

**BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES**

Financial Information Required by the  
Superintendency General of Financial Entities

Consolidated Financial Statements

December 31, 2017  
*(With corresponding figures for 2016)*

(With Independent Auditors' Report Thereon)

(Translation into English of the original  
Independent Auditors' Report issued in Spanish)



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## Independent Auditors' Report

The Superintendency General of Financial Entities (SUGEF)  
and the Board of Directors  
Banco Nacional de Costa Rica

### *Opinion*

We have audited the consolidated financial statements of Banco Nacional de Costa Rica and Subsidiaries (the Bank), which comprise the consolidated balance sheet as of December 31, 2017, the consolidated statements of comprehensive income, changes in equity, and cash flows for the year then ended, and notes, comprising significant accounting policies and other explanatory information.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Bank as of December 31, 2017, and of its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with the financial reporting provisions of the accounting regulations issued by the National Financial System Oversight Board (CONASSIF), the Superintendency General of Financial Entities (SUGEF), the National Securities Commission (SUGEVAL), the Pensions Superintendency (SUPEN), and the Superintendency General of Insurance (SUGESE).

### *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 *Auditors' Responsibilities for the Audit of the Consolidated Financial Statements* section of our report. We are independent of the Bank in accordance with the Code of Ethics for Professional Accountants, issued by the International Ethics Standards Board for Accountants (the IESBA Code), along with the ethical requirements that are relevant to our audit of the consolidated financial statements in the Republic of Costa Rica, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

### *Emphasis of Matter – Basis of Accounting*

Without modifying our opinion, we draw your attention to note 1-b to the consolidated financial statements, which describes the basis of accounting. The consolidated financial statements have been prepared in accordance with the financial reporting provisions of the accounting regulations issued by CONASSIF, SUGEF, SUGEVAL, SUPEN, and SUGESE. Therefore, the consolidated financial statements may not be suitable for another purpose. Our opinion has not been modified in this regard.

### *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.

Key Audit Matter	Auditor's Response
<p>1. Valuation of derivative financial instruments</p> <p>The Bank has derivative financial instruments, which are valued through the application of valuation techniques that often entail the use of judgments, estimates, and assumptions.</p>	<p>Our audit procedures included the following:</p> <ul style="list-style-type: none"> <li>• Our specialists assessed the methodologies, inputs, and assumptions used by the Bank in the fair value determination;</li> <li>• We questioned the observable inputs in the valuation models, i.e. quoted prices; and</li> <li>• For a sample of derivative instruments, we assessed that the Bank's valuations fall within a reasonable range, compared to the valuations derived from our valuation model, considering the inherent uncertainties disclosed in the financial statements.</li> </ul>
<p>2. Income tax notice of deficiency</p> <p>The Bank was subject to a review by the Tax Authorities for the years 2010 to 2013 (see note 44). As a result, notices of deficiency and observations were issued in relation to the filed income tax returns. The analysis of the different concepts of the notices of deficiency and observations requires judgments and estimates by management and by its tax advisors.</p>	<p>Our audit procedures included the following:</p> <ul style="list-style-type: none"> <li>• We analyzed the confirmations received from the tax advisors regarding the status and probability of success.</li> <li>• We reviewed management's analysis, including judgments, estimates, and conclusions reached, for each of the concepts included in the notices of deficiency and observations.</li> <li>• Our tax specialists reviewed each of the items in dispute.</li> </ul>



Key Audit Matter	Auditor's Response
<b>3. Provisions</b> The Bank operates within a regulatory environment and noncompliance with certain regulations may result in fines, penalties, litigation, etc. that require judgments and estimates to determine the relevance and the liability, based on management's assessment of the most likely outcome.	Our audit procedures included the following: <ul style="list-style-type: none"> <li>• We assessed management's estimates and judgments that consider the most recent information available and we assessed the accuracy and reliability of the sources of such information.</li> <li>• We verified the adequacy of management's assumptions regarding the confirmations by the Legal Department.</li> <li>• We considered management's estimates based on the most likely outcomes within according to the range of possible outcomes.</li> </ul>

*Responsibilities of Management and those Charged with Governance for the Consolidated Financial Statements*

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with the financial reporting provisions of the accounting regulations issued by CONASSIF, SUGEF, SUGEVAL, SUPEN, and SUGESE, 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 Bank's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Bank or to cease operations, or has no realistic alternative but to do so.

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

*Auditors' 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 auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could 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 Bank's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bank's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the 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 auditors' report. However, future events or conditions may cause the Bank to cease to continue as a going concern.
- Evaluate the overall presentation, structure, and content of the 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.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Bank to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision, and performance of the group audit. We remain solely responsible for our audit opinion.



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

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

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

February 23, 2018

San José, Costa Rica  
Erick Brenes Flores  
Member No. 2520  
Policy No. 0116 FIG 7  
Expires 9/30/2018

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BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEET  
AS OF DECEMBER 31, 2017  
(With corresponding figures for 2016)  
(In colones)

	Note	2017	2016
<b>ASSETS</b>			
<b>Cash and due from banks</b>	<b>4</b>	<b>1,282,770,297,705</b>	<b>937,810,182,994</b>
Cash		67,739,161,551	56,192,345,858
Demand deposits in BCCR		857,735,999,161	689,309,617,609
Demand deposits in local financial entities		16,722,017,718	7,462,507,464
Demand deposits in foreign financial entities		321,425,149,449	178,157,371,306
Other cash and due from banks		19,147,247,731	6,688,245,083
Accrued interest receivable		722,095	95,674
<b>Investments in financial instruments</b>	<b>5</b>	<b>1,097,332,342,386</b>	<b>956,600,207,359</b>
Available for sale		1,061,043,947,907	912,646,019,784
Held to maturity		18,562,535,348	27,181,284,510
Derivative financial instruments	<b>6</b>	6,321,903,607	5,893,164,907
Accrued interest receivable		11,477,429,720	10,939,171,834
(Allowance for impairment of investments in financial instruments)		(73,474,196)	(59,433,676)
<b>Loan portfolio</b>	<b>7</b>	<b>4,384,681,312,469</b>	<b>4,057,363,892,824</b>
Current		4,261,225,313,188	3,922,221,361,522
Past due		131,836,522,732	105,532,644,255
In legal collection		100,044,384,206	87,853,245,295
Accrued interest receivable		31,743,485,704	27,221,501,072
(Allowance for loan losses)		(140,168,393,361)	(85,464,859,320)
<b>Accounts and fees and commissions receivable</b>	<b>8</b>	<b>2,136,433,509</b>	<b>2,060,363,518</b>
Fees and commissions receivable		1,261,195,967	1,292,023,911
Accounts receivable for brokerage operations		-	3,828,079
Accounts receivable for transactions with related parties		26,675,994	20,707,083
Income tax receivable		560,184,667	199,695,701
Other receivables		3,879,229,636	3,993,335,555
Accrued interest receivable		1,724,156	1,800,923
(Allowance for impairment of accounts and fees and commissions receivable)		(3,592,576,911)	(3,451,027,734)
<b>Foreclosed assets</b>	<b>9</b>	<b>18,784,905,854</b>	<b>17,751,098,959</b>
Assets and securities acquired in lieu of payment		81,249,127,569	77,394,578,153
Other foreclosed assets		1,832,418	1,471,878
(Allowance for impairment of foreclosed assets and per legal requirements)		(62,466,054,133)	(59,644,951,072)
<b>Investments in other companies</b>	<b>10</b>	<b>61,782,698,467</b>	<b>57,191,201,983</b>
<b>Property and equipment, net</b>	<b>11</b>	<b>180,045,509,253</b>	<b>177,105,051,446</b>
<b>Other assets</b>	<b>12</b>	<b>48,193,633,629</b>	<b>38,821,584,257</b>
Deferred charges		8,915,121,031	11,899,941,334
Intangible assets		7,343,386,585	5,225,669,321
Other assets		31,935,126,013	21,695,973,602
<b>TOTAL ASSETS</b>		<b>7,075,727,133,272</b>	<b>6,244,703,583,340</b>

The notes are an integral part of these consolidated financial statements.

Continued...

BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEET  
AS OF DECEMBER 31, 2017  
(With corresponding figures for 2016)  
(In colones)

<b>LIABILITIES AND EQUITY</b>	<b>Note</b>	<b>2017</b>	<b>2016</b>
<b>LIABILITIES</b>			
<b>Obligations with the public</b>	<b>13</b>	<b>4,854,295,679,256</b>	<b>4,190,136,402,593</b>
Demand obligations		2,723,524,433,301	2,606,807,068,581
Term obligations		2,071,892,923,304	1,534,747,038,588
Other obligations		22,916,380,358	26,448,255,041
Finance charges payable		35,961,942,293	22,134,040,383
<b>Obligations with BCCR</b>	<b>14</b>	<b>125,644,412</b>	<b>125,644,412</b>
Term obligations		125,644,412	125,644,412
<b>Obligations with entities</b>	<b>15</b>	<b>1,325,520,882,251</b>	<b>1,224,853,283,638</b>
Demand obligations		206,588,859,907	215,439,288,466
Term obligations		1,109,107,522,604	999,839,001,470
Finance charges payable		9,824,499,740	9,574,993,702
<b>Accounts payable and provisions</b>		<b>97,871,079,473</b>	<b>121,037,729,284</b>
Accounts payable for brokerage services		1,257,574,677	1,434,466,447
Deferred tax	<b>16-b</b>	9,451,493,555	10,594,748,946
Provisions	<b>17</b>	20,863,416,068	26,294,108,721
Other sundry accounts payable	<b>18</b>	66,298,595,173	82,714,405,170
<b>Other liabilities</b>	<b>19</b>	<b>98,542,307,102</b>	<b>46,777,896,327</b>
Deferred income		32,055,196,858	24,745,614,291
Allowance for stand-by credit losses		265,681,489	540,840,567
Other liabilities		66,221,428,755	21,491,441,469
<b>Subordinated obligations</b>	<b>20</b>	<b>75,136,063,242</b>	<b>72,675,778,397</b>
Subordinated obligations		73,634,600,000	71,263,400,000
Finance charges payable		1,501,463,242	1,412,378,397
<b>TOTAL LIABILITIES</b>		<b>6,451,491,655,736</b>	<b>5,655,606,734,651</b>
<b>EQUITY</b>			
<b>Share capital</b>		<b>172,237,030,102</b>	<b>118,130,303,482</b>
Paid-in capital	<b>21-a</b>	172,237,030,102	118,130,303,482
<b>Equity adjustments</b>		<b>68,259,558,421</b>	<b>67,476,783,612</b>
Surplus from revaluation of property	<b>21-b</b>	61,425,174,760	60,806,752,437
Adjustment for valuation of available-for-sale investments	<b>21-c</b>	(1,998,318,958)	159,197,995
Adjustment for valuation of restricted financial instruments	<b>21-c</b>	(306,670,697)	(1,617,218,764)
Surplus from revaluation of other assets		43,748,630	43,748,630
Adjustment for valuation of investments in other companies	<b>1-e (iv) and 21-d</b>	9,095,624,686	8,084,303,314
<b>Capital reserves</b>	<b>21-e</b>	<b>311,121,806,369</b>	<b>274,614,308,392</b>
<b>Prior period retained earnings</b>		<b>12,741,841,466</b>	<b>54,106,726,619</b>
<b>Income for the year</b>		<b>32,763,283,165</b>	<b>53,018,907,264</b>
<b>Equity of the Development Financing Fund</b>	<b>21-f</b>	<b>27,111,958,013</b>	<b>21,749,819,320</b>
<b>TOTAL EQUITY</b>		<b>624,235,477,536</b>	<b>589,096,848,689</b>
<b>TOTAL LIABILITIES AND EQUITY</b>		<b>7,075,727,133,272</b>	<b>6,244,703,583,340</b>
<b>DEBIT MEMORANDA ACCOUNTS</b>	<b>22</b>	<b>657,366,663,011</b>	<b>607,278,057,097</b>
<b>TRUST ASSETS</b>	<b>23</b>	<b>1,640,112,224,019</b>	<b>1,395,438,209,356</b>
<b>TRUST LIABILITIES</b>		<b>122,035,907,919</b>	<b>51,558,918,092</b>
<b>TRUST EQUITY</b>		<b>1,518,076,316,100</b>	<b>1,343,879,291,264</b>
<b>TRUST MEMORANDA ACCOUNTS</b>		<b>50,624,717,665</b>	<b>27,200,220,639</b>
<b>OTHER DEBIT MEMORANDA ACCOUNTS</b>	<b>24</b>	<b>20,651,794,446,437</b>	<b>19,573,797,402,675</b>
Own debit memoranda accounts		7,064,476,982,966	7,280,944,022,035
Third-party debit memoranda accounts		2,542,913,153,061	2,268,532,958,984
Own debit memoranda accounts for custodial activities		371,296,353,570	231,082,070,315
Third-party debit memoranda accounts for custodial activities		10,673,107,956,840	9,793,238,351,341

Juan Carlos Corrales Salas  
General Manager

Gerardo Gómez Solís  
General Accountant

Ricardo Araya Jiménez  
General Auditor

The notes are an integral part of these consolidated financial statements.



**BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME**  
**FOR THE YEAR ENDED DECEMBER 31, 2017**  
*(With corresponding figures for 2016)*  
(In colones)

	Note	2017	2016
<b>Finance income</b>			
Cash and due from banks	28	3,070,207,582	714,614,012
Investments in financial instruments	28	50,868,726,626	47,878,571,350
Loan portfolio	29	403,941,137,471	351,653,217,587
Gain on available-for-sale financial instruments		1,334,175,875	1,742,702,304
Gain on derivative financial instruments, net	6	5,358,047,633	-
Other finance income	30	21,529,123,297	47,396,113,701
<b>Total finance income</b>		<b>486,101,418,484</b>	<b>449,385,218,954</b>
<b>Finance costs</b>			
Obligations with the public	31	150,479,704,763	107,153,234,146
Obligations with BCCR		525,157,625	-
Obligations with financial entities	32	69,311,544,010	57,605,739,683
Subordinated, convertible, and preferred obligations		4,533,029,823	4,075,879,448
Loss on foreign exchange differences and development units, net	46-c	887,627,523	1,618,236,228
Loss on available-for-sale financial instruments		236,439,720	73,531,374
Loss on derivative instruments	6	-	9,473,071,759
Other finance costs	33	15,102,613,455	28,462,832,392
<b>Total finance costs</b>		<b>241,076,116,919</b>	<b>208,462,525,030</b>
Allowance for impairment of assets	34	71,531,245,221	39,297,902,715
Recovery of assets and decrease in allowances	35	13,161,810,394	13,098,376,497
<b>FINANCE INCOME</b>		<b>186,655,866,738</b>	<b>214,723,167,706</b>
<b>Other operating income</b>			
Service fees and commissions	36	131,606,200,430	122,521,808,391
Foreclosed assets		4,173,235,947	8,653,833,259
Gain on investments in other foreign companies	1-a and 3	2,615,822,520	1,690,868,660
Gain on investments in other local companies		7,563,715	16,313,452
Foreign currency exchange and arbitrage		23,941,424,933	24,421,625,521
Other operating income	37	10,109,015,743	22,169,036,567
<b>Total other operating income</b>		<b>172,453,263,288</b>	<b>179,473,485,850</b>

The notes are an integral part of these consolidated financial statements.

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**BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME**  
**FOR THE YEAR ENDED DECEMBER 31, 2017**  
*(With corresponding figures for 2016)*  
(In colones)

		2017	2016
<b>Other operating expenses</b>			
Service fees and commissions		4,793,663,158	5,968,026,398
Foreclosed assets	38	21,447,997,288	22,170,699,085
Sundry assets		37,083,882	1,271,238,538
Provisions	39	9,703,807,979	24,866,688,525
Bonuses on fees and commissions of voluntary pension funds		87,568,316	78,536,057
Foreign currency exchange and arbitrage		1,217,909	7,112,245
Other operating expenses	40	71,897,137,265	60,534,614,566
Amortization of deferred direct costs related to credits		737,233,459	426,736,284
<b>Total other operating expenses</b>		<b>108,705,709,256</b>	<b>115,323,651,698</b>
<b>GROSS OPERATING INCOME</b>		<b>250,403,420,770</b>	<b>278,873,001,858</b>
<b>Administrative expenses</b>			
Personnel expenses	41	128,940,456,126	133,090,357,597
Other administrative expenses	42	70,237,716,270	65,883,085,543
<b>Total administrative expenses</b>		<b>199,178,172,396</b>	<b>198,973,443,140</b>
<b>NET OPERATING INCOME BEFORE TAXES AND STATUTORY ALLOCATIONS</b>		<b>51,225,248,374</b>	<b>79,899,558,718</b>
Current tax expense	16-a	6,319,603,620	12,424,439,845
Deferred tax expense	16-a	339,827,581	222,500,640
Decrease in current tax for the period	16-a	1,366,885,756	1,478,222,342
Decrease in prior period income tax	16-a	12,253,356	16,380,331
Increase in deferred income tax	16-a	404,747,515	1,425,091,743
Statutory allocations	43	13,687,533,696	17,153,405,385
Decrease in statutory allocations	43	101,113,061	-
<b>INCOME FOR THE YEAR</b>		<b>32,763,283,165</b>	<b>53,018,907,264</b>
<b>OTHER COMPREHENSIVE INCOME, NET OF TAX</b>			
Surplus from revaluation of property		2,210,993,196	537,766,102
Adjustment for valuation of available-for-sale investments, net of income tax		(2,157,516,952)	(3,144,026,874)
Adjustment for valuation of restricted financial instruments, net of income tax		1,310,548,066	(1,181,803,515)
Surplus from revaluation of other assets		-	(25,930,157)
Adjustment for valuation of investments in other companies		1,011,321,372	999,676,663
<b>OTHER COMPREHENSIVE INCOME FOR THE YEAR, NET OF TAX</b>		<b>2,375,345,682</b>	<b>(2,814,317,781)</b>
<b>TOTAL COMPREHENSIVE INCOME FOR THE YEAR</b>		<b>35,138,628,847</b>	<b>50,204,589,483</b>

Juan Carlos Corrales Sulas  
General Manager

Gerardo Gómez Solís  
General Accountant

Ricardo Araya Jiménez  
General Auditor

The notes are an integral part of these consolidated financial statements.



BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES  
CONSOLIDATED STATEMENT OF CHANGES IN EQUITY  
FOR THE YEAR ENDED DECEMBER 31, 2017  
(In colones)

Note	Share capital	Equity adjustments				Total equity adjustments	Capital reserves	Retained earnings	Equity of the Development Financing Fund	Total
		Surplus from revaluation of property	Adjustment for valuation of available-for-sale investments and restricted financial instruments	Surplus from revaluation of other assets	Adjustment for valuation of investments in other companies					
Balance at January 1, 2016	118,130,303,482	63,572,929,305	2,867,809,620	69,678,787	7,084,626,651	73,595,044,363	247,784,553,250	81,237,495,076	18,144,863,035	538,892,259,206
Transactions with owners booked directly in equity:										
Legal reserves	-	-	-	-	-	-	23,820,704,712	(23,820,704,712)	-	-
Other statutory reserves	-	-	-	-	-	-	3,009,050,430	(3,009,050,430)	-	-
Equity of the Development Financing Fund	-	-	-	-	-	-	-	(3,604,956,285)	3,604,956,285	-
Total transactions with owners booked directly in equity	-	-	-	-	-	-	26,829,755,142	(30,434,711,427)	3,604,956,285	-
Comprehensive income for the year:										
Income for the year	-	-	-	-	-	-	-	53,018,907,264	-	53,018,907,264
Adjustment for valuation of available-for-sale investments, net of income tax	5	-	(3,144,026,874)	-	-	(3,144,026,874)	-	-	-	(3,144,026,874)
Adjustment for valuation of restricted financial instruments, net of income tax	5	-	(1,181,803,515)	-	-	(1,181,803,515)	-	-	-	(1,181,803,515)
Adjustment for revaluation of investments in other companies	1-e (iv)	-	-	-	999,676,663	999,676,663	-	-	-	999,676,663
Surplus from revaluation of property	-	537,766,102	-	-	-	537,766,102	-	-	-	537,766,102
Realization of surplus from revaluation of other assets	-	-	-	(25,930,157)	-	(25,930,157)	-	-	-	(25,930,157)
Realization of surplus from revaluation of property	-	(3,303,942,970)	-	-	-	(3,303,942,970)	-	3,303,942,970	-	-
Total comprehensive income for the year	-	(2,766,176,868)	(4,325,830,389)	(25,930,157)	999,676,663	(6,118,260,751)	-	56,322,850,234	-	50,204,589,483
Balance at December 31, 2016	21	118,130,303,482	60,806,752,437	(1,458,020,769)	43,748,630	8,084,303,314	274,614,308,392	107,125,633,883	21,749,819,320	589,096,848,689
Transactions with owners booked directly in equity:										
Legal reserves	-	-	-	-	-	-	33,747,788,494	(33,747,788,494)	-	-
Other statutory reserves	-	-	-	-	-	-	2,759,709,483	(2,759,709,483)	-	-
Capitalization of retained earnings for capital increases	-	54,106,726,620	-	-	-	-	-	(54,106,726,620)	-	-
Equity of the Development Financing Fund	-	-	-	-	-	-	-	(5,362,138,693)	5,362,138,693	-
Total transactions with owners booked directly in equity	-	54,106,726,620	-	-	-	-	36,507,497,977	(95,976,363,290)	5,362,138,693	-
Comprehensive income for the year:										
Income for the year	-	-	-	-	-	-	-	32,763,283,165	-	32,763,283,165
Adjustment for valuation of available-for-sale investments, net of income tax	5	-	(2,157,516,952)	-	-	(2,157,516,952)	-	-	-	(2,157,516,952)
Adjustment for valuation of restricted financial instruments, net of income tax	5	-	1,310,548,066	-	-	1,310,548,066	-	-	-	1,310,548,066
Adjustment for valuation of investments in other companies	1-e (iv)	-	-	-	1,011,321,372	1,011,321,372	-	-	-	1,011,321,372
Surplus from revaluation of property	-	2,210,993,196	-	-	-	2,210,993,196	-	-	-	2,210,993,196
Realization of surplus from revaluation of property	-	(1,592,570,873)	-	-	-	(1,592,570,873)	-	1,592,570,873	-	-
Total comprehensive income for the year	-	618,422,323	(846,968,886)	-	1,011,321,372	782,774,809	-	34,355,854,838	-	35,138,628,847
Balance at December 31, 2017	21	172,237,030,102	61,425,174,760	(2,304,989,655)	43,748,630	9,095,624,686	311,121,806,369	45,505,124,631	27,111,958,013	624,235,477,536

Juan Carlos Corrales Salas  
General Manager

Gerardo Gómez Solís  
General Accountant

Ricardo Araya Jiménez  
General Auditor

The notes are an integral part of these consolidated financial statements.

**BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENT OF CASH FLOWS**  
**FOR THE YEAR ENDED DECEMBER 31, 2017**  
*(With corresponding figures for 2016)*  
(In colones)

	Note	2017	2016
<b>Cash flows from operating activities</b>			
Income for the year		32,763,283,165	53,018,907,264
<b>Items not requiring cash</b>			
Loss on foreign exchange differences and development units, net		25,923,488,901	15,742,283,733
Loss on allowance for loan losses, net		57,098,285,134	27,904,474,431
Gain (loss) on allowance for impairment of investments, net		12,077,667	(76,967,726)
Gain (loss) on allowance for other receivables, net		1,259,072,026	(1,627,980,487)
Gain (loss) on allowance for foreclosed assets, net		2,821,103,061	(1,516,071,844)
Loss on sale of foreclosed assets		9,379,473,223	7,935,053,900
Provision expense, net of payments		(327,622,233)	(12,282,509,121)
Depreciation and amortization		20,734,953,255	16,008,770,591
Share in net profit of foreign associate		(2,615,822,520)	(1,690,868,660)
Statutory allocations, net		13,586,420,635	17,153,405,385
Income tax expense, net		4,875,544,574	9,727,246,069
Finance income on loan portfolio and investments	16-a	(454,809,864,097)	(399,531,788,937)
Finance costs on term obligations with the public and financial entities		179,439,799,405	133,159,583,372
		<u>(109,859,807,804)</u>	<u>(136,076,462,030)</u>
<b>(Increase) decrease in assets</b>			
Credits and cash advances		(362,877,222,686)	(398,559,507,811)
Foreclosed assets		19,669,691,724	16,980,925,818
Accrued interest receivable on other receivables		76,767	189,214
Other assets		(17,048,590,045)	(13,163,209,310)
		<u>(470,115,852,044)</u>	<u>(530,818,064,119)</u>
<b>Net increase (decrease) in liabilities</b>			
Demand and term obligations		721,009,859,573	323,248,259,650
Other accounts payable and provisions		(30,162,164,862)	10,329,163,140
Other liabilities		51,363,536,873	4,298,012,865
		<u>272,095,379,540</u>	<u>(192,942,628,464)</u>
Interest received on loan portfolio and investments		449,749,621,579	396,866,596,331
Income tax paid		(19,708,918,793)	(8,785,784,930)
Interest paid on term obligations with the public and financial entities		(165,362,391,457)	(128,985,623,683)
<b>Net cash from operating activities</b>		<u>536,773,690,869</u>	<u>66,152,559,254</u>
<b>Cash flows from investing activities</b>			
Increase in financial instruments		(17,878,535,120,085)	(15,841,483,511,874)
Decrease in financial instruments		17,892,294,576,235	15,974,082,277,262
Acquisition of property and equipment		(6,098,303,769)	(14,669,445,315)
Sale of property and equipment		164,933,333	1,511,516,134
Cash investments in other companies		-	15,557,425
<b>Net cash from investing activities</b>		<u>7,826,085,714</u>	<u>119,456,393,632</u>
<b>Cash flows from financing activities</b>			
Other new financial obligations		(52,971,581,352)	107,351,729,914
Settlement of obligations		(9,697,922,608)	(274,806,414,303)
<b>Net cash used in financing activities</b>		<u>(62,669,503,960)</u>	<u>(167,454,684,389)</u>
<b>Net increase in cash and cash equivalents</b>		481,930,272,623	18,154,268,497
<b>Cash and cash equivalents at beginning of year</b>		1,019,158,980,617	1,001,004,712,154
<b>Cash and cash equivalents at end of year</b>	4	<u>1,501,089,253,240</u>	<u>1,019,158,980,651</u>

Juan Carlos Cortales Salas  
General Manager

Gerardo Gómez Solís  
General Accountant

Ricardo Araya Jiménez  
General Auditor

The notes are an integral part of these consolidated financial statements.

# BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

## Notes to the Consolidated Financial Statements

December 31, 2017

(With corresponding figures for 2016)

### (1) Summary of operations and significant accounting policies

#### (a) Operations

Banco Nacional de Costa Rica (the Bank) is an autonomous, independently managed, public law institution. As a State-owned bank, it is regulated by the *Internal Regulations of the National Banking System* (IRNBS), the *Internal Regulations of the Central Bank of Costa Rica*, and the *Political Constitution of the Republic of Costa Rica*. It is also subject to oversight by the General Superintendency of Financial Entities (SUGEF) and the Comptroller General of the Republic (CGR). The Bank's registered office is located in San José, Costa Rica.

Pursuant to current regulations, the services offered by the Bank have been divided into three departments: Commercial Banking, Mortgage Banking, and Rural Credit Banking.

In agreement with IRNBS, if a bank divides its services into departments, its operations must be conducted through those departments based on the nature of the operations, rather than as a single banking institution. The Bank's three departments are independent from one another, except for administrative limitations established by the aforementioned regulations. Those regulations also prescribe that earnings must be calculated by combining the gains and losses of all departments and proportionally distributing the resulting net earnings to each department's equity.

Currently, due to innovations in information technology and telecommunications, and especially because of the competition in the national and international financial sectors, the Bank has become a universal bank that offers services in all sectors of the Costa Rican market. Those services include: personal, business, corporate, and institutional banking, stock market, pension fund management, investment funds, insurance brokerage, international banking services, and electronic banking services. The Bank aims to improve the quality of life of the largest possible number of people by offering premium financial services that promote the sustainable creation of wealth.

As of December 31, 2017, the Bank has 176 offices, 474 automated teller machines, and a total of 5,844 employees (2016: 175 offices, 476 automated teller machines, and 5,868 employees). Employees are distributed as follows: Banco Nacional de Costa Rica - 5,442 employees (2016: 5,452); BN Valores Puesto de Bolsa, S.A. - 70 employees (2016: 70); BN Vital Operadora de Planes de Pensiones Complementarias, S.A. - 163 employees (2016: 173); BN Sociedad Administradora de Fondos de Inversión, S.A. - 79 employees (2016: 84); and BN Corredora de Seguros, S.A. - 90 employees (2016: 89). The Bank's website is [www.bncr.fi.cr](http://www.bncr.fi.cr).

(Continued)

BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

The following subsidiaries are wholly owned by the Bank:

BN Valores Puesto de Bolsa, S.A. (the Brokerage Firm) was organized as a corporation in 1998 under the laws of the Republic of Costa Rica. Its main activity is executing securities transactions in the Costa Rican National Stock Exchange (Bolsa Nacional de Valores, S.A.) on behalf of third parties. Such transactions are regulated by the Costa Rican National Stock Exchange, the regulations and provisions issued by the Superintendency General of Securities (SUGEVAL), and the *Securities Market Regulatory Law*.

BN Sociedad Administradora de Fondos de Inversión, S.A. (the Investment Fund Manager) was organized as a corporation on April 29, 1998 under the laws of the Republic of Costa Rica. Its main activity is the management, on behalf of third parties, of closed and open investment funds listed in the Costa Rican National Stock Exchange and SUGEVAL.

BN Vital Operadora de Planes de Pensiones Complementarias, S.A. (the Pension Fund Manager) was organized as a corporation on December 31, 1998 under the laws of the Republic of Costa Rica. Its main activity is offering supplemental old-age and death benefit plans and promoting medium- and long-term planning and savings. Its activities are governed by the *Law of the Private Supplemental Pension Fund System* (Law No. 7523) and the amendments thereto, the *Employee Protection Law* (Law No. 7983), and the *Regulations on Opening and Operating Regulated Entities and Operating Pension, Compulsory, and Voluntary Retirement Savings Funds* as prescribed in the *Employee Protection Law*, *Regulations on Regulated-Entity Investments*, and the directives issued by the Pensions Superintendency (SUPEN).

BN Corredora de Seguros, S.A. (the Insurance Brokerage Firm) was organized as a corporation on May 19, 2009 under the laws of the Republic of Costa Rica. Its main activity is insurance brokerage for policies issued by insurance companies authorized to operate in Costa Rica. Its activities are governed by the *Insurance Market Regulatory Law* (Law No. 8653) and the regulations and provisions issued by the Superintendency General of Insurance (SUGESE).



# BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

## Notes to the Consolidated Financial Statements

The Bank holds 49% ownership interest in the following associate:

Banco Internacional de Costa Rica, S.A. and Subsidiary (BICSA), which was organized under the laws of the Republic of Panama in 1976. BICSA operates under a general license granted by the Superintendency of Banks of Panama to engage in banking operations in Panama or abroad. BICSA's registered office is located in Panama City, Republic of Panama, calle Manuel María Icaza No. 25. BICSA has a branch in Miami, Florida, United States of America. Banco de Costa Rica holds the remaining 51% ownership interest.

As of December 31, the main components that comprise the financial statements of the entities in which the Bank holds ownership interest are detailed below:

2017					
	Brokerage Firm	Pension Fund Manager	Investment Fund Manager	Insurance Brokerage Firm	BICSA
Assets	56,653,442,602	8,532,692,389	6,986,458,994	3,322,074,869	499,013,719,791
Liabilities	41,121,378,325	1,184,699,913	369,535,519	617,538,048	437,281,644,627
Equity	15,532,064,277	7,347,992,476	6,616,923,473	2,704,536,821	61,732,075,164
Income for the year	1,776,740,964	726,185,040	1,741,738,338	2,260,896,821	2,615,822,520
Memoranda accounts	947,725,437,529	1,294,003,298,068	426,177,564,389	-	-
2016					
	Brokerage Firm	Pension Fund Manager	Investment Fund Manager	Insurance Brokerage Firm	BICSA
Assets	55,432,733,834	9,691,092,683	6,622,494,603	2,479,076,938	463,178,771,141
Liabilities	37,872,113,554	2,396,687,260	676,663,523	659,305,471	406,038,192,458
Equity	17,560,620,280	7,294,405,423	5,945,831,080	1,819,771,467	57,140,578,683
Income for the year	2,423,490,098	1,172,980,254	1,614,887,969	1,376,131,467	1,690,868,660
Memoranda accounts	939,715,141,870	1,156,846,965,515	358,238,446,450	-	-

### (b) Basis of preparation of the consolidated financial statements

- Statement of compliance

The consolidated financial statements have been prepared in accordance with the accounting regulations issued by the National Financial System Oversight Board (CONASSIF), SUGEF, SUGEVAL, SUPEN, and SUGESE.

(Continued)

## BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

### Notes to the Consolidated Financial Statements

- Basis of measurement applied to assets and liabilities

The consolidated financial statements have been prepared on a historical cost basis except for the following items:

- available-for-sale assets and derivative instruments are measured at fair value
- property is measured at revalued cost.

The accounting policies have been consistently applied.

- (c) Functional and presentation currency

These consolidated financial statements and notes thereto are expressed in colones (¢), the monetary unit of the Republic of Costa Rica, in accordance with the accounting regulations issued by CONASSIF, SUGEF, SUGEVAL, SUPEN, and SUGESE.

- (d) Basis of consolidation

- i. Subsidiaries*

Subsidiaries are entities controlled by the Bank. Control exists when the Bank has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

As of December 31, 2017 and 2016, the consolidated financial statements include the financial figures of the following subsidiaries:

Subsidiary	Ownership interest
BN Valores Puesto de Bolsa, S.A.	100%
BN Vital Operadora de Planes de Pensiones Complementarias, S.A.	100%
BN Sociedad Administradora de Fondos de Inversión, S.A.	100%
BN Corredora de Seguros, S.A.	100%

(Continued)

## BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

### Notes to the Consolidated Financial Statements

Subsidiaries were consolidated based on the following accounting principles:

- All subsidiaries which the Bank controls, whether directly or indirectly, are consolidated.
- In case there are long-term financial or legal restrictions on the transfer of resources or in case the Bank controls the subsidiary temporarily, the subsidiary is not consolidated.
- On consolidation:
  - The effect of the equity method shown in the parent company's unconsolidated financial statements has been eliminated.
  - Balances of accounts related to reciprocal intra-group transactions have been eliminated from the consolidated balance sheet and consolidated statement of comprehensive income.
  - Uniform accounting policies have been applied by group entities.
  - All significant intra-group balances and transactions have been eliminated. Profit or loss presented in the consolidated financial statements does not differ from profit or loss presented in the parent company's unconsolidated financial statements since the subsidiaries were measured by the equity method when preparing the parent company's unconsolidated financial statements.

#### *ii. Associates*

Associates are those entities in which the Bank has significant influence, but not control. The Bank updates the value of its associates using the equity method from the date that significant influence commences until the date significant influence ceases. As of December 31, 2017 and 2016, the Bank holds 49% ownership interest in BICSA.

#### *(e) Foreign currency*

##### *i. Foreign currency transactions*

Assets and liabilities held in foreign currency are translated into colones at the foreign exchange rate ruling at the consolidated balance sheet date, except for transactions that have a contractually agreed exchange rate. Transactions in foreign currency during the year are translated at the exchange rates ruling on the dates of the transactions. Foreign exchange gains and losses arising on translation are reflected in profit or loss for the period.

(Continued)

BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

ii. *Monetary unit and foreign exchange regulations*

The parity of the colon with the dollar of the United States of America is determined in a free exchange market, under the supervision of the Central Bank of Costa Rica (BCCR) through a managed float regime. Under the managed float regime, the exchange rate is determined by the market, but BCCR still reserves the right to intervene in the foreign currency market to moderate significant fluctuations in the exchange rate and prevent deviations from the behavior of the variables that explain its medium- and long-term trends.

In accordance with the Chart of Accounts, assets and liabilities denominated in foreign currency should be expressed in colones using the reference buy rate published by BCCR. As of December 31, 2017, the exchange rate was established at ₡566.42 and ₡572.56 (2016: ₡548.18 and ₡561.10) to US\$1.00 for the purchase and sale of U.S. dollars, respectively.

iii. *Valuation method for assets and liabilities denominated in foreign currency*

As of December 31, 2017, assets and liabilities denominated in U.S. dollars were valued at the exchange rate of ₡566.42 to US\$1.00 (2016: ₡548.18 to US\$1.00), which is the reference buy rate published by BCCR for that date.

As of December 31, 2017, assets and liabilities denominated in euros were valued at the exchange rate of ₡676.70 to €1.00 (2016: ₡573.07 to €1.00). This exchange rate was calculated by multiplying the international exchange rate published by Reuters by the reference buy rate for U.S. dollars published by BCCR on the last business day of the month.

As of December 31, 2017, assets and liabilities denominated in Development Units (DU) were valued at the exchange rate of ₡880.47 to DU1.00 (2016: ₡859.52 to DU1.00). This exchange rate is based on the DU value tables published by SUGEVAL.

iv. *Financial statements of foreign operations (BICSA)*

The financial statements of BICSA are presented in U.S. dollars, which is the entity's functional currency. As of December 31, 2017 and 2016, the Bank holds 49% ownership interest in BICSA. Accordingly, the Bank should value its investment in that entity by the equity method rather than on a consolidated basis.

(Continued)



## BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

### Notes to the Consolidated Financial Statements

The financial statements of foreign operations are translated as follows:

- Monetary assets and liabilities denominated in U.S. dollars have been translated at the closing exchange rate.
- Non-monetary assets and liabilities have been translated at the exchange rate in effect on the date of the transaction (historical rates).
- Equity balances, except profit or loss for the period, have been translated at the exchange rate in effect on the date of the transaction (historical rates).
- Income and expenses have been translated at average exchange rates in effect for the year, except depreciation expense, which has been translated at historical rates.

For the year ended December 31, 2017, a foreign exchange gain in the amount of ¢1,011,321,372 (2016: foreign exchange gain of ¢999,676,663) is presented in equity for the translation of the consolidated financial statements of foreign operations. As of December 31, 2017, the adjustment for valuation of investments in other companies amounts to ¢9,095,624,686 (2016: ¢8,084,303,314).

(f) Financial assets and financial liabilities

i. *Recognition*

The Bank initially recognizes loans and advances, deposits, and debt securities issued on the date on which they are originated. Regular-way purchases and sales of financial assets are recognized on the trade date, which is the date on which the Bank commits to purchase or sell the asset. All assets and liabilities are recognized initially on the trade date, which is the date on which the Bank becomes a party to the contractual provisions of the instrument.

ii. *Classification*

Cash and cash equivalents

Cash and cash equivalents include cash on hand, cash deposited in BCCR, deposits in other banks, and highly-liquid short-term investments with maturities of two months or less at the time of purchase.

