4,398**	**27,991**	**32,389**

Securities sold under repurchase agreements are transferred to a third party and the Group receives cash in exchange. If the securities increase or decrease in value, the Group may, in certain circumstances, require, or be required, to pay additional collateral in the form of cash and/or other securities. The Group has determined that it retains substantially all the risks and rewards of these securities, which include credit risk, market risk, country risk and operational risk, and therefore has not derecognized them. In addition, it recognizes a financial liability for cash received.

The fair value of investment securities available for sale sold under repurchase agreements is equal to their carrying amount (Note 24).

The related liabilities, which are recorded against the cash received for such transactions, are presented in amounts due to banks and other financial institutions in the consolidated statement of financial position as at 31 December 2017 (31 December 2016: in amounts due to banks and other financial institutions).

26. Segment information

For management purposes, the Group identifies the following three operating segments based on its lines of services:

Credit investment activity	Investment banking services, including long-term corporate and interbank financing
Treasury	Operations in financial markets, transactions with securities, derivative financial instruments and foreign currency, and liquidity management
Other operations	Operational leasing services, other operations

(Thousands of euros)

26. Segment information (continued)

Management monitors the operating results of its business units separately for the purpose of making decisions about resource allocation and performance assessment. Segment performance, as explained in the table below, is measured differently from profit or loss in the consolidated financial statements. The following table presents income, profit, assets and liabilities of the Group's operating segments:

2017	***Credit investment activity***	***Treasury***	***Other operations***	***Total***
Income				
External customers				
Interest income	26,662	9,263	38	**35,963**
Fee and commission income	1,763	–	–	**1,763**
Net gains from operations in foreign currencies and with derivatives	–	15,928	21	**15,949**
Net gains from available-for-sale investment securities	–	7,399	–	**7,399**
Dividend income	–	123	–	**123**
Income from lease of investment property	–	–	4,034	**4,034**
Reversal of allowance for impairment of other assets	–	–	29	**29**
Other segment income	329	–	214	**543**
Total income	**28,754**	**32,713**	**4,336**	**65,803**
Interest expenses	(18,656)	(13,910)	–	**(32,566)**
Fee and commission expense	(16)	(109)	(8)	**(133)**
Allowance for impairment of financial assets	(12,165)	–	–	**(12,165)**
Net losses from revaluation of investment property	–	–	(26)	**(26)**
Other segment expenses	(79)	(23)	(934)	**(1,036)**
Segment results	**(2,162)**	**18,671**	**3,368**	**19,877**
Other unallocated expenses				**(18,872)**
Profit for the period				**1,005**
Development portfolio	648,404	104,932	–	**753,336**
Other segment assets	15,997	229,906	96,801	**342,704**
Total segment assets	**664,401**	**334,838**	**96,801**	**1,096,040**
Total segment liabilities	**359,918**	**334,477**	**5,983**	**700,378**
Other segment information				
Capital expenditures	–	–	1,013	**1,013**

The Group's management separates the "Development portfolio" assets allocated within operating segments. The criteria of separation is orientation of the assets on the fulfilling of the Group's mission. "Development portfolio" includes loans to banks and loans to customers excluding impaired loan projects and the investments in debt securities purchased upon initial placement by the issuer.

(Thousands of euros)

26. Segment information (continued)

2016	*Credit investment activity*	*Treasury*	*Other operations*	*Total*
Income				
External customers				
Interest income	20,348	12,093	14	**32,455**
Fee and commission income	843	–	–	**843**
Net gains from operations in foreign currencies and with derivatives	–	10,033	(54)	**9,979**
Net gains from available-for-sale investment securities	–	10,515	–	**10,515**
Income from lease of investment property	–	–	3,442	**3,442**
Reversal of allowance for impairment of other assets	–	–	67	**67**
Other segment income	(331)	616	162	**447**
Total income	**20,860**	**33,257**	**3,631**	**57,748**
Interest expenses	(11,250)	(16,401)	–	**(27,651)**
Fee and commission expense	(5)	(128)	(5)	**(138)**
Allowance for impairment of financial assets	(7,646)	–	89	**(7,557)**
Net losses from revaluation of investment property	–	–	(2,174)	**(2,174)**
Other segment expenses	(162)	(68)	(257)	**(487)**
Segment results	**1,797**	**16,660**	**1,284**	**19,741**
Other unallocated expenses				**(18,939)**
Profit for the period				**802**
Development portfolio	363,403	68,349	–	**431,752**
Other segment assets	–	353,239	96,452	**449,691**
Total segment assets	**363,403**	**421,588**	**96,452**	**881,443**
Total segment liabilities	**160,065**	**325,579**	**5,581**	**491,225**
Other segment information				
Capital expenditures	–	–	1,065	**1,065**

In 2017, the Group's revenue from lease operations with two external counterparties (2016: two external counterparties) exceeded 20% of the Group's total revenue (2017: EUR 2,996 thousand; 2016: EUR 2,160 thousand).