Cash and cash equivalents are recognized in the consolidated balance sheet at amortized cost.

(Continued)

## BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

### Notes to the Consolidated Financial Statements

#### Investments in financial instruments

Investments in financial instruments are initially measured at fair value plus incremental direct transaction costs and subsequently accounted for depending on their classification as trading, available for sale, or held to maturity.

Under current regulations, trading instruments are investments in open investment funds that the Bank holds for the purpose of short-term profit taking.

Available-for-sale assets are financial assets that are not held for trading purposes, originated by the Bank, or held to maturity.

Held-to-maturity assets are financial assets with fixed or determinable payments and fixed maturity that the Bank has the positive intent and ability to hold to maturity. According to regulations, the Bank is barred from holding investments in financial instruments classified as held to maturity, except for the securities denominated in DU.

As of December 31, 2017, the Bank no longer classifies financial instruments as held-to-maturity, except for the securities denominated in DU received from the Central Government to capitalize the Bank. Those securities were authorized by the Executive Branch of the Government of Costa Rica as a capital contribution and are funded under the *Amendment to Law No. 8627 on the Ordinary and Extraordinary Budget of the Republic for Tax Year 2008* (Law No. 8703).

#### Securities sold under repurchase agreements

The Bank sells securities under agreements to repurchase them on a certain date in the future at a fixed price. The obligation to repurchase securities sold is reflected as a liability in the consolidated balance sheet and presented at the value of the original agreement. The underlying securities are booked in asset accounts. Interest is presented as finance costs in the consolidated statement of comprehensive income and accrued interest payable is recognized in the consolidated balance sheet.

#### Securities purchased under reverse repurchase agreements

The Bank purchases securities under agreements to sell them on a certain date in the future at a fixed price. The obligation to sell securities purchased is reflected as an asset in the consolidated balance sheet and stated at the value of the original agreement. The underlying securities are booked in asset accounts. Interest earned is presented as finance income in the consolidated statement of comprehensive income and accrued interest receivable is recognized in the consolidated balance sheet.

(Continued)

## BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

### Notes to the Consolidated Financial Statements

#### Derivative financial instruments

Derivative financial instruments are recognized initially at cost. Subsequent to initial recognition, derivative financial instruments are stated at fair value. The Bank does not hold derivative financial instruments for trading purposes.

Valuation gains or losses are recorded in the consolidated statement of comprehensive income. The Bank will exercise the option when the interest rate reaches the agreed limit.

#### Originated loans and other receivables

Originated loans and other receivables are loans and receivables originated by the Bank providing money to a debtor, other than those created with the intention of short-term profit taking. Originated loans and other receivables comprise loans and advances to banks and customers other than loans and bonds purchased from the original issuer.

#### Deposits and debt securities issued

Deposits and debt securities issued are the Bank's sources of debt funding.

Deposits and debt securities issued are initially measured at fair value plus directly attributable transaction costs, and subsequently measured at their amortized cost using the effective interest method.

#### *iii. Derecognition*

A financial asset is derecognized when the Bank loses control over the contractual rights that comprise the asset. This occurs when the rights are realized, expire, or are surrendered. A financial liability is derecognized when the specific contractual obligation has been paid or settled, or when the obligation has expired.

#### *iv. Offsetting*

Financial assets and financial liabilities are offset and the net amount presented in the consolidated financial statements when the Bank has a legal right to set off the amounts and it intends to settle them on a net basis.

(Continued)

BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

v. *Amortized cost measurement*

The amortized cost of a financial asset or financial liability is the amount at which the financial asset or financial liability is measured at initial recognition, minus principal repayments, plus or minus the cumulative amortization of any difference between the initial amount recognized and the maturity amount, minus any reduction for impairment.

All non-trading financial assets and liabilities and originated loans and other receivables are measured at amortized cost, less impairment losses. Any premium or discount is included in the carrying amount of the underlying instrument and amortized to finance income or finance costs.

vi. *Fair value measurement*

The fair value of financial instruments is based on their quoted market price at the date of the consolidated financial statements, without any deduction for transaction costs.

Determination of fair value for financial assets and liabilities for which there is no market price requires the use of valuation techniques. For financial instruments that trade infrequently and have little price transparency, fair value is less objective, and requires varying degrees of judgment depending on liquidity, concentration, uncertainty of market factors, pricing assumptions, and other variables affecting the specific instrument.

Valuation techniques include present value and discounted cash flow models, comparison with similar instruments for which observable market prices exist and other valuation models. The Bank selects the valuation model that most adequately reflects the fair value of each class of financial instrument based on its complexity. Unlike market prices, fair values cannot be implicitly determined using professional judgment. Models used are revised periodically to update market factors and allow the Bank determine the fair value of its financial instruments.

Management of the Bank considers such valuations necessary and appropriate to ensure that its instruments are accurately presented in the consolidated financial statements.



## BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

### Notes to the Consolidated Financial Statements

#### Investments in financial instruments

Financial instruments are measured initially at fair value, including transaction costs.

Subsequent to initial recognition, all trading and available-for-sale investments are measured at fair value, except for any investment or instrument that does not have a quoted market price in an active market and whose fair value cannot be reliably measured, which is stated at cost, including transaction costs, less impairment losses. As of December 31, 2017 and 2016, the market price valuation methodology established by VALMER Costa Rica, S.A. is used. This methodology has been duly approved by SUGEVAL.

For securities issued by foreign entities and listed in open systems such as Bloomberg, the permanent quotes published in these primary sources should be used. Given that the information in open systems is obtained from financial systems all over the world, the last price listed is used as the price of the security. As an exception applicable to all currencies, when it is not possible to obtain a quote from open systems, the security is valued at an amount equivalent to its purchase price.

Internal debt Central Bank bonds received for the capitalization of State-owned banks are classified as held-to-maturity investments, as set forth in Law No. 8703 of December 23, 2008, which reads as follows: "These securities shall be delivered directly to State-owned banks and held to maturity and, therefore, they are not available for sale. Accordingly, these securities shall not be subject to market price valuation." Consequently, the classification applied to these securities is justified by the fact that it is prescribed by law. These securities are recognized at amortized cost and are zero-coupon securities.

The effect of the valuation of trading investments at market price is booked directly in profit or loss for the year.

#### Derivative financial instruments

The valuation methodology applied to derivative financial instruments varies depending on the type of product to be valued.

In the case of foreign exchange forward contracts (FX forwards), with short credit positions and maturities generally not exceeding one year, valuation involves comparing the present value of the negotiated forward exchange rate and the current foreign exchange rate. The present value of the negotiated forward exchange rate is calculated by using the difference of the zero coupon rates.

(Continued)

BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

In the case of swaps (FX swap or currency swap), valuation involves two steps. In the first step, future cash flows are estimated based on current market prices. The estimation of fixed-rate cash flows does not require assumptions, but variable-rate cash flows are estimated based on the rates in effect. Calculating the present value of each type of cash flows requires a valuation rate for each cash flow, which is equivalent to the base rate plus a credit spread.

For fixed-rate cash flows, the base rate is the zero coupon rate. For variable-rate cash flows, the base rate is the benchmark rate plus the spread applicable to the term of the cash flow. The spread is applicable to the Bank's cash flows receivable or payable and depends on the credit rating of the counterparty and the instruments' maturity.

vii. *Gains and losses on subsequent measurement*

Gains and losses arising from changes in the fair value of available-for-sale assets are recognized directly in equity until an investment is considered to be impaired, at which time the loss is recognized in the consolidated statement of comprehensive income. When the financial assets are sold, collected, or otherwise disposed of, the accumulated gain or loss recognized in equity is transferred to the consolidated statement of comprehensive income.

viii. *Impairment of financial assets*

The carrying amount of an asset is reviewed at each consolidated balance sheet date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated. An impairment loss is recognized whenever the carrying amount of an asset exceeds its recoverable amount. Impairment losses are recognized in the consolidated statement of comprehensive income for assets carried at cost and treated as a decrease in unrealized gains for assets carried at fair value.

The recoverable amount of an asset is the greater of its net selling price and its value in use. The net selling price is equivalent to the value obtained in an arm's length transaction. Value in use is the present value of future cash flows and disbursements expected to arise from the continuing use of an asset and from its disposal at the end of its useful life.

If, in a subsequent period, the amount of the impairment loss decreases, and the decrease can be related objectively to an event occurring after the impairment loss was recognized, then the impairment loss write-down is reversed through the consolidated statement of comprehensive income or the consolidated statement of changes in equity, as appropriate.

(Continued)

BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

(g) Loan portfolio

SUGEF defines a credit operation as any operation related to any type of underlying instrument or document, except investments in financial instruments, whereby credit risk is assumed either by providing or committing to provide funds or credit facilities, acquiring collection rights, or guaranteeing that obligations with third parties will be honored. Credit operations include loans, guarantees, letters of credit, pre-approved lines of credit, and loans pending disbursement.

The loan portfolio is presented at the amount of outstanding principal. Interest is calculated based on the value of outstanding principal and the contractual interest rates, and is accounted for as income using the accrual method of accounting. The Bank follows the policy of suspending interest accruals on loans when principal or interest payments are more than 180 days past due. The recovery or collection of that interest is recognized as income when collected.

(h) Allowance for loan losses

The allowance for loan losses is based on a periodic assessment of the collectibility of the loan portfolio that considers a number of factors, including current economic conditions, prior experience with the allowance, the portfolio structure, borrower liquidity, and loan guarantees.

Additionally, the collectibility of the loan portfolio is assessed in conformity with the provisions of SUGEF Directive 1-05 *Regulations for Borrower Classification*, which was approved by CONASSIF on November 24, 2005, was published in Official Gazette No. 238 dated December 9, 2005, and is effective as of October 9, 2006. That assessment considers parameters including borrower payment history, creditworthiness, quality of guarantees, and delinquency.

SUGEF may require an allowance to be established for an amount greater than the amount determined by the Bank.

Management considers the allowance to be sufficient to absorb any potential losses that may be incurred on recovery of the portfolio.

As of December 31, 2017 and 2016, increases in the allowance for loan losses are included in the accounting records in accordance with Article 10 of IRNBS.

BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

(i) Allowance for impairment of derivative instruments other than hedges

The provisions of Article 35 of SUGEF Directive 9-08 are to be applied in calculating the allowance for clearing price risk in respect of each customer or counterparty. For such purposes, the capital requirement adjusted for clearing price risk (as defined in Article 28 of SUGEF Directive 3-06) must be multiplied by the respective allowance percentage corresponding to the borrower rating included in SUGEF Directive 1-05.

(j) Other receivables

The recoverability of these accounts is assessed by applying criteria similar to those established by SUGEF Directive 1-05 for the loan portfolio. Notwithstanding the results of the assessment, if an account is not recovered within 120 days from the due date, an allowance is established for an amount equivalent to 100% of the balance receivable. Accounts with no specified due date are considered payable immediately.

(k) Foreclosed assets

Foreclosed assets are assets owned by the Bank for realization or sale (i.e. assets received in lieu of payment, assets awarded in judicial auctions, assets purchased to be leased under finance and operating leases, assets produced for sale, idle property and equipment, and other foreclosed assets).

Foreclosed assets are valued at the lower of cost and market value. If market value is less than the cost booked in the accounting records, an impairment allowance must be booked for the amount of the difference between both values. Cost is the historical acquisition or production value in local currency. These assets should not be revalued or depreciated for accounting purposes, and they are to be booked in local currency. The cost booked in the accounting records for a foreclosed asset may only be increased by the amount of improvements or additions, up to the amount by which they increase the asset's realizable value. Other expenditures related to foreclosed assets are to be expensed in the period incurred.



BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

The net realizable value of an asset should be used as its market value. Net realizable value is determined by applying strictly conservative criteria and is calculated by subtracting expenses to be incurred in the sale of the asset from its estimated selling price. The estimated selling price of the asset is determined by an appraiser based on current market conditions. Future expectations for market improvements are not considered, and it is assumed that the assets must be sold in the shortest period of time possible to enable the Bank to recover the money invested and use it for its business activities. For all foreclosed assets, reports should be prepared by the appraisers who performed the appraisals, and those reports must be updated at least annually.

If an asset booked in this group is used by the Bank, it should be reclassified to the appropriate account in the corresponding group.

SUGEF Directive 34-02 requires that the allowance for impairment of foreclosed assets acquired or produced after May 2010 be established gradually by booking one-twenty-fourth of the value of such assets each month during two years until the allowance is equivalent to 100% of the assets' carrying amount.

For foreclosed assets prior to the aforementioned date, management of the Bank follows the policy of recognizing an allowance equivalent to 100% of the realizable value for assets that are not sold or leased, within two years from the date of acquisition or production.

(l) Investments in other companies

Investments in the share capital of entities over which the Bank exercises control or significant influence are accounted for using the equity method. The Bank's investments in other companies are as follows:

Entity	Ownership interest
BN Valores Puesto de Bolsa, S.A.	100%
BN Vital Operadora de Planes de Pensiones Complementarias, S.A.	100%
BN Sociedad Administradora de Fondos de Inversión, S.A.	100%
BN Corredora de Seguros, S.A.	100%
Banco Internacional de Costa Rica, S.A. (Panama)	49%

Investments in other companies are recorded using the equity method, which initially recognizes investments at acquisition cost. Subsequently, the carrying amounts of the investments are increased or decreased in order to recognize the Bank's proportional share in the profits or losses of the issuer of the capital assets (see note 1a).

(Continued)

BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

The operations of subsidiaries that affect the Bank's equity but have no effect on the results of its operations are also included in the Bank's accounting records.

As of December 31, 2017 and 2016, the Bank has no full or partial share or influence over the management of other companies, in accordance with Article 73 of IRNBS and Article 146 of the *Internal Regulations of the Central Bank of Costa Rica*.

(m) Property, furniture and equipment

*i. Own assets*

Property and equipment is stated at cost, net of accumulated depreciation. Significant improvements are capitalized, while minor repairs and maintenance that do not extend the useful life or improve the asset are directly expensed when incurred.

Pursuant to the requirements established by the regulating entity SUGEF in Article 8 of Directive 34-02, the Bank must have its real property appraised at least once every five years by an independent appraiser, authorized by the corresponding institute, in order to determine its net realizable value (NRV). If the net realizable value is less or more than the carrying amount, the carrying amount must be adjusted to the appraisal value.

*ii. Leased assets*

Leases in terms of which the Bank assumes substantially all the risks and rewards of ownership are classified as finance leases.

Property and equipment acquired under finance leases is measured at the lower of its fair value and the present value of minimum payments at the date of inception of the lease, less accumulated depreciation and amortization and impairment losses.

*iii. Subsequent expenditure*

Expenditure incurred to replace a component of an item of property and equipment is capitalized and accounted for separately. Subsequent expenditure is capitalized only when it increases the future economic benefits. All other expenditure is recognized in the consolidated statement of comprehensive income when incurred.

BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

iv. *Depreciation and amortization*

Depreciation and amortization are charged to the consolidated statement of comprehensive income on a straight-line basis over the estimated useful lives of the assets, as follows:

<u>Type of asset</u>	<u>Estimated useful life</u>
Buildings	25 to 120 years (1)
Vehicles	10 years
Furniture and equipment	10 years
Computer hardware	5 years
Portable computers	3 years
Leasehold improvements	To be determined or established in the lease terms

(1) *The useful life of buildings varies according to the valuations performed.*

(n) Intangible assets

i. *Other intangible assets*

Other intangible assets acquired by the Bank are stated at cost less accumulated amortization and impairment losses.

ii. *Subsequent expenditure*

Subsequent expenditure is capitalized only when it increases future economic benefits. All other expenditure is recognized in the consolidated statement of comprehensive income when incurred.

iii. *Amortization*

Amortization is charged to profit or loss on a straight-line basis over the estimated useful lives of the related assets. Computer software and software licenses have an estimated useful life of three years and one year, respectively.

(Continued)

BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

(o) Impairment of non-financial assets

The carrying amount of an asset is reviewed at each consolidated balance sheet date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated. An impairment loss is recognized whenever the carrying amount of an asset exceeds its recoverable amount. Impairment losses are recognized in the consolidated statement of comprehensive income for assets carried at cost and treated as a revaluation decrease for assets carried at revalued amounts.

The recoverable amount of an asset is the greater of its net selling price and its value in use. The net selling price is equivalent to the value obtained in an arm's length transaction. Value in use is the present value of future cash flows and disbursements expected to arise from the continuing use of an asset and from its disposal at the end of its useful life.

If, in a subsequent period, the amount of the impairment loss decreases, and the decrease can be linked objectively to an event occurring after the write-down, the write-down is reversed through the consolidated statement of comprehensive income or consolidated statement of changes in equity, as appropriate.

(p) Accounts payable and other liabilities

Accounts payable and other liabilities are carried at cost.

(q) Provisions

A provision is recognized in the consolidated balance sheet if, as a result of a past event, the Bank has a present legal or constructive obligation, and it is probable that an outflow of economic benefits will be required to settle the obligation. The provision made approximates settlement value; however, final amounts may vary. The estimated value of provisions is adjusted at the consolidated balance sheet date, directly affecting the consolidated statement of comprehensive income.

BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

(r) Employee benefits

i. *Severance benefits*

Costa Rican legislation requires the payment of severance benefits to employees in the event of retirement, death, or dismissal without just cause, equivalent to seven days' salary for employees with between three and six months of service, 14 days' salary for employees with between six months and one year of service, and an amount prescribed by the *Employee Protection Law* for employees with more than 1 year of service, up to a maximum of eight years.

In the specific case of the Bank, that limit is 17 years for employees with more than 25 years of service. The Bank follows the policy of booking a provision to cover future disbursements related thereto for employees with more than 20 years of service, in compliance with Article 34 of the *Collective Bargaining Agreement*. As of December 31, 2017 and 2016, severance is included in the provisions account (see note 17), which meets the legal provisioning requirements in effect as of those dates.

Pursuant to the *Employee Protection Law*, all employers must contribute 3% of monthly employee salaries during the entire term of employment to the Supplemental Pension System. Contributions are collected through the Costa Rican Social Security Administration (CCSS) and are then transferred to pension fund operators selected by employees.

The Bank follows the practice of making monthly transfers to the Employee Association equivalent to 5.33% of member employees' monthly salaries for management and custody, which are expensed in the period incurred. The aforementioned contributions are considered advance severance payments.

ii. *Short-term employee benefits*

*Statutory Christmas bonus*

Costa Rican legislation requires the payment of one-twelfth of an employee's monthly salary for each month of service. That payment is made to the employee in December, even in the event of dismissal. The Bank books a monthly accrual to cover future disbursements related thereto.

## BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

### Notes to the Consolidated Financial Statements

#### *Vacation*

Costa Rican legislation entitles employees to a certain number of vacation days for every year of service. The Bank follows the policy of provisioning the payment of vacation days on an accrual basis. The Bank establishes a provision for payment of vacation benefits to its employees.

#### *Back-to-school bonus*

The Back-to-school bonus is a percentage of the employee's salary earned during the year and is paid in the second week of January of the following year. The Bank establishes a fixed percentage of 8% for every year. The Bank books a monthly accrual to cover future disbursements related thereto.

#### *Incentives and Performance Assessment System (SEDI)*

SEDI is an economic incentive that is granted provided that the following two conditions are met:

- The Bank reports profits in its audited financial statements for the corresponding period.
- The employee eligible for the SEDI incentive has worked for at least six months for the Bank during the period and has obtained the required minimum score in the assessed areas.

The incentive aims to promote effective achievement of institutional objectives and goals, which requires continuous efforts by the Bank to coordinate and consolidate its work force, increase its productivity, and ensure its compensation is market-competitive.

The method applied considers the above conditions and income after income tax and statutory allocations. The incentive to be granted to each employee is determined based on salaries earned during the year and the score obtained by the employee. Incentives are paid to employees in a lump sum. Expenses are booked against a provision account on a monthly basis and, in the following year, that account is cleared upon payment of incentives to employees that met the aforementioned conditions.

## BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

### Notes to the Consolidated Financial Statements

#### *iii. Employee Protection and Retirement Fund*

The Employee Protection and Retirement Fund of Banco Nacional de Costa Rica (the Fund) was created by Law No. 16 (*Law of Banco Nacional de Costa Rica*) dated November 5, 1936 and has been amended on a number of occasions. The most recent amendment was included in Law No. 7107 (*Law to Modernize the Financial System of the Republic*) of October 26, 1988. Pursuant to Law No. 16, the Fund was established as a special employee protection and retirement system for the Bank's employees. The Fund is comprised of the following:

- items established by the laws and regulations related to the Fund
- contributions made by the Bank equivalent to 10% of total wages
- contributions made by employees equivalent to 5% of total wages to strengthen the Fund
- income from investments made by the Fund and other potential income.

For members of the Fund who terminate their employment prior to being entitled to a pension, the member's accrued balance is paid in accordance with the conditions stipulated in the *Fund's Regulations on Retirement*.

The Governing Body is responsible for the Fund's Internal Management. The Fund's accounting records are kept by Bank employees selected based on their qualifications, in accordance with the provisions of the Governing Body and with the oversight of the Internal Audit Department. Those employees are independent from the Bank's general accounting department. The Fund operates based on the principle of solidarity.

The Bank's contributions to the Fund are considered defined contribution plans. Consequently, the Bank has no additional obligations.

#### (s) Deferred income

Deferred income corresponds to income received in advance by the Bank and its subsidiaries that should not be recognized in profit or loss since it has not yet been accrued. Deferred income is recognized and credited to the corresponding income account as it accrues.



# BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

## Notes to the Consolidated Financial Statements

### (t) Legal reserve

Pursuant to Article 12 of IRNBS, the Bank appropriates 50% of each year's earnings after income taxes and statutory allocations to a legal reserve. Such appropriation is performed pursuant to the Chart of Accounts for Financial Entities, Groups, and Conglomerates. Accordingly, in the first and second halves of each year, income and expenses are offset, and the sum of the results of each half year is transferred to opening retained earnings.

### Other statutory reserves

In order to comply with Panamanian regulations, the associate BICSA must create the following statutory reserves:

Statutory reserve	Agreement of the Superintendency of Banks of Panama
Statutory reserve for foreclosed assets	Agreement No. 003-2009
Excess of statutory reserve for loans	Resolution No. SBP-GJD-003-2013
Statutory dynamic provision	Agreement No. 004-2014

### (u) Revaluation surplus

Revaluation surplus included in the consolidated statement of changes in equity may be transferred directly to prior period retained earnings when the surplus is realized. Total surplus is realized on the retirement, disposal, or use of the asset. The transfer of revaluation surplus to prior period retained earnings is not made through the consolidated statement of comprehensive income. The Bank follows the policy of transferring the revaluation surplus to prior period retained earnings, for its subsequent capitalization, in accordance with Article No. 8 of IRNBS (Law No. 1644) and SUGEF Directive 33-07.

### (v) Income tax

Income tax is determined pursuant to the provisions of the *Income Tax Law*, which require that the Bank file its income tax returns for the 12 months ending December 31 of each year. Any resulting tax is recognized in profit or loss for the year and credited to a liability account in the consolidated balance sheet.

#### *i. Current tax*

Current tax is the expected tax payable on taxable income for the year, using tax rates enacted at the consolidated balance sheet date, and any adjustment to tax payable in respect of previous years.

(Continued)

BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

ii. *Deferred tax*

Deferred tax is provided using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. In accordance with this method, temporary differences are identified as either taxable temporary differences (which result in future taxable amounts) or deductible temporary differences (which result in future deductible amounts). A deferred tax liability represents a taxable temporary difference, and a deferred tax asset represents a deductible temporary difference.

A deferred tax asset is recognized only to the extent that there is a reasonable probability that it will be realized.

Regarding the tax benefits applied to the Development Credit Fund (DCF) as part of the resources of the Development Banking System managed by the Bank, as established in Article 15 of the *Comprehensive Amendment to Law No. 8634, Development Banking System Act, and Amendment to Other Laws* (Law No. 9274), effective from November 27, 2014, that fund is exempt from income tax and from any other type of tax.

The 8% exemption on securities is effective from August 23, 2016, as evidenced in certification SRCST-TV-009-2016 of the Ministry of Finance issued for the period of one year, which was renewed indefinitely by means of resolution DGCN-146-2017, at the request of the banks that manage the fund, i.e. Banco Nacional de Costa Rica and Banco de Costa Rica.

(w) Segment reporting

A business segment is a distinguishable component of the Bank that is engaged either in providing a specific product or service, or a group of related products or services within a particular economic environment and that is subject to risks and returns different from those of other business segments.

(x) Combination of financial statements of departments

The financial statements of the Commercial Banking, Mortgage Banking, and Rural Credit Banking departments were combined to determine the financial and economic position of the legal entity (the Bank), since those departments are dedicated to banking activities and are directly subordinated to the Bank's General Board of Directors, which is responsible for making decisions related to those departments.

(Continued)

## BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

### Notes to the Consolidated Financial Statements

All inter-department assets, liabilities, income, and expenses have been eliminated in the process of combining the financial statements.

Pursuant to the provisions of IRNBS, the accounting records of each of the Bank's departments are kept separately.

(y) Use of estimates

The preparation of the financial statements requires management to make judgments, estimates, and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income, and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised and in any future periods affected.

Material estimates that are particularly susceptible to significant changes are related to determination of the allowances for loan losses, determination of the fair value of financial instruments, determination of the useful lives of property and equipment, and determination of provisions for credit card points and miles.

(z) Recognition of income and costs

*i. Finance income and finance costs*

Finance income and finance costs are recognized in the consolidated statement of comprehensive income as they accrue. Finance income and finance costs include amortization of any premium or discount during the term of the instrument until maturity.

The Bank follows the policy of suspending interest accruals on loans when principal or interest payments are more than 180 days past due. Finance income on those loans is recognized when collected.

DU are valued using the rates provided by SUGEVAL for such purposes. The effect of valuation of assets and liabilities denominated in DU is directly booked in the corresponding foreign exchange gain and foreign exchange loss accounts in the consolidated statement of comprehensive income.

(Continued)

BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

*ii. Fee and commission income*

Fee and commission income arises on services provided by the Bank and is recognized when the corresponding service is provided. When fees and commissions are an integral part of the return on the underlying operation, they are deferred over the term of the operation and amortized using the effective interest method.

*iii. Income from foreign currency exchange and arbitrage*

Income from foreign currency exchange and arbitrage corresponds to foreign exchange gains arising from the purchase and sale of foreign currency. Cumulative foreign exchange gains arising from purchases and sales of foreign currency conducted during the month are recognized in the consolidated statement of comprehensive income on a monthly basis.

*iv. Operating lease expenses*

Payments for operating lease agreements are recognized in the consolidated statement of comprehensive income over the life of the lease.

(aa) Statutory allocations

In accordance with SUGEF's Chart of Accounts, statutory allocations on the period's net earnings payable to the National Institute for Cooperative Development (INFOCOOP), the National Emergency Commission (CNE), the National Commission for Educational Loans (CONAPE), and the Disability, Old Age, and Death Benefit System (RIVM) are recognized as expenses in the consolidated statement of comprehensive income.

Under Article 12 of IRNBS, the net earnings of commercial State-owned banks are allocated as follows: 50% to a legal reserve; 10% to increase the capital of INFOCOOP; and the remainder to increase the Bank's capital, pursuant to Article 20 of Law No. 6074.

Pursuant to paragraph a) of Article 20 of the *Law to Create the National Commission for Education* (CONAPE) (Law No. 6041), the Bank is required to make statutory allocations equivalent to 5% of earnings before taxes and statutory allocations to CONAPE.

## BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

### Notes to the Consolidated Financial Statements

In accordance with Article 46 of the National Emergency and Risk Prevention Act, all institutions of the central administration and decentralized public administration, as well as State-owned entities, must contribute three percent (3%) of their reported earnings before taxes and statutory allocations and of their accumulated budget surplus to CNE. Such funds are deposited in the National Emergency Fund to finance the National Risk Management System.

Article 78 of the *Employee Protection Law* (Law No. 7983) establishes a contribution of up to 15% of the earnings of State-owned public companies, with the purpose of strengthening the funding base for the RIVM of CCSS and to provide universal CCSS coverage for impoverished non-salaried workers. Accordingly, through Executive Order No. 37127-MTSS, published in Official Gazette No. 103 dated May 29, 2012, this contribution is established gradually as follows:

- 5% starting 2013
- 7% starting 2015
- 15% starting 2017

For the Pension Fund Manager, Article No. 49 of Law No. 7983 establishes that public capital pension operators must allocate 50% of their earnings to the affiliates of the Compulsory Retirement Savings Fund. Through Articles No. 5 and No. 13 of the minutes of meetings No. 1128-2014 and No. 1129-2014, respectively, held on September 29, 2014, CONASSIF established the monthly recording of this allocation as earnings are generated during the period. The allocation amount must be adjusted at the end of the period based on the annual earnings reflected in the audited financial statements. The recognition of such allocation became effective as of January 1, 2015; therefore, financial statements for 2014 do not reflect this expense.

#### (bb) Development Financing Fund (FOFIDE)

In accordance with Article 32 of the *Development Banking System Act* No. 8634, all State-owned banks, except Banco Hipotecario para la Vivienda (BANHVI), must appropriate each year at least five percent (5%) of their net earnings after income taxes to create and strengthen their own development funds. The objective of that appropriation is to provide financing to individuals and legal entities that present viable and feasible projects in conformity with the provisions of the aforementioned law.

## BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

### Notes to the Consolidated Financial Statements

For purposes of establishing and strengthening development financing funds, all State-owned banks must transfer to their respective funds the amount corresponding to prior period's earnings in the second quarter of each year. At that time, the development financing programs that have been approved by the Governing Board will start operations.

(cc) Development Credit Fund (FCD)

The Development Credit Fund (FCD) is comprised of the funds prescribed in Article 59 of IRNBS (Law No. 1644). The FCD will be managed by State-owned banks. Accordingly, in compliance with Law No. 9094 *Repeal of Transition Provision VII of Law No. 8634*, and Article 35 of the *Development Banking System Act* (Law No. 8634), in meeting No. 119 of January 16, 2013, through agreement No. AG-1015-119-2013, Banco de Costa Rica and Banco Nacional de Costa Rica are appointed managers for five years from the date of signing of the respective management agreements. Each bank is awarded the management of fifty percent (50%) of such fund.

As a result, through Official Letter CR/SBD-014-2013, the Technical Secretariat of the Governing Board required all private banks to open checking accounts with both Banco Nacional de Costa Rica and Banco de Costa Rica (Managing Banks) in local and foreign currency and allocate fifty percent (50%) of those funds to each Managing Bank.

The powers granted by the Governing Board to the Managing Banks are as follows:

- a. Pursuant to Article 6 of Law No. 8634, the Managing Banks may offer first-tier banking services to the beneficiaries of the Development Banking System.
- b. Pursuant to Article 35 of Law No. 8634, the Managing Banks may offer second-tier banking services with FCD funds for financial entities other than private banks, provided that the purposes and obligations established in Law No. 8634 are met and such entities are duly authorized by the Governing Board.
- c. Pursuant to Article 35 of Law No. 8634, the Managing Banks may channel FCD funds through placements to: associations, cooperatives, foundations, non-governmental organizations, producer organizations, or other formal entities, provided that they perform loan operations through development financing programs that meet the objectives established in Law No. 8634 and are duly authorized by the Governing Board.

(Continued)

BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

- d. The term of the agreement is five years, renewable for equal and successive periods, unless a written order by the Governing Board provides otherwise and is notified at least three months in advance. If a lack of capacity and competence is proven by the Managing Banks, this agreement may be terminated under paragraph j), Article 12 of Law No. 8634, and the executive regulations thereto.

(dd) Trust operations

Assets managed by the Bank as trustee are not considered part of the Bank's equity and, therefore, are not included in the consolidated financial statements. Fee and commission income derived from trust management is recognized on an accrual basis.



BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

(2) Collateralized or restricted assets

As of December 31, collateralized or restricted assets are as follows:

Restricted asset	Cause of restriction	2017 Carrying amount	2016 Carrying amount
<i>Cash and due from banks:</i>			
Checking account – colones (note 4)	Minimum legal deposit	506,614,839,613	435,159,276,456
Checking account – U.S. dollars (note 4)	Minimum legal deposit	277,771,308,370	221,712,351,226
Checking account – euros (note 4)	Minimum legal deposit	4,005,701,580	4,350,556,378
Other cash and due from banks (note 4)	Custody of liabilities of Banco Crédito Agrícola de Cartago	8,900,457,858	-
Other cash and due from banks (note 4)	Margin calls for tri-party repurchase agreements	112,717,628	-
Other cash and due from banks (note 4)	Contribution to FOGABONA	187,856,613	248,795,209
		<u>797,592,881,662</u>	<u>661,470,979,269</u>
<i>Investments in financial instruments:</i>			
Investments in financial instruments	Guarantee for tri-party repurchase agreements	25,698,653,608	26,849,711,867
Investments in financial instruments	Liquidity market operations	22,382,659,573	14,875,504,659
Securities issued by BCCR and the Government	Investments securing repurchase agreements	203,162,716	1,054,894,475
External debt bonds	Nomura Bank guarantee	82,461,472,891	71,767,100,042
External debt bonds	Credit Suisse guarantee	-	57,001,678,155
		<u>130,745,948,788</u>	<u>171,548,889,198</u>
<i>Other assets:</i>			
Other assets (note 12)	Guarantee deposits	573,576,820	529,333,103

As of December 31, 2017, the Brokerage Firm has restricted assets in the amount of ₡48,381,887,422 (2016: ₡41,974,011,735), corresponding to guarantees for tri-party repurchase agreements, operations in the liquidity market, and contributions to the liquidation and compensation risk management fund.

(Continued)

BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

(3) Balances and transactions with related parties

As of December 31, balances and transactions with related parties are as follows:

	<u>2017</u>	<u>2016</u>
<u>Assets:</u>		
Checking accounts in foreign financial entities (1) (note 4)	¢ 17,091,195,563	9,738,754,875
Investments in financial instruments and accrued interest receivable (2)	-	5,481,827,848
Accounts receivable (3)	-	20,707,083
Allowance for impairment for transactions with related parties (3)	(18,809,848)	(12,179,982)
Investments in other companies (4) (note 10)	61,782,698,467	57,191,201,983
	¢ <u>78,855,084,182</u>	<u>72,420,311,807</u>
<u>Liabilities:</u>		
Demand obligations with entities (5)	15,795,754	36,789,117
	¢ <u>15,795,754</u>	<u>36,789,117</u>
<u>Income:</u>		
Gain on investments in foreign companies	2,615,822,520	1,690,868,660
	¢ <u>2,615,822,520</u>	<u>1,690,868,660</u>

The aforementioned balances are related to:

- 1) Foreign checking accounts with BICSA.
- 2) Term certificate of deposit issued by BICSA, maturing on January 6, 2017.
- 3) Accounts receivable associated with transactions with employees and related allowance for impairment in accordance with SUGEF Directive 1-05.
- 4) Investments in the share capital of entities over which the Bank exercises control or significant influence (see note 1.1).
- 5) Subsidiaries' checking accounts with the Bank.

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BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

For the year ended December 31, compensation to key personnel is as follows:

	2017	2016
Short-term benefits	¢ 1,977,961,998	1,790,244,979
Long-term benefits	257,135,059	232,731,848
Per diem – Board of directors	141,469,264	137,406,012
	¢ <u>2,376,566,321</u>	<u>2,160,382,839</u>

(4) Cash and cash equivalents

As of December 31, for reconciliation purposes of the consolidated statement of cash flows, cash and cash equivalents are as follows:

	2017	2016
Cash and due from banks	¢ 1,282,770,297,705	937,810,182,994
Investments with maturities of two months or less	218,318,955,536	81,348,797,657
	¢ <u>1,501,089,253,241</u>	<u>1,019,158,980,651</u>

(Continued)

BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

As of December 31, cash and due from banks is as follows:

	2017	2016
Cash on hand and in vaults	¢ 49,786,135,981	45,605,575,176
Cash in transit	17,953,025,570	10,586,770,682
Checking account in BCCR (1)	79,815,528,179	32,873,027,519
Minimum legal deposits in BCCR (1)	777,920,470,982	656,436,590,090
Checking accounts and demand deposits in State-owned commercial banks and banks created under special laws	71,384,980	4,706,195,026
Checking accounts and other demand accounts in private financial entities	15,710,632,738	2,756,312,438
Overnight deposits in local financial entities	940,000,000	-
Checking accounts in foreign financial entities	299,621,722,806	162,549,650,880
Deposits and other demand accounts in foreign financial entities	25,876,591	20,654,470
Checking accounts and demand deposits in related entities (note 3)	17,091,195,563	9,738,754,875
Overnight deposits in foreign financial entities	4,686,354,489	5,848,311,081
Transfers through the Interbank Electronic Payment System (SINPE)	4,178,591,648	3,477,754,224
Local notes receivable	4,357,069,947	2,154,613,317
Foreign notes receivable	1,410,554,037	807,082,333
Margin calls for tri-party repurchase agreements	112,717,628	-
Fondo de Garantía de la Bolsa Nacional de Valores (FOGABONA)	187,856,613	248,795,209
Other restricted cash and due from banks (2)	8,900,457,858	-
Accrued interest receivable	722,095	95,674
	¢ <u>1,282,770,297,705</u>	<u>937,810,182,994</u>

(1) Checking accounts and demand deposits in BCCR include the balances of the minimum legal deposits required for each year (see note 2).

(2) "Other restricted cash and due from banks" includes the banking mandate for custody of liabilities, checking accounts, savings accounts, and term certificates of deposit of Banco Crédito Agrícola de Cartago.

As of December 31, 2017 and 2016, the percentage for the minimum legal deposit is 15%. The corresponding amount must be deposited in cash in BCCR pursuant to current banking legislation. Such deposit is calculated as a percentage of third-party deposits, which varies based on the term and form of deposit-taking used by the Bank.