Geographical information

Allocation of the Group's revenue from transactions with external customers and non-current assets based on the location of these customers and assets for the years ended 31 December 2017 and 31 December 2016 is presented in the table below:

	2017				*2016*			
	Russia	*Other member countries*	*Other countries*	*Total*	*Russia*	*Other member countries*	*Other countries*	*Total*
Interest income	9,346	17,417	9,200	**35,963**	7,755	16,095	8,600	**32,450**
Income from lease of investment property	3,860	174	–	**4,034**	3,442	–	–	**3,442**
Non-current assets	79,917	14,324	–	**94,241**	79,242	14,439	–	**93,681**

Non-current assets include property and equipment and investment property.

(Thousands of euros)

26. Segment information (continued)

Geographical information (continued)

The geographical concentration of the Group's assets and liabilities based on the location of the Group's counterparties as at 31 December 2017 is presented below:

	2017										
	Russian Federation	***Republic of Bulgaria***	***Romania***	***Slovak Republic***	***Hungary***	***Mongolia***	***Socialist Republic of Vietnam***	***Czech Republic***	***Republic of Cuba***	***Other countries***	***Total***
Assets											
Cash and cash equivalents	1,209	792	226	35	–	–	–	36	–	63,799	**66,097**
Deposits with banks and other financial institutions	3,082	–	–	–	–	32,132	–	–	–	10,675	**45,889**
Derivative financial instruments	3,340	–	–	–	–	–	–	–	–	4,421	**7,761**
Available-for-sale investment securities	11,947	30,098	–	10,010	13,817	–	–	34,107	–	115,448	**215,427**
Loans to banks	89,545	–	–	–	–	33,735	25,252	–	49,863	3,240	**201,635**
Loans to customers	81,817	57,694	73,185	60,464	42,910	24,425	–	49,967	–	72,052	**462,514**
Other financial assets	382	6	–	–	5	5	–	1	–	329	**728**
Assets	**191,322**	**88,590**	**73,411**	**70,509**	**56,732**	**90,297**	**25,252**	**84,111**	**49,863**	**269,964**	**1,000,051**
Liabilities											
Due to banks and other financial institutions	1,460	–	–	7,508	–	–	–	1,566	–	54,977	**65,511**
Derivative financial instruments	4,480	–	1,213	–	–	–	–	–	–	9,380	**15,073**
Long-term loans of banks	9,959	7,470	–	–	20,367	–	–	–	–	57,796	**95,592**
Long-term securities issued	266,191	–	212,869	30,153	–	–	–	–	–	–	**509,213**
Other financial liabilities	1,658	33	15	8	–	237	–	–	–	197	**2,148**
Liabilities	**283,748**	**7,503**	**214,097**	**37,669**	**20,367**	**237**	**–**	**1,566**	**–**	**122,350**	**687,537**

(Thousands of euros)

26. Segment information (continued)

Geographical information (continued)

	2016									
	Russian Federation	***Republic of Bulgaria***	***Romania***	***Slovak Republic***	***Hungary***	***Mongolia***	***Socialist Republic of Vietnam***	***Czech Republic***	***Other countries***	***Total***
Assets										
Cash and cash equivalents	16,398	808	26	38	–	–	–	–	75,761	**93,031**
Deposits with banks and other financial institutions	7,159	–	–	–	–	–	–	–	38,178	**45,337**
Derivative financial instruments	2,980	–	–	–	–	–	–	–	11,382	**14,362**
Available-for-sale investment securities	44,688	49,482	36,713	10,286	3,475	–	–	–	124,663	**269,307**
Loans to banks	27,378	–	–	–	–	47,970	19,019	–	–	**94,367**
Loans to customers	61,213	58,967	37,981	308	–	5,683	–	22,930	81,954	**269,036**
Other financial assets	1,407	8	–	1	–	–	–	–	4	**1,420**
Assets	**161,223**	**109,265**	**74,720**	**10,633**	**3,475**	**53,653**	**19,019**	**22,930**	**331,942**	**786,860**
Liabilities										
Due to banks and other financial institutions	–	–	–	7,508	–	–	–	–	111,417	**118,925**
Derivative financial instruments	4,528	–	633	–	–	–	–	–	6,462	**11,623**
Long-term loans of banks	9,840	21,690	–	–	7,380	–	–	–	34,439	**73,349**
Long-term securities issued	151,434	–	90,967	30,127	–	–	–	–	–	**272,528**
Other financial liabilities	1,805	–	–	19	–	–	–	–	39	**1,863**
Liabilities	**167,607**	**21,690**	**91,600**	**37,654**	**7,380**	**–**	**–**	**–**	**152,357**	**478,288**

Other countries include non-member countries.