(Continued)

BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

(5) Investments in financial instruments

As of December 31, investments in financial instruments are as follows:

	2017	2016
<i>Available-for-sale:</i>		
<u>Local issuers:</u>		
Government of Costa Rica	¢ 585,738,378,031	421,249,348,757
BCCR	99,282,603,047	160,717,002,649
State-owned banks	44,620,801,705	85,495,879,525
Private banks	-	7,932,586,072
Private issuers	7,859,915,398	9,550,559,893
	<u>737,501,698,181</u>	<u>684,945,376,896</u>
<u>Foreign issuers:</u>		
Governments	74,980,395,191	37,716,583,192
Private issuers	88,709,226,103	124,832,201,140
Private banks	159,852,628,432	65,151,858,556
	<u>323,542,249,726</u>	<u>227,700,642,888</u>
	<u>1,061,043,947,907</u>	<u>912,646,019,784</u>
<i>Held-to-maturity:</i>		
Government of Costa Rica	18,562,535,348	27,181,284,510
	<u>18,562,535,348</u>	<u>27,181,284,510</u>
<i>Derivative financial instruments:</i>		
Interest rate futures - Hedges (note 6)	6,179,274,814	5,893,164,907
Purchase of FX futures – Other than hedges (note 6)	22,730,053	-
Sale of FX futures – Other than hedges (note 6)	119,898,739	-
	<u>6,321,903,607</u>	<u>5,893,164,907</u>
<i>Allowance for impairment:</i>		
Allowance for impairment of investments	(58,720,473)	(59,433,676)
Allowance for impairment of derivative instruments other than hedges	(14,753,724)	-
	<u>(73,474,196)</u>	<u>(59,433,676)</u>
Accrued interest receivable on investments	11,477,429,720	10,939,171,834
	<u>¢ 1,097,332,342,386</u>	<u>956,600,207,359</u>

(Continued)

BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

As of December 31, movement in the allowance for impairment of financial instruments is as follows:

	2017	2016
Opening balance	¢ 59,433,676	134,640,661
Allowance expense (note 34)	29,794,522	20,527,703
Decrease in allowance (note 35)	(17,716,855)	(97,495,429)
Foreign exchange differences	1,962,853	1,760,741
Closing balance	¢ 73,474,196	59,433,676

As of December 31, 2017, the allowance for impairment of investments in non-derivative financial instruments amounts to ¢58,720,473 (2016: ¢59,433,676) and is booked for investments in Z Bonds related to the Mortgage Securitization Trust (impairment of 26% for both years).

As of December 31, 2017, the Bank recognized an allowance for impairment of derivative instruments other than hedges in the amount of ¢14,753,724, for sales of FX futures other than hedges in accordance with SUGEF Directive 09-08 (2016: nil).

As of December 31, annual returns on investments in financial instruments are as follows:

Currency	2017	2016
Colones	4.00% to 11.13%	0.75% to 11.13%
U.S. dollars	0.50% to 6.85%	0.63% to 6.55%
Euros	1.10% to 2.00%	1.10% to 5.50%
DU	0.00% to 0.74%	0.00% to 0.74%

As of December 31, 2017, the valuation of available-for-sale investments and restricted financial instruments gave rise to an unrealized loss, net of deferred tax, in the amount of ¢846,968,886 (2016: unrealized loss of ¢4,325,830,389). Accordingly, as of December 31, 2017, the cumulative balance of equity adjustments arising from valuation of these investments is an unrealized loss of ¢2,304,989,655 (2016: unrealized loss of ¢1,458,020,769).

(Continued)

BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

(6) Derivative financial instruments

As of December 31, the Bank holds the following types of derivative financial instruments:

✓ Derivatives as risk hedging instruments:

Interest rate futures - hedges:

The Bank obtained interest rate hedges to hedge exposure to the LIBOR rate on international debt issues made in October 2013 and April 2016 in U.S. dollars at a fixed rate. The purpose of these financial instruments is to offset the changes in fair value attributable to fluctuations in such a reference rate.

Derivative financial instruments are as follows:

Issuing bank	2017		Purpose
	Notional amount	Valuation	
Citibank	US\$ 100,000,000	US\$ 2,175,372	Swaps to hedge 10-year term obligations in issue (maturing in 2023)
JP Morgan	200,000,000	4,349,026	
Bank of America	200,000,000	4,350,745	
Amount in colones	US\$ 500,000,000	US\$ 10,875,143	
	¢ 283,210,000,000	¢ 6,159,898,720	
Bank of America	250,000,000	(6,845,495)	Swaps to hedge 5-year term obligations in issue (maturing in 2021)
JP Morgan	250,000,000	(6,845,495)	
Amount in colones	US\$ 500,000,000	US\$ (13,690,990)	
	¢ 283,210,000,000	¢ (7,754,850,556)	
Chicago Board of Trade	US\$ 18,000,000	US\$ (2,871)	Standardized futures contracts (maturing in 2018)
Amount in colones	¢ 10,195,560,000	¢ (1,626,192)	

(Continued)



BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

Issuing bank	2016		Purpose
	Notional amount	Valuation	
Citibank	US\$ 100,000,000	US\$ 2,150,085	Swaps to hedge 10-year term obligations in issue (maturing in 2023)
JP Morgan	200,000,000	4,300,167	
Bank of America	200,000,000	4,300,167	
	US\$ 500,000,000	US\$ 10,750,419	
Amount in colones	¢ 274,090,000,000	¢ 5,893,164,907	
Citibank	100,000,000	(325,520)	Swaps to hedge 5-year term obligations in issue (maturing in 2018)
JP Morgan	150,000,000	(488,281)	
	US\$ 250,000,000	US\$ (813,801)	
Amount in colones	¢ 137,045,000,000	¢ (446,109,432)	
Bank of America	250,000,000	(7,963,964)	Swaps to hedge 5-year term obligations in issue (maturing in 2021)
JP Morgan	250,000,000	(7,963,964)	
	US\$ 500,000,000	US\$ (15,927,928)	
Amount in colones	¢ 274,090,000,000	¢ (8,731,371,571)	
Citibank	US\$ 5,964,211	US\$ (36,656)	Standardized futures contracts (maturing in 2017)
Amount in colones	¢ 3,269,461,186	¢ (20,094,448)	

As of December 31, 2017, total notional amounts of US\$1,018,000,000, equivalent to ¢576,615,560,000 (2016: US\$1,255,964,211, equivalent to ¢688,494,461,186) are booked under “Other debit memoranda accounts” (see note 24).

Gains and losses on the valuation of derivative financial instruments are booked under asset and liability accounts, respectively.

As of December 31, 2017, the Bank books an increase in the fair value of these hedges in the amount of US\$10,875,143, equivalent to ¢6,159,898,719 (see note 5) and a decrease in the fair value of these hedges in the amount of US\$13,690,990, equivalent to ¢7,754,850,556 (see note 5).

As of December 31, 2016, the Bank books an increase in the fair value of these hedges in the amount of US\$10,750,419, equivalent to ¢5,893,164,907 (see note 5) and a decrease in the fair value of these hedges in the amount of US\$16,778,385, equivalent to ¢9,197,575,451 (see note 5).

(Continued)

# BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

## Notes to the Consolidated Financial Statements

For valuation purposes of the aforementioned interest rate swaps, the Bank decided to apply the Fair Value Hedge Method, while the Dollar Offset Method is used to test hedge effectiveness. The latter method was established by SUGEF and prescribes that effectiveness is to be assessed retrospectively. A hedge is considered highly effective if the ratio of the changes in the derivative and primary instruments ranges between 80% and 125%.

As of December 31, effectiveness of the valuation of derivative financial instruments is as follows:

	Effective rate	
	2017	2016
5-year issue (maturing in 2018)	-	83.62%
10-year issue (maturing in 2023)	105.40%	98.00%
5-year issue (maturing 2021)	84.60%	93.97%

A valuation was performed as of December 31, 2017 and 2016 to calculate the change in the fair value of the primary and derivative instruments based on the following inputs:

- a 5- or 10-year LIBOR rate at the issue of the bond
- discount rates from Bloomberg
- zero rates corresponding to the swap curve as of December 31, 2017 and 2016
- only a portion of the bond cash flows is hedged (corresponding to the 5- and 10-year LIBOR rate in effect at the issue of the bond) rather than the total interest amount
- accrued and earned interest were segregated from the instruments to obtain variations in clean prices
- forward rate to calculate variable interest.

As of December 31, 2017, standardized futures contracts were negotiated as part of the financial derivatives portfolio. The Bank booked a notional amount for the sale and purchase of these futures contracts in the amount of US\$18,000,000, equivalent to ¢10,195,560,000.

As of December 31, 2017, the Bank booked an increase in fair value due to the negotiation of these futures contracts in the amount of US\$34,208, equivalent to ¢19,376,095, and a decrease in the fair value of these hedges in the amount of US\$37,079, equivalent to ¢21,002,287, which is booked in "Other sundry accounts payable" (see note 18), establishing the net position of these instruments in the amount of US\$2,871, equivalent to ¢1,626,192.

(Continued)

BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

✓ Derivatives for trading purposes:

Currency forwards:

The Bank entered into currency forwards with several clients. Under these derivative financial instruments, the Bank acts as an authorized intermediary (counterparty). These instruments serve as a trading tool that is not used for currency speculation and whereby no risks are hedged.

These types of instruments are products which the Bank can offer to its clients pursuant to the authorization provided by BCCR to operate exchange rate derivatives.

As of December 31, 2017, the total notional amount is US\$27,906,944, equivalent to ₡15,807,051,435. As of December 31, 2016, the Bank had no currency forwards (see note 22).

As of December 31, 2017, the Bank booked an increase in the fair value of these forwards in the amount of ₡142,628,793 under an asset account, and a decrease in the liability account in the amount of ₡46,913,807 (2016: nil) (see note 5).

For currency forwards, the Bank considers three risk factors in determining the value of a forward contract: the spot exchange rate and the interest rates in both local and foreign currency. The value of these financial instruments is determined using data related to the average exchange rate at MONEX and the market interest rates in colones and U.S. dollars applicable to different terms.

As of December 31, the effect on profit or loss of derivative financial instruments is as follows:

	2017	2016
Gain on derivative financial instruments	₡ 24,217,078,104	32,487,947,468
Loss on derivative financial instruments	(18,859,030,471)	(41,961,019,227)
Gain (loss), net	₡ 5,358,047,633	(9,473,071,759)

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BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

(7) Loan portfolio

(a) Loan portfolio by sector

As of December 31, the loan portfolio by sector is as follows:

	2017	2016
Trade	¢ 410,062,171,620	383,913,120,090
Services	925,588,456,250	886,844,738,498
Financial services	136,448,769,907	143,227,870,068
Mining	911,515,744	1,078,059,706
Manufacturing and quarrying	179,083,732,196	164,439,989,019
Construction	106,205,953,983	102,337,598,821
Agriculture and forestry	125,660,078,600	119,200,690,631
Livestock, hunting, and fishing	83,621,737,863	75,554,660,408
Electricity, water, sanitation, and other related sectors	438,885,802,997	397,442,725,153
Transportation and telecommunications	46,069,196,429	41,876,391,133
Housing	1,304,758,486,194	1,192,797,400,089
Personal or consumer loans	554,958,089,721	445,416,562,419
Tourism	180,852,228,622	161,477,445,037
	<u>4,493,106,220,126</u>	<u>4,115,607,251,072</u>
Accrued interest receivable	31,743,485,704	27,221,501,072
Allowance for loan losses	<u>(140,168,393,361)</u>	<u>(85,464,859,320)</u>
	<u>¢ 4,384,681,312,469</u>	<u>4,057,363,892,824</u>

As of December 31, annual interest rates on loans receivable are as follows:

Currency	2017		2016	
	Rates	Average (1)	Rates	Average (1)
Colones	4.40% to 40.56%	14.96%	4.45% to 39.00%	13.23%
U.S. dollars	3.00% to 34.92%	9.44%	3.00% to 34.92%	8.93%
DU	3.85% to 11.00%	6.57%	3.85% to 11.00%	6.58%

(1) Corresponds to the simple average between the minimum and maximum values of the portfolio as of December 31, 2017 and 2016.

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BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

(b) Loan portfolio by arrears

As of December 31, the loan portfolio by arrears is as follows:

	2017	2016
Current	¢ 4,261,582,917,145	3,922,996,772,133
1 to 30 days	56,313,279,440	46,067,740,682
31 to 60 days	44,153,684,890	38,346,524,164
61 to 90 days	23,102,210,055	19,993,513,410
91 to 120 days	15,367,490,160	10,101,589,852
121 to 180 days	10,774,616,091	12,237,325,773
More than 180 days	81,812,022,345	65,863,785,058
Total loan portfolio - gross	4,493,106,220,126	4,115,607,251,072
Accrued interest receivable	31,743,485,704	27,221,501,072
Allowance for loan losses	(140,168,393,361)	(85,464,859,320)
	¢ <u>4,384,681,312,469</u>	<u>4,057,363,892,824</u>

(c) Allowance for loan losses

As of December 31, movement in the allowance for loan losses is as follows:

	2017	2016
Opening balance	¢ 85,464,859,320	62,968,882,979
Expense for the year (note 34)	69,399,079,403	37,490,816,079
Settlements	(14,982,163,099)	(15,733,523,078)
Decrease in allowance charged to profit or loss	(720,000,000)	-
Foreign exchange differences	1,006,617,737	738,683,340
Closing balance	¢ <u>140,168,393,361</u>	<u>85,464,859,320</u>

Management considers the allowance for loan losses to be sufficient based on its assessment of the recoverability of the portfolio and existing guarantees.

(Continued)

BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

(8) Accounts and fees and commissions receivable

As of December 31, accounts and fees and commissions receivable are as follows:

	2017	2016
Fees and commissions	¢ 1,261,195,967	1,292,023,911
Accounts receivable for brokerage operations	-	3,828,079
Accounts receivable for transactions with related parties (officers, employees)	26,675,994	20,707,083
Income tax deferred	319,978,674	-
Income tax receivable (1)	240,205,993	199,695,701
Other sundry accounts receivable	3,879,229,636	3,993,335,555
Accrued interest receivable on other sundry accounts receivable	1,724,156	1,800,923
Allowance for impairment of accounts receivable	(3,592,576,911)	(3,451,027,734)
	¢ 2,136,433,509	2,060,363,518

(1) Income tax receivable, by entity, is as follows:

	2017	2016
Banco Nacional de Costa Rica	¢ 134,516,249	140,319,872
BN Vital Operadora de Planes de Pensiones Complementarias, S.A.	-	225,091
BN Valores Puesto de Bolsa, S.A.	-	59,150,738
BN Corredora de Seguros, S.A.	105,689,744	-
	¢ 240,205,993	199,695,701

As of December 31, movement in the allowance for impairment of other accounts receivable is as follows:

	2017	2016
Opening balance	¢ 3,451,027,735	5,920,917,785
Allowance expense (note 34)	2,026,114,296	1,601,223,913
Decrease in allowance (note 35)	(767,042,270)	(3,229,204,400)
Items settled against allowance	(1,120,015,549)	(845,837,775)
Foreign exchange differences	2,492,699	3,928,211
Closing balance	¢ 3,592,576,911	3,451,027,734

(Continued)

BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

(9) Foreclosed assets

As of December 31, foreclosed assets are presented net of the allowance for impairment as follows:

	2017	2016
Assets received in lieu of payment	¢ 81,249,127,569	77,394,578,153
Idle property and equipment	1,832,418	1,471,878
Allowance for impairment	(62,466,054,133)	(59,644,951,072)
	¢ 18,784,905,854	17,751,098,959

As of December 31, movement in the allowance for impairment of foreclosed assets is as follows:

	2017	2016
Opening balance	¢ 59,644,951,072	61,161,022,915
Allowance expense (note 38)	6,059,997,296	4,906,253,492
Decrease in allowance	(3,238,894,235)	(6,422,325,335)
Closing balance	¢ 62,466,054,133	59,644,951,072

(10) Investments in other companies

As of December 31, investments in other companies are as follows:

	2017	2016
Other financial and non-financial entities	¢ 50,623,300	50,623,300
Banco Internacional de Costa Rica, S.A. and Subsidiary (BICSA) (note 3)	61,732,075,167	57,140,578,683
	¢ 61,782,698,467	57,191,201,983

The Bank holds 49% ownership interest in BICSA, represented in 2017 and 2016 by 6,506,563 ordinary shares of US\$10 par value each.

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BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

As of December 31, the Bank's investments in other entities are as follows:

	2017	2016	Concept
National Stock Exchange			Investment to operate as custodian of electronic securities
Central de Valores de la Bolsa Nacional de Valores, S.A.	15,000,000	15,000,000	Investment to operate as custodian of electronic securities
Interclear Central de Valores	15,000,000	15,000,000	Investment to operate as custodian of electronic securities
Depósito Libre Comercial Golfito (Golfito Duty Free Shopping Center) per Article 24 of Law No. 7131	5,200,000	5,200,000	Investment in the Golfito Duty Free Shopping Center
Other financial entities	423,300	423,300	Investments in various cooperatives
	<u>50,623,300</u>	<u>50,623,300</u>	

(Continued)

BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

(11) Property and equipment

As of December 31, property and equipment is as follows:

	2017				
	Land	Buildings	Furniture and equipment	Computer hardware	Vehicles
					Total
Cost:					
Historical cost balance at beginning of year	4,207,876,870	63,103,140,736	61,092,968,044	59,600,997,629	188,475,905,793
Revalued cost balance at beginning of year	42,270,752,875	57,905,955,091	(9,764,538)	(33,599,038)	100,133,344,390
Additions	331,825,827	2,352,349,672	5,565,273,956	7,889,562,502	16,139,011,957
Revaluation of assets	1,011,670,989	3,851,382,933	-	-	4,863,053,922
Disposals	-	-	(4,111,179,980)	(15,387,620,688)	(19,519,376,728)
Sales	-	-	(6,125,849)	-	(158,471,412)
Adjustments	-	73,745,123	216,619,400	135,681,787	426,046,310
Balance at end of year	47,822,126,561	127,286,573,555	62,747,791,033	52,238,621,230	290,359,514,232
Accumulated depreciation:					
Balance at beginning of period	-	33,183,853,177	33,869,123,760	44,114,779,021	111,504,198,737
Depreciation expense on historical cost	-	1,583,624,839	5,760,711,545	6,510,362,273	13,879,577,197
Depreciation expense on revaluation	-	1,406,062,470	-	-	1,406,062,470
Disposals	-	-	(4,026,036,958)	(15,324,376,143)	(19,370,989,160)
Sales	-	-	(4,520,023)	-	(137,405,629)
Adjustments	-	2,747,891,281	186,872,150	102,259,945	3,037,081,387
Balance at end of year	-	38,921,431,767	35,786,150,474	35,403,025,096	110,314,004,979
Net balance at end of year	47,822,126,561	88,365,141,788	26,961,640,559	16,835,596,134	180,045,509,253

(Continued)

## BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

## Notes to the Consolidated Financial Statements

2016

	Land	Buildings	Furniture and equipment	Computer hardware	Vehicles	Total
<u>Cost:</u>						
Balance at beginning of period	¢ 4,218,965,394	62,430,854,914	59,048,581,832	57,942,113,324	451,048,332	184,091,563,796
Revalued cost at beginning of period	42,395,124,332	57,353,344,058	-	-	-	99,748,468,390
Additions	-	783,223,809	5,759,938,623	7,614,884,356	-	14,158,046,788
Disposals	-	-	(3,837,327,753)	(5,916,904,016)	-	(9,754,231,769)
Sales	(135,459,981)	(168,500,338)	(273,875)	-	(13,644,336)	(317,878,530)
Adjustments	-	611,075,765	122,389,129	(50,183,386)	-	683,281,508
Reclassifications	-	(902,381)	(10,104,450)	11,087,351	(80,520)	-
Balance at end of period	46,478,629,745	121,009,095,827	61,083,203,506	59,600,997,629	437,323,476	288,609,250,183
<u>Accumulated depreciation:</u>						
Balance at beginning of period	-	29,704,829,213	31,171,302,930	44,614,967,063	321,446,224	105,812,545,430
Depreciation expense on historical cost	-	1,355,676,895	5,298,486,956	5,382,224,643	28,721,410	12,065,109,904
Depreciation expense on revaluation	-	1,364,745,840	-	-	-	1,364,745,840
Disposals	-	-	(2,634,688,039)	(5,841,055,189)	-	(8,475,743,228)
Sales	-	(70,932,726)	(273,875)	-	(13,644,336)	(84,850,937)
Adjustments	-	830,436,336	39,607,166	(47,651,774)	-	822,391,728
Reclassifications	-	(902,381)	(5,311,378)	6,294,278	(80,519)	-
Balance at end of period	-	33,183,853,177	33,869,123,760	44,114,779,021	336,442,779	111,504,198,737
Net balance at end of period	¢ 46,478,629,745	87,825,242,650	27,214,079,746	15,486,218,608	100,880,697	177,105,051,446

(Continued)

# BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

## Notes to the Consolidated Financial Statements

As of the December close, appraisals of the Bank's land and buildings were performed by an independent appraiser, obtaining the NRV, which was compared to the carrying amount to determine the equity increase, affecting the related accounts for accumulated depreciation and revaluation.

As of December 31, 2017, for buildings, the total equity increase amounts to ¢991,879,746: retained earnings ¢768,103,339, revaluation surplus ¢319,680,581, and deferred tax (¢95,904,174). For land, the increase due to revaluation surplus amounts to ¢1,011,670,989. This process was performed with the balances as of August 4, 2017.

### (12) Other assets

As of December 31, other assets are as follows:

	2017	2016
<i>Deferred charges:</i>		
Leasehold improvements	¢ 859,770,993	1,230,240,341
Cost of issue of financial instruments, net (3)	1,440,638,368	1,888,423,058
Cost of subordinated debt project	396,529,566	474,798,764
Deferred direct costs related to loans	4,957,012,106	5,673,603,092
Other deferred charges	1,261,169,998	2,632,876,079
	<u>8,915,121,031</u>	<u>11,899,941,334</u>
<i>Intangible assets:</i>		
Software (2)	6,520,658,430	5,221,524,241
Other intangible assets (2)	822,728,155	4,145,080
	<u>7,343,386,585</u>	<u>5,225,669,321</u>
<i>Other assets:</i>		
Prepaid interest and fees and commissions	178,093,731	274,408,717
Prepaid taxes	5,298,499,077	14,745,606
Prepaid insurance policy	196,153,628	253,224,405
Other prepaid expenses	593,292,402	119,811,455
Stationery, office supplies, and other materials	631,381,590	624,937,164
Leased assets	99,453,445	100,810,170
Library and artwork	429,918,818	349,918,818
Construction work-in-progress	6,121,061,364	5,741,165,428
Software under development	6,694,166	343,328,418
Rights in welfare and trade associations	600,000	600,000
Other sundry assets	7,107,623,251	3,986,095,929
Cash shortage	-	3,000
Operations pending settlement	8,727,470,265	5,676,583,226
Other operations pending application	1,971,307,456	3,681,008,163
Guarantee deposits (1)	390,534,759	341,347,456
Legal and administrative deposits (1)	183,042,061	187,985,647
	<u>31,935,126,013</u>	<u>21,695,973,602</u>
¢	<u>48,193,633,629</u>	<u>38,821,584,257</u>

(Continued)

BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

(1) As of December 31, 2017, guarantee deposits amount to ¢573,576,820 (2016: ¢529,333,103) (see note 2).

(2) As of December 31, net intangible assets are as follows:

	2017		
	Software	Other intangible assets	Total
<i>Cost:</i>			
Opening balance	¢ 22,163,996,115	98,174,640	22,262,170,755
Additions	4,930,852,196	2,002,014,358	6,932,866,554
Disposals	(111,419,028)	-	(111,419,028)
Reclassifications	-	(12,586,344)	(12,586,344)
Adjustments	(358,172,122)	-	(358,172,122)
Closing balance	26,625,257,161	2,087,602,654	28,712,859,815
<i>Accumulated amortization:</i>			
Opening balance	16,942,471,872	94,029,559	17,036,501,431
Expense for the year	3,192,411,142	1,183,431,284	4,375,842,426
Disposals	(12,917,054)	-	(12,917,054)
Reclassifications	(19,894,400)	(12,586,344)	(32,480,744)
Adjustments	2,527,171	-	2,527,171
Closing balance	20,104,598,731	1,264,874,499	21,369,473,230
Net closing balance	¢ 6,520,658,430	822,728,155	7,343,386,585

	2016		
	Software	Other intangible assets	Total
<i>Cost:</i>			
Opening balance	¢ 20,535,208,567	96,302,651	20,631,511,217
Additions	3,257,298,745	18,480,098	3,275,778,843
Disposals	(1,699,395,942)	-	(1,699,395,942)
Reclassifications	-	(16,608,110)	(16,608,110)
Adjustments	70,884,743	-	70,884,743
Closing balance	22,163,996,113	98,174,639	22,262,170,751
<i>Accumulated amortization:</i>			
Opening balance	16,546,267,398	94,029,559	16,640,296,957
Expense for the year	2,109,325,149	16,608,110	2,125,933,259
Disposals	(1,679,487,450)	(16,608,110)	(1,696,095,560)
Adjustments	(33,633,225)	-	(33,633,225)
Closing balance	16,942,471,872	94,029,559	17,036,501,430
Net closing balance	¢ 5,221,524,241	4,145,080	5,225,669,321

(Continued)

BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

(3) As of December 31, costs related to the issue of financial instruments are as follows:

	2017			Total
	5-year issue (maturing in 2018)	10-year issue (maturing in 2023)	5-year issue (maturing in 2021)	
Commission - structuring banks	¢ 283,210,000	283,210,000	481,457,000	1,047,877,000
Commission - Moody's Investors Service	141,605,000	141,605,000	-	283,210,000
Commission - Société de la Bourse de Luxembourg, S.A.	6,922,219	6,922,219	-	13,844,438
RR Donelley	6,200,600	6,200,577	3,711,906	16,113,083
BNY Mellon	2,239,058	2,239,058	3,266,544	7,744,660
Moody's - issuer rating	18,748,502	18,748,502	141,605,000	179,102,004
Fitch Ratings	141,605,000	141,605,000	141,605,000	424,815,000
Milbank	83,354,367	83,354,367	111,596,414	278,305,148
Shearman & Sterling	83,462,553	83,462,553	124,155,922	291,081,028
External audit	107,619,800	107,619,800	131,409,440	346,649,040
Perkins Cole (Broker)	-	-	7,429,759	7,429,759
Printing of documents	-	-	8,957,842	8,957,842
	874,967,099	874,967,076	1,155,194,827	2,905,129,002
Amortization	(723,529,495)	(334,347,616)	(406,613,523)	(1,464,490,634)
	¢ 151,437,604	540,619,460	748,581,304	1,440,638,368

	2016			Total
	5-year issue (maturing in 2018)	10-year issue (maturing in 2023)	5-year issue (maturing in 2021)	
Commission - structuring banks	¢ 274,090,000	274,090,000	465,953,000	1,014,133,000
Commission - Moody's Investors Service	137,045,000	137,045,000	-	274,090,000
Commission - Société de la Bourse de Luxembourg, S.A.	6,699,308	6,699,308	-	13,398,616
RR Donelley	6,000,926	6,000,905	3,592,374	15,594,205
BNY Mellon	2,166,956	2,166,956	3,161,354	7,495,266
Moody's - issuer rating	18,144,758	18,144,758	137,045,000	173,334,516
Fitch Ratings	137,045,000	137,045,000	137,045,000	411,135,000
Milbank	80,670,169	80,670,169	108,002,758	269,343,096
Shearman & Sterling	80,774,871	80,774,871	120,157,822	281,707,564
External audit	104,154,200	104,154,200	127,177,760	335,486,160
Perkins Cole (Broker)	-	-	7,190,504	7,190,504
Printing of documents	-	-	8,669,379	8,669,379
	846,791,188	846,791,167	1,117,994,951	2,811,577,306
Amortization	(521,521,223)	(231,871,584)	(169,761,441)	(923,154,248)
	¢ 325,269,965	614,919,583	948,233,510	1,888,423,058

Issue costs are amortized over the term of the financial instrument.

(Continued)

BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

(13) Obligations with the public

As of December 31, obligations with the public by cumulative amount are as follows:

	2017	2016
<i>Demand deposits:</i>		
Checking accounts	¢ 1,315,990,860,053	1,278,957,424,500
Certified checks	129,984,033	122,039,022
Savings deposits	1,356,884,997,468	1,296,486,039,607
Matured term deposits	23,250,148,019	17,819,303,823
Other demand deposits	504,652,034	611,720,829
Drafts and transfers payable	60,778,419	163,530,110
Cashier's checks	5,351,772,739	4,084,392,512
Advance collections from customers for credit cards	12,442,854,649	8,526,828,123
Banking mandates	8,900,457,858	-
Trust fund obligations	7,928,029	35,790,055
	<u>2,723,524,433,301</u>	<u>2,606,807,068,581</u>
<i>Term deposits:</i>		
Deposits from the public	1,918,015,501,978	1,453,379,510,857
Other term deposits	153,877,421,326	81,367,527,731
	<u>2,071,892,923,304</u>	<u>1,534,747,038,588</u>
<i>Other obligations with the public:</i>		
Obligations with third parties for third-party repurchase agreements	22,916,380,358	26,448,255,041
	<u>22,916,380,358</u>	<u>26,448,255,041</u>
Interest payable for obligations with the public	35,961,942,293	22,134,040,383
	<u>¢ 4,854,295,679,256</u>	<u>4,190,136,402,593</u>

As of December 31, 2017, deposits in checking accounts denominated in colones bear interest at a maximum rate of 2.55% per annum (2016: 1.50% per annum) on balances and at a minimum rate of 0.00% per annum (2016: 0.00% per annum) on balances greater than or equal to ¢500,001. Deposits in checking accounts denominated in U.S. dollars bear interest at a maximum rate of 0.45% per annum (2016: 0.40% per annum) on balances and at a minimum rate of 0.00% per annum (2016: 0.00% per annum) on balances greater than or equal to US\$1,000.

(Continued)

BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

Term obligations correspond to term certificates of deposit in colones and U.S. dollars. As of December 31, term certificates bear annual interest at the following rates:

Currency	2017	2016
Colones	4.00% to 8.20%	1.15% to 7.40%
U.S. dollars	0.50% to 5.10%	0.45% to 5.85%

The Bank has term certificates of deposit that are restricted to secure certain loan operations. As of December 31, 2017, the balance of those term certificates of deposit is ¢40,267,805,245 (2016: ¢32,221,517,946). As of that date, the Bank has no inactive deposits with State-owned entities or other banks.

(14) Obligations with BCCR

As of December 31, obligations with BCCR are as follows:

	2017	2016
Financing for loans using external funds	125,644,412	125,644,412
	¢ 125,644,412	125,644,412

(Continued)



BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

(15) Obligations with entities

Obligations with entities are as follows:

	2017	2016
<i><u>Demand:</u></i>		
Checking accounts with local financial entities	¢ 60,409,743,139	67,079,202,786
Savings deposits with local financial entities	67,571,081	34,068,844
Development Credit Fund (FCD) management	144,413,540,280	145,344,840,301
Outstanding checks	1,682,209,656	1,947,218,401
Checking accounts and obligations with related parties	15,795,751	36,789,113
Other demand obligations with financial entities	-	997,169,021
	<u>206,588,859,907</u>	<u>215,439,288,466</u>
<i><u>Term:</u></i>		
Term deposits from local financial entities	117,218,311,393	2,702,114,143
Term deposits from foreign financial entities	5,664,200,000	5,481,800,000
Term obligations with foreign financial entities (2)	841,601,971,462	815,040,918,559
Liquidity market obligations	16,022,595,002	7,700,000,000
Loans from local financial entities	30,494,577,677	8,138,797,739
Loans from foreign financial entities (1)	98,105,867,070	160,775,371,029
	<u>1,109,107,522,604</u>	<u>999,839,001,470</u>
Interest payable on other demand and term obligations with financial entities – foreign currency	180,661,307	38,405,886
Interest payable on other demand and term obligations with financial entities – local currency	1,089,818,278	123,680,533
Interest payable on loans with foreign financial entities (1)	438,383,591	1,413,597,675
Interest payable on loans with local financial entities	91,353,129	9,776,425
Interest payable on term deposits from foreign financial entities (2)	8,024,283,437	7,989,533,183
	<u>9,824,499,740</u>	<u>9,574,993,702</u>
¢	<u>1,325,520,882,251</u>	<u>1,224,853,283,638</u>

(Continued)

BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

- (1) As of December 31, loans due to foreign financial entities bear interest at rates ranging between 3.32% and 6.65% per annum (2016: between 2.54% and 6.65% per annum).
- (2) Loans from foreign financial entities are as follows:

Date of issue	Face value	Characteristics
01/11/2013	US\$500 million	<ul style="list-style-type: none"> <li>• Traded amount: 99.331%</li> <li>• Term: 5 years</li> <li>• Interest rate: 4.875% per coupon payment</li> </ul>
01/11/2013	US\$500 million	<ul style="list-style-type: none"> <li>• Traded amount: 99.072%</li> <li>• Term: 10 years</li> <li>• Interest rate: 6.250% per coupon payment</li> </ul>
25/04/2016	US\$500 million	<ul style="list-style-type: none"> <li>• Traded amount: 99.68%</li> <li>• Term: 5 years</li> <li>• Interest rate: 5.875% per coupon payment</li> </ul>

As of December 31, balances according to the term of the obligations are as follows:

	2017			Total
	5-year issue (maturing in 2018)	10-year issue (maturing in 2023)	5-year issue (maturing in 2021)	
Issue	¢ 281,315,325,100	280,581,811,200	282,020,508,371	843,917,644,671
Adjustment to fair value of hedged item measured at cost of international issues	(648,209,761)	4,515,695,088	(8,898,709,124)	(5,031,223,797)
Amortization of discount in traded amount of issues	1,543,736,361	897,534,405	274,279,822	2,715,550,588
	282,210,851,700	285,995,040,693	273,396,079,069	841,601,971,462
Interest payable	2,301,081,250	2,950,103,978	2,773,098,207	8,024,283,435
	¢ 284,511,932,950	288,945,144,671	276,169,177,276	849,626,254,897

(Continued)

BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

	2016			
	5-year issue (maturing in 2018)	10-year issue (maturing in 2023)	5-year issue (maturing in 2021)	Total
Issue	¢ 273,840,105,083	308,765,469,368	275,425,692,866	858,031,267,317
Adjustment to fair value of hedged item measured at cost of international issues	(2,224,689,858)	(31,561,996,331)	(11,056,020,380)	(44,842,706,569)
Amortization of discount in traded amount of issues	1,107,715,702	639,844,894	104,797,215	1,852,357,811
	272,723,130,927	277,843,317,931	264,474,469,701	815,040,918,559
Interest payable	2,226,981,250	2,855,104,181	2,907,447,752	7,989,533,183
	¢ 274,950,112,177	280,698,422,112	267,381,917,453	823,030,451,742

Maturities of loans due to entities

As of December 31, loans due to entities mature as follows:

	2017		
	Local	Foreign	Total
Less than 1 year	¢ -	2,288,044,850	2,288,044,850
Between 1 and 2 years	-	6,948,572,303	6,948,572,303
Between 3 and 5 years	125,644,411	-	125,644,411
More than 5 years	30,585,930,807	89,307,633,508	119,893,564,315
	¢ 30,711,575,218	98,544,250,661	129,255,825,879

	2016		
	Local	Foreign	Total
Less than 1 year	¢ 397,938,239	61,328,159,986	61,726,098,225
Between 1 and 2 years	-	2,745,006,304	2,745,006,304
Between 3 and 5 years	125,644,412	8,783,221,884	8,908,866,296
More than 5 years	7,750,635,925	89,332,580,530	97,083,216,455
	¢ 8,274,218,576	162,188,968,704	170,463,187,280

As of December 31, 2017 and 2016, loans due to local entities correspond to obligations with Banco Crédito Agrícola de Cartago.

(Continued)

BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

(16) Income tax

Pursuant to the *Costa Rican Income Tax Law*, the Bank is required to file income tax returns each year. As of December 31, income tax is as follows:

a) Current tax

As of December 31, the income tax expense is as follows:

	2017	2016
<u>Current tax:</u>		
Income tax expense for the period	¢ 5,485,229,323	12,424,439,845
Prior-period income tax expense	834,374,297	-
	<u>6,319,603,620</u>	<u>12,424,439,845</u>
Income tax expense for the period	¢ 5,485,229,323	12,424,439,845
Decrease in income tax for the period	(1,366,885,756)	(1,478,222,342)
Decrease in prior-period income tax	<u>(12,253,356)</u>	<u>(16,380,331)</u>
Total current tax expense, net	4,106,090,211	10,929,837,172
<u>Deferred tax:</u>		
Deferred tax expense	339,827,581	222,500,640
Increase in deferred tax	<u>(404,747,515)</u>	<u>(1,425,091,743)</u>
Total deferred tax expense, net	<u>(64,919,934)</u>	<u>(1,202,591,103)</u>
Total income tax expense, net	¢ <u>4,041,170,277</u>	<u>9,727,246,069</u>

(Continued)

BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

For the year ended December 31, the difference between income tax expense and the amount that would result from applying the corresponding tax rate to pre-tax income (30%) is reconciled as follows:

	2017	2016
Profit before tax	¢ 51,225,248,374	79,899,558,718
<i>Plus (less) tax effect of:</i>		
Non-deductible expenses	39,792,929,302	39,089,602,098
Deductible expenses	(3,683,988,092)	(4,516,208,212)
Non-taxable income	(73,606,377,691)	(77,985,560,932)
Taxable income	13,727,811,893	36,487,391,672
Tax base	30%	30%
Subtotal - income tax expense	4,118,343,567	10,946,217,502
Decrease in income tax from prior periods	(12,253,356)	(16,380,331)
Total current income tax expense	4,106,090,212	10,929,837,171
Deferred income tax expense	339,827,581	222,500,640
Income from deferred income tax	(404,747,515)	(1,425,091,743)
Total income tax expense, net	¢ 4,041,170,277	9,727,246,069

b) Deferred tax

As of December 31, deferred tax assets and liabilities are as follows:

	2017		
	Assets	Liabilities	Net
Unrealized losses	¢ 986,501,497	-	986,501,497
Provisions	281,420,008	-	281,420,008
Tax base of furniture and equipment	708,372	-	708,372
Unrealized gains	-	(318,355,247)	(318,355,247)
Revaluation of assets	-	(10,081,789,511)	(10,081,789,511)
	¢ 1,268,629,877	(10,400,144,758)	(9,131,514,881)

(Continued)

BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

		2016	
		Assets	Liabilities
Unrealized losses	¢	669,043,212	-
Provisions		347,434,855	-
Difference in useful lives		-	(518,000)
Unrealized gains		-	(1,271,480,448)
Revaluation of assets		-	(10,339,228,565)
	¢	<u>1,016,478,067</u>	<u>(11,611,227,013)</u>
			<u>Net</u>
			669,043,212
			347,434,855
			(518,000)
			(1,271,480,448)
			(10,339,228,565)
			<u>(10,594,748,946)</u>

Deferred tax assets and liabilities are as follows:

	December 31, 2016	Included in the income statement	Included in equity	December 31, 2017
Unrealized losses	¢ 670,233,485	-	316,268,012	986,501,497
Provisions	346,244,582	(64,824,574)	-	281,420,008
Tax base of furniture and equipment	-	708,372	-	708,372
Unrealized gains	(1,271,998,447)	259,975,365	693,667,836	(318,355,246)
Revaluation of assets	(10,339,228,566)	-	257,439,054	(10,081,789,512)
	¢ <u>(10,594,748,946)</u>	<u>195,859,162</u>	<u>1,267,374,903</u>	<u>(9,131,514,881)</u>

	December 31, 2015	Included in the income statement	Included in equity	December 31, 2016
Unrealized losses	¢ 503,251,465	-	166,982,020	670,233,485
Provisions	328,772,903	17,471,679	-	346,244,582
Allowance for doubtful accounts	17,552,696	(17,552,696)	-	-
Unrealized gains	(3,787,978,234)	737,948,880	1,778,030,907	(1,271,998,447)
Revaluation of assets	(11,524,732,938)	-	1,185,504,372	(10,339,228,566)
	¢ <u>(14,463,134,108)</u>	<u>737,867,863</u>	<u>3,130,517,299</u>	<u>(10,594,748,946)</u>

A deferred tax liability represents a taxable temporary difference and a deferred tax asset represents a deductible temporary difference.