(Thousands of euros)

27. Offsetting of financial instruments

The table below shows the effect of enforceable master netting agreements and similar arrangements that do not result in an offset in the consolidated statement of financial position as at 31 December 2017:

2017	*Gross amount of recognized financial assets*	*Gross amount of recognized financial liabilities set off in the statement of financial position*	*Net amount of financial assets presented in the statement of financial position*	*Related amounts not set off in the statement of financial position*		*Net amount*
				Financial instruments	*Cash collateral received*	
Financial assets						
Financial assets pledged under repurchase agreements	76,723	–	76,723	(62,015)	–	**14,708**
Total	**76,723**	**–**	**76,723**	**(62,015)**	**–**	**14,708**
Financial liabilities						
Repurchase agreements	62,015	–	62,015	(62,015)	–	**–**
Total	**62,015**	**–**	**62,015**	**(62,015)**	**–**	**–**

The table below shows financial assets offset against financial liabilities in the consolidated statement of financial position as at 31 December 2016 as well as the effect of enforceable master netting agreements and similar arrangements that do not result in an offset in the consolidated statement of financial position:

2016	*Gross amount of recognized financial assets*	*Gross amount of recognized financial liabilities set off in the statement of financial position*	*Net amount of financial assets presented in the statement of financial position*	*Related amounts not set off in the statement of financial position*		*Net amount*
				Financial instruments	*Cash collateral received*	
Financial assets						
Financial assets pledged under repurchase agreements	98,458	–	98,458	(66,069)	–	**32,389**
Total	**98,458**	**–**	**98,458**	**(66,069)**	**–**	**32,389**
Financial liabilities						
Repurchase agreements	66,069	–	66,069	(66,069)	–	**–**
Total	**66,069**	**–**	**66,069**	**(66,069)**	**–**	**–**

(Thousands of euros)

28. Related party disclosures

Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operational decisions as defined by IAS 24 *Related Party Disclosures*. In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form.

Transactions and settlements with related parties were carried out on conditions similar to those which prevail in transactions between independent parties.

The volumes of related party transactions, outstanding balances at the year end, and related expenses and income for 2017 and 2016 are as follows:

	Related party	*31 December 2017* *Carrying amount*	*31 December 2016* *Carrying amount*
Consolidated statement of financial position			
Current customer accounts	Key management personnel	1,420	1,783
Other liabilities	Key management personnel	593	416

	Related party	*2017* *Income/(expense)*	*2016* *Income/(expense)*
Consolidated income statement			
Interest expenses on current customer accounts	Key management personnel	(52)	(61)
Net interest expenses after allowance for impairment of loans		**(52)**	**(61)**
Expenses from operating activities		**(52)**	**(61)**
Employee benefits	Key management personnel	(1,398)	(1,365)
Compensation for travel expenses and medical insurance	Key management personnel	(32)	(55)
Operating expenses		**(1,430)**	**(1,420)**
Net loss for the year		**(1,482)**	**(1,481)**

29. Changes in liabilities arising from financing activities

	Note	*Debt securities issued*	*Long-term loans of banks*	*Total liabilities arising from financing activities*
Carrying amount at 31 December 2015		**212,724**	**44,187**	**256,911**
Additions		67,398	60,000	**127,398**
Repayment		(43,910)	(29,569)	**(73,479)**
Interest paid		(23,493)	(2,831)	**(26,324)**
Translation differences		37,380	(277)	**37,103**
Non-cash transactions		(82)	−	**(82)**
Interest accrued		22,511	1,839	**24,350**
Carrying amount at 31 December 2016		**272,528**	**73,349**	**345,877**
Additions		348,661	36,185	**384,846**
Repayment		(88,290)	(13,451)	**(101,741)**
Interest paid		(24,522)	(1,690)	**(26,212)**
Translation differences		(26,095)	(1,178)	**(27,273)**
Non-cash transactions		(920)	−	**(920)**
Interest accrued		27,851	2,377	**30,228**
Carrying amount at 31 December 2017		**509,213**	**95,592**	**604,805**

Translation differences represent a daily revaluation of liabilities denominated in a currency other than the euro. The Group uses derivatives to mitigate the currency risks (Note 7).

(Thousands of euros)

30. Capital adequacy

Capital adequacy ratio is the most important financial indicator characterizing credibility of credit institutions and is estimated as the ratio of capital base to risk-weighted assets expressed as a percentage. Approval of the capital adequacy ratio is the sole power of the Bank's Council.

The Basel Committee on Banking Supervision recommends maintaining the ratio of capital to risk-weighted assets ("capital adequacy ratio") above the prescribed minimum level. As at 31 December 2017, this minimum level was 8% (2016: 8%).

Besides, taking into account the Bank's status as the multilateral development institution and the structure of the Bank's member countries and respective decision of the Council, the capital adequacy ratio was set at the level of not less than 25% as at 31 December 2017 (2016: 25%).

The following table shows the composition of the Group's capital position computed in accordance with the Basel Accord (Basel II) as at 31 December 2017 and 31 December 2016.

	2017	***2016***
Capital		
Tier 1 capital	380,745	378,034
Tier 2 capital	13,988	11,439
Total regulatory capital	**394,733**	**389,473**
Risk-weighted assets		
Credit risk	822,189	482,693
Market risk	177,273	186,588
Operational risk	43,411	57,999
Total risk-weighted assets	**1,042,873**	**727,280**
Total capital expressed as a percentage of risk-weighted assets, % ("capital adequacy ratio")	37.85%	53.55%
Total tier 1 capital expressed as a percentage of risk-weighted assets, % ("tier-1 capital adequacy ratio")	36.51%	51.98%

(The end)