Tax returns filed by the Bank for the years ended December 31, 2014, 2015, 2016, 2017 and the tax return that will be filed for the year ended December 31, 2018 are open to review by the Tax Authorities.

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BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

(17) Provisions

As of December 31, provisions are as follows:

	2017	2016
Severance benefits	¢ 1,208,537,980	2,848,046,997
Litigation	4,716,284,942	5,114,477,995
Other (1)	14,938,593,146	18,331,583,729
	¢ <u>20,863,416,068</u>	<u>26,294,108,721</u>

As of December 31, movement in provisions is as follows:

	Severance benefits	Litigation	Other (1)	Total
Balance as of December 31, 2015	¢ 19,351,170,766	4,759,970,548	11,810,578,826	35,921,720,140
Increase in provision	7,122,139,578	1,944,689,188	15,799,859,759	24,866,688,525
Used	(23,271,121,855)	(801,840,797)	(8,256,828,606)	(32,329,791,258)
Decrease in provision	(354,141,492)	(788,340,944)	(1,022,026,250)	(2,164,508,686)
Balance as of December 31, 2016	<u>2,848,046,997</u>	<u>5,114,477,995</u>	<u>18,331,583,729</u>	<u>26,294,108,721</u>
Increase in provision	1,338,573,809	537,644,287	7,827,589,882	9,703,807,978
Used	(1,510,122,975)	(919,224,585)	(10,404,304,705)	(12,833,652,265)
Decrease in provision	(1,467,959,851)	(16,612,755)	(816,275,760)	(2,300,848,366)
Balance as of December 31, 2017	¢ <u>1,208,537,980</u>	<u>4,716,284,942</u>	<u>14,938,593,146</u>	<u>20,863,416,068</u>

(1) As of December 31, the “Other provisions” account includes ¢2,914,325,415 due to the variation in the methodology to calculate contributions to CCSS and RIVM (2016: ¢2,098,131,236).

As of December 31, 2017 and 2016, the Bank is a defendant in litigation and management considers that an outflow of economic benefits will be required to settle the corresponding obligations. The Bank has estimated future outflows and made the following provisions:

Type	Claimed amount		Provision	
	2017	2016	2017	2016
Ordinary - in colones	64,839,814,231	66,170,702,983	3,430,405,879	3,914,211,465
Ordinary - in U.S. dollars	194,802,842,755	190,575,986,833	452,922,717	423,919,453
Criminal - in colones	1,020,877,223	1,009,129,410	487,964,155	496,046,408
Labor	856,520,335	1,616,275,443	344,992,191	280,300,669
	<u>261,520,054,544</u>	<u>259,372,094,669</u>	<u>4,716,284,942</u>	<u>5,114,477,995</u>

(Continued)

BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

(18) Other sundry accounts payable

As of December 31, other sundry accounts payable are as follows:

	2017	2016
Professional fees	¢ 2,675,117	2,558,750
Creditors - goods and services	3,592,576,341	3,384,330,555
Current tax	630,918,287	4,052,523,071
Employer contributions	5,734,415,243	8,457,415,872
Court-ordered withholdings	3,541,023,002	3,161,186,737
Tax withholdings	4,010,652,312	3,851,464,157
Employee withholdings	708,613,111	681,405,584
Other third-party withholdings	3,632,240	9,455,319
Compensation	5,854,098,303	6,702,950,151
Statutory allocations	13,669,031,627	17,153,405,402
Obligations on loans with related parties	27,784	83,835
Clearing house operations	487,367,695	4,617,080,542
Accrued vacation	6,491,300,766	6,944,862,199
Accrued statutory Christmas bonus	1,156,780,715	1,651,621,193
Contributions to the Superintendencies' budget	3,356,740	9,839,843
Foreclosed assets	398,477,384	354,942,685
Various creditors - Local currency	5,518,664,360	6,327,166,650
Various creditors - Foreign currency	6,672,217,496	6,154,583,169
Interest rate futures - Hedges (note 6)	7,775,852,843	9,197,575,451
Purchase of FX futures (Other than hedges)	46,913,807	-
	¢ 66,298,595,173	82,714,405,170

(Continued)



BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

As of December 31, 2017, the "Various creditors" account includes ¢4,185 million (2016: ¢2,746 million) corresponding to the operations of the Bank's Electronic Processing of Payments Office (VISA). The remaining amount corresponds to the normal operations of other divisions.

(19) Other liabilities

As of December 31, other liabilities are as follows:

	2017	2016
<i>Deferred income:</i>		
Deferred finance income	¢ 32,021,086,861	24,722,362,957
Deferred fees and commissions for trust management	34,109,997	23,251,334
	<u>32,055,196,858</u>	<u>24,745,614,291</u>
Allowance for stand-by credit losses (1)	265,681,489	540,840,567
<i>Operations pending application:</i>		
Operations pending settlement	56,259,287,267	19,153,979,611
Other operations pending application	9,962,141,488	2,337,461,858
	<u>66,221,428,755</u>	<u>21,491,441,469</u>
	<u>¢ 98,542,307,102</u>	<u>46,777,896,327</u>

(1) As of December 31, movement in the allowance for stand-by credit losses is as follows:

	2017	2016
Opening balance	¢ 540,840,567	1,545,597,997
Allowance expense (note 34)	76,257,000	185,335,020
Decrease in allowance (note 35)	(360,000,141)	(1,229,913,214)
Adjustment for foreign exchange differences	8,584,063	39,820,764
Closing balance	<u>¢ 265,681,489</u>	<u>540,840,567</u>

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BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

(20) Subordinated obligations

As of December 31, the Bank's subordinated obligations are as follows:

Annual interest rate	Term	Maturity		2017	2016
6-month LIBOR + 4.50% in the first 5 years and 6-month LIBOR + 5.00% thereafter	10 years	05/27/2024	US\$	100,000,000	100,000,000
6-month LIBOR + 5.25% in the first 5 years and 6-month LIBOR + 5.75% thereafter	15 years	10/23/2029		30,000,000	30,000,000
			US\$	130,000,000	130,000,000
	Total in colones		¢	73,634,600,000	71,263,400,000
	Finance charges payable			1,501,463,242	1,412,378,397
			¢	75,136,063,242	72,675,778,397

In accordance with IRNBS (Law No. 1644), the debt of State-owned commercial banks will be secured with guarantees issued by the Government and all its divisions and institutions. Government guarantees provided for in the aforementioned regulations apply to subordinated loans subscribed by State-owned commercial banks or rights and obligations derived therefrom. Subordinated financial instruments or loans (and the rights and obligations derived therefrom) may only be subscribed by multilateral development banks or bilateral development organizations.

Pursuant to SUGEF's prudential regulations on full unsubordinated debt prepayment by borrowers, if classified as Tier II capital, loans (including principal and interest) will be categorized as subordinated debt and ranked below other loans, such that borrowers will first fully repay any unsubordinated debt (existing on the effective date, or subsequently subscribed, assumed, or secured) in accordance with banking regulations.

(Continued)

BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

(21) Equity

(a) Share capital

As of December 31, the Bank's share capital is as follows:

	2017	2016
Capital under Law No. 1644	¢ 144,618,072,265	90,511,345,645
Bank capitalization bonds	27,618,957,837	27,618,957,837
	¢ 172,237,030,102	118,130,303,482

On December 23, 2008, the Executive Branch of the Costa Rican Government authorized a capital contribution funded by the *Amendment to Law No. 8627 on the Ordinary and Extraordinary Budget of the Republic for Tax Year 2008* (Law No. 8703). This law grants funds to capitalize three State-owned banks, including the Bank, in order to stimulate productive sectors, particularly small and medium-sized enterprises. For such purposes, the Bank received a total of US\$50,000,000 (equivalent to ¢27,619,000,002), by means of four securities denominated in DU, and maturing in 2013, 2017, 2018, and 2019 (No. 4183, No. 4184, No. 4185, and No. 4190 for DU 10,541,265 each, at a reference exchange rate of ¢655.02 to DU1.00). As of December 31, 2017, based on the exchange rate as of that date, the balance of those investments amounts to ¢18,562,535,348 (2016: ¢27,181,284,510) (see note 5).

By means of a study performed for the capitalization of retained earnings as of the 2015 close, and in conformity with SUGEF Directive 8-08, report UGC-001-17 "Capitalization of Retained Earnings" was submitted to the board of directors for approval, along with note DGF-J012-2017 dated January 31, 2017. In Article 10 of Meeting No. 12,137, held on February 6, 2017, it was unanimously agreed to authorize the capitalization of the balance of account 350 Retained Earnings for the period from 2009-2015 in the amount of ¢54,106,726,620. In Article 9 of the Minutes of Meeting No. 1324-2017, held on April 18, 2017, CONASSIF authorized the Bank to increase its capital in the amount of ¢54,106,726,620; thus, the total capital amounts to ¢172,237,030,102.

(b) Revaluation surplus

Revaluation surplus corresponds to the increase in the fair value of property.

As of December 31, 2017, the revaluation surplus amounts to ¢61,425,174,760 (2016: ¢60,806,752,437).

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BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

(c) Adjustment for valuation of available-for-sale investments and restricted financial instruments

This item corresponds to variations in the fair value of available-for-sale investments and restricted financial instruments.

As of December 31, 2017, the adjustment for the valuation of available-for-sale investments and restricted financial instruments results in an unrealized loss of ¢2,304,989,655 (2016: unrealized loss of ¢1,458,020,769).

(d) Adjustment for valuation of investments in other companies

As of December 31, 2017, the adjustment for valuation of investments in foreign associates by the equity method amounts to ¢9,095,624,686 (2016: ¢8,084,303,314). These investments correspond to the Bank's 49% ownership interest in BICSA and Subsidiary.

(e) Capital reserves

Capital reserves are as follows:

	2017	2016
Legal reserve	¢ 295,477,646,483	261,729,857,989
Statutory reserve for foreclosed assets	154,543,607	142,801,520
Excess of statutory reserve for loans	7,219,571,030	4,770,983,124
Statutory dynamic provision	8,270,045,249	7,970,665,759
	¢ <u>311,121,806,369</u>	<u>274,614,308,392</u>

(f) Equity of the Development Financing Fund

As of December 31, 2017, the allocation of the Bank's earnings for the creation of the Development Financing Fund (FOFIDE) amounts to ¢27,111,958,013 (2016: ¢21,749,819,320).

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BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

(22) Commitments and contingencies

The Bank has off-balance sheet commitments and contingencies that arise in the normal course of business and involve elements of credit and liquidity risk. As of December 31, the notional amounts of foreign exchange derivatives are as follows:

	2017	2016
Performance bonds	¢ 34,914,023,652	30,682,050,718
Bid bonds	2,380,121,728	1,342,107,486
Other guarantees	4,422,676,186	3,980,030,923
Letters of credit	19,229,683,722	10,690,229,800
Credits pending disbursement	224,551,326	253,629,299
	<u>61,171,056,614</u>	<u>46,948,048,226</u>
Pre-approved lines of credit	280,374,178,088	262,526,260,221
Other contingencies not related to credits	25,898,061	818,024,507
Other contingencies - Pending litigation and lawsuits (note 47)	<u>299,988,478,812</u>	<u>296,985,724,143</u>
	<u>580,388,554,961</u>	<u>560,330,008,871</u>
FX futures - Other than hedges (note 6)	<u>15,807,051,436</u>	-
	<u>¢ 657,366,663,011</u>	<u>607,278,057,097</u>

Letters of credit, guarantees, and sureties granted expose the Bank to credit loss in the event of non-compliance by the customer. The Bank's policies and procedures for approving credit commitments and financial guarantees are the same as those for granting loans booked. Guarantees and sureties granted have fixed maturity dates and, in most cases, mature without requiring disbursement. Therefore, they do not represent a significant liquidity risk. Most letters of credit are used; however, those used are generally on demand, issued, and confirmed by correspondent banks, and payable immediately.

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BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

These commitments and contingent liabilities expose the Bank to credit risk since fees and commissions and losses are recognized in the consolidated balance sheet until the commitments are fulfilled or expire.

The Bank has off-balance sheet financial instruments (stand-by and without prior deposit) that arise in the ordinary course of business and involve elements of credit and liquidity risk. Those financial instruments include letters of credit, guarantees, and sureties without prior deposit.

(23) Trust assets (unaudited)

The Bank provides trust services whereby it manages assets per the customer instructions. The Bank receives a fee for providing those services. Those assets, liabilities, and equity are not recognized in the Bank's consolidated financial statements. The Bank is not exposed to any credit risk relating to such placements, as it does not guarantee these assets.

The types of trusts managed by the Bank are as follows:

- management and investment trusts
- management trusts with a testamentary clause
- guaranty trusts
- housing trusts
- management and investment public trusts.

BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

As of December 31, 2017, trust capital is invested in the following assets (unaudited):

Nature of trust	Cash or property management	Securitization	Portfolio management	Guaranty	Testamentary	Custody of stock with testamentary clauses	Custody of stock and management of funds	Cash guaranty and management	Guaranty and custody of stock	Total
<i>Trust assets</i>										
Cash and due from banks	102,952,351	2,760,570	627,856	-	86,274	-	8,573	-	-	106,435,624
Investment securities and term deposits	296,554,249,029	11,871,035,819	2,466,108,804	1,140,795,534,106	1,235,181,316	-	2,064,730	-	-	1,452,924,173,804
Loan portfolio	2,570,177,368	-	1,481,422,233	-	-	-	-	-	-	4,051,599,601
Accounts and accrued interest receivable	18,444,686,904	17,250,670,197	1,675,816,864	25,958,821	283,699	-	-	43,992,978	1,925,827	37,443,335,290
Foreclosed assets	85,634,655	-	-	-	-	-	-	-	-	85,634,655
Investments in other companies	-	-	-	-	2,320,000	614,329,393	-	-	906,272,000	1,522,921,393
Property and equipment	4,559,678,241	53,889,119,388	-	72,948,120,617	-	-	-	1,544,041,161	1,454,901,292	134,395,860,699
Other assets	6,388,269,009	8,896,450	-	1,508,767,715	1,825,053	-	-	-	1,674,504,726	9,582,262,953
<b>Total</b>	<b>328,705,647,557</b>	<b>83,022,482,424</b>	<b>5,623,975,757</b>	<b>1,215,278,381,259</b>	<b>1,239,696,342</b>	<b>614,329,393</b>	<b>2,073,303</b>	<b>1,588,034,139</b>	<b>4,037,603,845</b>	<b>1,640,112,224,019</b>

(Continued)

BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

As of December 31, 2016, trust capital is invested in the following assets (unaudited):

Nature of trust	Cash or property management	Securitization	Portfolio management	Guaranty	Testamentary	Custody of stock with testamentary clauses	Custody of stock and management of funds	Cash guaranty and management	Pre-sales management	Guaranty and custody of stock	Total
<i>Trust assets</i>											
Cash and due from banks	¢ 84,749,206	667,588,410	5,079,882	-	892,322	-	8,573	-	-	-	758,318,393
Investment securities and term deposits	193,209,749,751	7,005,541,450	1,978,345,006	1,025,988,873,967	1,182,795,790	-	1,984,220	-	-	-	1,229,367,290,184
Loan portfolio	2,683,406,286	-	1,311,997,204	-	-	-	-	-	-	-	3,995,403,490
Accounts and accrued interest receivable	9,599,521,995	12,834,002,406	1,769,982,758	24,682,121	475,951	-	-	34,848,960	-	548,180	24,264,062,371
Foreclosed assets	12,852,464	-	-	-	-	-	-	-	-	-	12,852,464
Investments in other companies	599,075,640	-	-	-	2,320,000	2,096,000	-	-	-	877,088,000	1,480,579,640
Property and equipment	4,560,607,132	49,080,535,436	-	72,930,401,803	-	-	-	1,544,041,161	-	1,454,901,292	129,570,486,824
Other assets	2,790,238,017	-	-	1,517,709,641	1,172,011	-	-	-	5,591,595	1,674,504,726	5,989,215,990
	¢ 213,540,200,491	69,587,667,702	5,065,404,850	1,100,461,667,532	1,187,656,074	2,096,000	1,992,793	1,578,890,121	5,591,595	4,007,042,198	1,395,438,209,356

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BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

The types of trusts managed by the Bank are as follows:

a) Housing mortgage

These trusts are exclusively dedicated to managing housing loan portfolios.

b) Cash or property management

These trusts are dedicated to managing cash or property for any of several purposes, including investing the cash or property placed in the trust and making payments.

c) Securitization

These trusts are used to obtain funds from liquid assets by issuing asset-backed securities.

d) Portfolio management

These trusts are dedicated to managing portfolios of loans granted for housing, agriculture, or reforestation projects or for any other activity aimed at promoting the country's socioeconomic development.

e) Special accounts

These accounts are "special" funds (not trusts) managed by BN-Fiduciaria that are created for different purposes in order to help facilitate the control, management, location, and future settlement of certain accounting items used to settle trust contingencies, the maturity of mortgage investment certificates (CIH), the management of fixed assets, etc.

f) Guaranty

These trusts hold trust property that is to be transferred as a guarantee for loan operations per the instructions of the trustor.

g) Testamentary

The purpose of these trusts is to meet the listed needs of individuals identified by the trustors upon their death. Testamentary trusts include life insurance policies, wills, and inheritances.

BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

h) Custody of stock with testamentary clause

These trusts hold in custody capital stock, plus an added value based on the testamentary trust agreement. The purpose of these trusts is to manage the assets represented by the aforementioned stock on behalf of third parties.

(24) Other debit memoranda accounts

As of December 31, other debit memoranda accounts are as follows:

	2017	2016
Pension Fund Manager's own investments in custody – Face value of principal (unaudited)	¢ 6,393,826,000	6,610,000,000
Pension Fund Manager's own investments in custody – Coupons (unaudited)	1,103,393,148	1,722,639,500
Pension Fund Manager's own investments in custody – Number of shares (unaudited)	23	23
Guarantees received in the Bank's custody	1,323,290,684	1,724,533,313
Other guarantees received in the Bank's custody	5,214,227,292,003	5,367,946,170,309
Lines of credit granted but unused	400,321,411,495	441,382,834,335
Loans pending disbursement	233,983,980,165	225,619,018,406
Unused overdrafts	207,927,441	578,306,470
Loans settled	173,858,782,945	166,459,634,866
Other accounts receivable settled	9,765,571,761	11,898,442,646
Accrued interest receivable settled	16,739,182,013	16,299,952,949
Interest income on non-accrual loans of loan portfolio	16,099,998,875	11,671,508,267
Supporting documentation received in the Bank's custody	1,255	1,255
Securities issued pending placement	26,914,226,643	13,869,211,606
Notified letters of credit	14,877,914,261	15,435,994,146
Notional value subject to interest rate futures (note 6)	576,615,560,000	688,494,461,153
Securities issued pending placement	16,866,526,419	-
Reversals made to expense accounts for the period	43,316,609,467	-
Non-deductible expenses	36,206,722,661	35,870,721,965
Non-taxable income	74,388,367,866	78,826,408,960
Other memoranda accounts	201,266,397,841	196,534,181,866
	<u>7,064,476,982,966</u>	<u>7,280,944,022,035</u>
Third-party debit memoranda accounts (unaudited)	2,542,913,153,061	2,268,532,958,984
Own debit memoranda accounts for custodial activities	371,296,353,570	231,082,070,315
Third-party debit memoranda accounts for custodial activities (unaudited)	10,673,107,956,840	9,793,238,351,341
	<u>13,587,317,463,471</u>	<u>12,292,853,380,640</u>
¢	<u>20,651,794,446,437</u>	<u>19,573,797,402,675</u>

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BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

As of December 31, other memoranda accounts by entity are as follows:

	2017	2016
Banco Nacional de Costa Rica	¢ 17,983,845,225,594	17,119,227,249,789
BN Valores Puesto de Bolsa, S.A. (unaudited) (note 25)	947,725,437,545	939,715,141,866
BN Sociedad Administradora de Fondos de Inversión, S.A. (unaudited) (note 26)	426,243,485,231	358,296,155,829
BN Vital Operadora de Planes de Pensiones Complementarias (unaudited) (note 27)	1,293,980,298,067	1,156,558,855,191
	¢ 20,651,794,446,437	19,573,797,402,675

As of December 31, third-party debit memoranda accounts are as follows:

	2017	2016
Management of banking mandates	¢ 830,355,188,266	762,122,383,713
Assets in custody on behalf of third parties	-	392,901
“TUDES” securities received in custody from affiliates under Article 75 of Law No. 7531	643,835,834	986,274,291
Pension funds (unaudited) (note 27)	1,285,736,564,900	1,147,185,461,582
Investment funds (unaudited) (note 26)	426,177,564,061	358,238,446,497
	¢ 2,542,913,153,061	2,268,532,958,984

(25) Current and term brokerage operations and security portfolio management (unaudited)

As of December 31, memoranda accounts for brokerage operations are summarized as follows:

	2017	2016
<i>Own</i>		
Trading securities in custody (note 25-a)	¢ 3,635,534,446	7,525,552,425
Trading securities received as guarantees	25,509,549,040	27,185,648,401
Repurchase agreements pending settlement (note 25-b)	23,095,103,676	26,591,702,575
Other own memoranda accounts	5,677,729,972	4,650,394,747
	57,917,917,134	65,953,298,148
<i>Third-party</i>		
Trading securities in custody (note 25-a)	614,375,579,007	608,181,806,524
Trading securities received as guarantees	67,272,074,945	73,711,662,718
Trading securities pledged as guarantees	86,028,264,841	72,336,434,299
Signed agreements pending settlement	2,901,000	-
Repurchase agreements pending settlement (note 25-b)	120,871,126,858	118,093,644,163
Cash and accounts receivable	1,257,573,760	1,438,296,014
	889,807,520,411	873,761,843,718
	¢ 947,725,437,545	939,715,141,866

(Continued)

BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

In accordance with the Regulations on Repurchase Agreements and the Regulations on Term Operations, all operations are backed by guarantees in order to cover any related contingencies.

Securities that back repurchase agreements are held in the custody of CEVAL or in foreign entities with which CEVAL has custody agreements.

a) As of December 31, securities held in custody are as follows:

Location	Type of custody	2017	2016
<i>Own custodial activities</i>			
Local	At face value - available	¢ 3,410,521,420	7,342,146,259
	At purchase value of shares - available	15,000,002	15,000,002
Local	At purchase value of investments - available	220,071	67,576,232
Local	At face value - pledged	207,500,000	100,000,000
	Amount of physical coupons - pledged	2,292,953	829,932
		<u>3,635,534,446</u>	<u>7,525,552,425</u>
<i>Custodial activities on behalf of third parties</i>			
Local	At face value - available	577,702,310,682	572,626,165,295
Local	At purchase value of shares - available	24,390,835,287	21,630,277,811
Local	At purchase value of investments - available	10,081,073,907	12,086,911,480
Local	At face value - pledged	1,939,292,642	1,764,518,041
Local	At purchase value of shares - pledged	64,581,389	63,720,864
Local	At purchase value of investments - pledged	194,584,100	10,213,033
Local	At purchase value of shares - pending delivery	2,901,000	-
		<u>614,375,579,007</u>	<u>608,181,806,524</u>
		¢ <u>618,011,113,453</u>	<u>615,707,358,949</u>

(Continued)

b) Term buyer and seller positions in third-party repurchase agreements involving the Brokerage Firm are as follows:

As of December 31, 2017, term buyer and seller positions in tri-party repurchase agreements in U.S. dollars were valued at the exchange rate of €566.42 (2016: €548.18) to US\$1.00.

(Continued)

BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

The maturity structure of term buyer and seller positions in tri-party repurchase agreements involving the Brokerage Firm is as follows:

2017				
	Term buyer		Term seller	
	Colones	U.S. dollars	Colones	U.S. dollars
<i>Own</i>				
31 to 60 days	7,735,107,138	2,879,850	-	-
61 to 90 days	4,736,767,662	15,875,188	-	-
	12,471,874,800	18,755,038	-	-
<i>Third parties</i>				
1 to 30 days	844,750,738	588,235	3,997,607,266	588,235
31 to 60 days	7,102,274,820	14,030,658	9,998,275,035	8,861,418
61 to 90 days	5,452,960,236	74,841,196	5,827,302,087	47,689,412
More than 91 days	-	4,070,534	-	4,070,534
	13,399,985,794	93,530,623	19,823,184,388	61,209,599
¢	25,871,860,594	112,285,661	19,823,184,388	61,209,599
2016				
	Term buyer		Term seller	
	Colones	U.S. dollars	Colones	U.S. dollars
<i>Own</i>				
1 to 30 days	¢ 6,437,317,658	752,598	-	-
31 to 60 days	9,040,100,002	13,562,802	-	-
61 to 90 days	1,519,954,941	3,186,752	-	-
	16,997,372,601	17,502,152	-	-
<i>Third parties</i>				
1 to 30 days	3,045,727,110	-	4,953,859,965	2,778,460
31 to 60 days	12,236,111,739	35,430,115	9,294,217,383	43,963,584
61 to 90 days	2,747,570,998	22,872,801	2,227,621,378	21,424,911
More than 91 days	404,223,956	12,269,541	404,223,956	12,269,541
	18,433,633,803	70,572,457	16,879,922,682	80,436,496
¢	35,431,006,404	88,074,609	16,879,922,682	80,436,496

In tri-party repurchase agreements and term operations, the Brokerage Firm is contingently liable for the short balance that arises when a security is sold for an amount that is less than the amount payable to the respective term seller. In accordance with the Regulations on Repurchase Agreements and the Regulations on Term Operations, all operations are backed by guarantees in order to cover any related contingencies.

(Continued)

BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

Securities that back tri-party repurchase agreements are held in the custody of CEVAL or in foreign entities with which CEVAL has custody agreements.

(26) Investment fund management agreements

As of December 31, the Investment Fund Manager's memoranda accounts are as follows:

		2017		
Fund		Net value	Shares	Value per share
<i>Funds in colones:</i>				
Súper Fondo - colones	¢	105,505,239,243	26,805,346,134	3.935977499
Fon Depósito - colones		47,487,806,799	32,886,877,389	1.443974332
Creci Fondo - colones		2,963,993,598	596,800,997	4.966468907
Redi Fondo - colones		10,693,512,151	3,021,703,666	3.53890167
Diner Fondo - colones		46,986,846,273	17,707,746,441	2.65346279
Subtotal in colones	¢	213,637,398,064	81,018,474,627	
<i>Funds in U.S. dollars:</i>				
Súper Fondo - U.S. dollars	US\$	23,056,057	15,597,383	1.478200356
Creci Fondo - U.S. dollars		5,248,967	2,951,123	1.778633668
Redi Fondo - U.S. dollars		24,480,312	16,353,095	1.49698346
Diner Fondo - U.S. dollars		101,975,640	79,056,666	1.289905639
Fon Depósito - U.S. dollars		65,921,797	60,341,692	1.092475129
Súper Fondo Plus - U.S. dollars		154,134,415	144,985,512	1.063102186
Fondo Hipotecario - U.S. dollars (mortgage fund)		191,773	189,937	216.2
BN Infraestructura Pública -1 – U.S. dollars (public infrastructure)		225,257	250	901.03
Subtotal in U.S. dollars	US\$	375,234,218	319,475,658	
Subtotal in U.S. dollars expressed in colones	¢	212,540,165,997	180,957,402,204	
Total assets of managed funds (note 24)	¢	426,177,564,061	261,975,876,831	
<i>Guarantees:</i>				
Performance bonds		63,945,866		
Outstanding checks		1,975,304		
Total memoranda accounts	¢	426,243,485,231		

(Continued)

BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

Fund	2016		
	Net value	Shares	Value per share
<i>Funds in colones:</i>			
Súper Fondo - colones	¢ 88,199,400,617	23,252,481,058	3.793117835
Fon Depósito - colones	53,636,792,605	38,322,215,707	1.399626603
Creci Fondo - colones	3,753,408,629	791,363,877	4.742961786
Redi Fondo - colones	15,292,938,274	4,534,360,488	3.372678091
Diner Fondo - colones	41,580,077,576	16,187,520,727	2.568650152
Subtotal in colones	¢ 202,462,617,701	83,087,941,857	
<i>Funds in U.S. dollars:</i>			
Súper Fondo - U.S. dollars	US\$ 22,956,865	15,831,245	1.450098562
Creci Fondo - U.S. dollars	3,051,306	1,788,904	1.705685106
Redi Fondo - U.S. dollars	15,474,216	10,745,047	1.440125492
Diner Fondo - U.S. dollars	75,626,981	59,540,550	1.270176062
Fon Depósito - U.S. dollars	54,448,574	50,655,433	1.074881226
Súper Fondo Plus - U.S. dollars	112,351,336	107,757,853	1.042627826
Fondo Hipotecario - U.S. dollars (mortgage fund)	259,843	258,127	292.95
Subtotal in U.S. dollars	US\$ 284,169,121	246,577,159	
Subtotal in U.S. dollars expressed in colones	¢ 155,775,828,796	135,168,667,021	
Total assets of managed funds (note 24)	¢ 358,238,446,497	218,256,608,878	
<i>Guarantees:</i>			
Performance bonds	¢ 55,734,028		
Outstanding checks	1,975,304		
Total memoranda accounts	¢ 358,296,155,829		

The main activity of the Investment Fund Manager is managing funds and securities in investment funds.

An investment fund is capital formed by contributions from individuals or legal entities for the purpose of investing such capital in securities or in other assets authorized by SUGEVAL, which is managed by a company dedicated to such activities on behalf of fund participants, who assume all related risks. Contributions are documented in share certificates. The objective of investment funds is to maximize goodwill on the invested amount by managing securities or other assets for which the respective return depends on changes in the fair value of the assets.

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BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

The Investment Fund Manager has registered the following funds with SUGEVAL:

- *BN SuperFondo - Colones No Diversificado* (non-diversified - colones): This is an open-end (floating number of outstanding shares) money market fund with a variable income portfolio. Returns on the investment portfolio are not distributed until the customer requests partial or full redemption of shares.
- *BN CreciFondo - Colones No Diversificado* (non-diversified - colones): This is an open-end (floating number of outstanding shares) growth fund with a variable income portfolio. Returns on the investment portfolio are not distributed until the customer requests partial or full redemption of shares.
- *BN RediFondo Mensual - Colones No Diversificado* (monthly, non-diversified - Colones): This is an open-end (floating number of outstanding shares) income fund with a fixed income portfolio. Returns on the investment portfolio are not distributed until the customer requests partial or full redemption of shares.
- *BN DinerFondo - Colones No Diversificado* (non-diversified - colones): This is an open-end (floating number of outstanding shares) money market fund with a fixed income portfolio. Returns on the investment portfolio are not distributed until the customer requests partial or full redemption of shares.
- *BN FonDepósito - Colones No Diversificado* (non-diversified - colones): This is an open-end (floating number of outstanding shares) money market fund with a fixed income portfolio. Returns on the investment portfolio are not distributed until the customer requests partial or full redemption of shares.
- *BN SuperFondo - Dólares Diversificado* (diversified - U.S. dollars): This is an open-end (floating number of outstanding shares) money market fund with a variable income portfolio. Returns on the investment portfolio are not distributed until the customer requests partial or full redemption of shares.
- *BN CreciFondo - Dólares No Diversificado* (non-diversified - U.S. dollars): This is an open-end (floating number of outstanding shares) growth fund with a variable income portfolio. Returns on the investment portfolio are not distributed until the customer requests partial or full redemption of shares.
- *BN RediFondo Trimestral - Dólares No Diversificado* (quarterly, non-diversified - U.S. dollars): This is an open-end (floating number of outstanding shares) income fund with a fixed income portfolio. Returns on the investment portfolio are not distributed until the customer requests partial or full redemption of shares.

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BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

- *BN DinerFondo - Dólares No Diversificado* (non-diversified - U.S. dollars): This is an open-end (floating number of outstanding shares) money market fund with a fixed income portfolio. Returns on the investment portfolio are not distributed until the customer requests partial or full redemption of shares.
- *BN FonDepósito - Dólares No Diversificado* (non-diversified - U.S. dollars): This is an open-end (floating number of outstanding shares) money market fund with a fixed income portfolio. Returns on the investment portfolio are not distributed until the customer requests partial or full redemption of shares.
- *BN Fondo de Inversión de Titularización Hipotecaria (FHIPO) - Dólares* (mortgage securitization - U.S. dollars): This is mainly a closed-end mortgage investment fund, i.e. investor shares are listed and traded on a stock exchange.
- *BN SuperFondo Dólares Plus No Diversificado - Dólares* (non-diversified - U.S. dollars): This fund is aimed at conservative investors looking for short-term investments. It allows obtaining reimbursement of the shares one business day and up to a maximum of three business days from the date of receipt of the withdrawal request. Since it is a short-term fund, it allows the investor to manage resources to address its present or future liquidity needs. The goal of the fund is to offer an investment mechanism that seeks to obtain higher returns than other investment alternatives under similar liquidity, term, and risk parameters, taking advantage of the short-term part of the yield curve in the composition of its portfolio.
- *BN Inmobiliario CR-2 - Dólares* (real estate development – U.S. dollars): This is a long-term, closed-end fund, in U.S. dollars, which has the goal of investing in real estate for its exploitation through leasing and sale. It is aimed at investors interested in diversifying their investments portfolio by including real estate property located in national territory and mainly occupied by public institutions. As of December 31, 2017 and 2016, this fund does not have operations.
- *Fondo de Inversión de Desarrollo Inmobiliario BN-1 - Dólares* (real estate development - U.S. dollars): This fund invests in the construction of buildings to be occupied by entities of the Banco Nacional Conglomerate (BNCR Conglomerate). Once the works are completed, the buildings will be sold to an entity of the BNCR Conglomerate or a real estate fund managed by BN Fondos, and investors thus realize their potential gains. If the buildings are sold to a real estate fund, such fund will lease the buildings to an entity of the BNCR Conglomerate. As of December 31, 2017 and 2016, this fund does not have operations.

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BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

- *Fondo de Inversión de Desarrollo Inmobiliario de Infraestructura Pública - 1 - Dólares* (real estate development - U.S. dollars): This fund will invest in the construction of buildings to be occupied by the Maximum Deconcentration Organizations and other entities of BCCR. Once the works are completed, the buildings will be leased with a purchase option to BCCR or sold to BCCR or to a real estate fund managed by BN Fondos, and investors thus realize their potential gains. If the buildings are sold to a real estate fund, such fund will lease the buildings to BCCR. As of December 31, 2017 and 2016, this fund does not have operations.

(27) Pension fund management agreements (unaudited)

As of December 31, the Pension Fund Manager's memoranda accounts are as follows:

	2017	2016
Mandatory Pension Fund (ROP)	¢ 1,046,233,902,919	929,721,280,369
ROP erroneous	14,193,844,128	13,479,971,402
Mandatory Retirement Savings Account (FCL)	95,495,091,369	85,281,350,061
FCL erroneous	3,317,116,474	3,153,850,226
Pension Fund in Colones A (FPC A)	63,853,227,581	60,036,878,001
Pension Fund in Colones B (FPC B)	16,632,424,516	13,447,299,353
Notary Fund (NOT)	25,828,064,933	24,200,252,141
Pension Fund in U.S. dollars A (FPD A) (a)	11,493,786,637	10,750,781,762
Pension Fund in U.S. dollars B (FPD B) (b)	8,689,106,343	7,113,798,267
Total assets of managed funds (note 24)	1,285,736,564,900	1,147,185,461,582
Securities and assets in own custody	7,497,219,171	8,332,639,523
Bid and performance bonds – colones	21,841,425	16,674,605
Bid and performance bonds – U.S. dollars (c)	80,836,738	37,805,190
Securities in DU	643,835,834	986,274,291
Total memoranda accounts (note 24)	¢ 1,293,980,298,068	1,156,558,855,191

- (a) As of December 31, 2017, this fund amounts to US\$20,291,986 and is valued at the exchange rate of ¢566.42 to US\$1.00 (2016: US\$19,611,773 valued at the exchange rate of ¢548.18 to US\$1.00).
- (b) As of December 31, 2017, this fund amounts to US\$15,340,395 and is valued at the exchange rate of ¢566.42 to US\$1.00 (2016: US\$12,977,127 valued at the exchange rate of ¢548.18 to US\$1.00).
- (c) As of December 31, 2017, this fund amounts to US\$142,715 and is valued at the exchange rate of ¢566.42 to US\$1.00 (2016: US\$68,965 valued at the exchange rate of ¢548.18 to US\$1.00).

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BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

(28) Finance income on financial instruments

For the year ended December 31, finance income on financial instruments is as follows:

	2017	2016
<i>Cash and due from banks:</i>		
Deposits in BCCR	23,345,998	5,174,157
Checking accounts and demand deposits in local entities	108,259,964	80,539,932
Checking accounts and demand deposits in foreign entities	2,938,601,620	628,899,923
	<u>3,070,207,582</u>	<u>714,614,012</u>
<i>Financial instruments:</i>		
Investments in available-for-sale securities	48,444,879,258	41,123,344,888
Investment in securities and restricted deposits	2,423,847,368	6,755,226,462
	<u>50,868,726,626</u>	<u>47,878,571,350</u>
	<u>53,938,934,208</u>	<u>48,593,185,362</u>

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BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

(29) Finance income on loan portfolio

For the year ended December 31, finance income on the loan portfolio is as follows:

	2017	2016
<i>Current loans:</i>		
Checking account overdrafts	¢ 68,710,086	57,373,872
Discounted notes	-	626,964
Loans granted with funds from BCCR	993,429,685	1,165,002,915
Loans granted with other funds	331,989,878,208	285,867,415,972
Credit cards	24,699,442,068	21,141,765,663
Issued letters of credit	579,034	112,709
Other loans	4,545,784	4,509,536
	<u>357,756,584,865</u>	<u>308,236,807,631</u>
<i>Past due loans and loans in legal collection:</i>		
Checking account overdrafts	2,419,699	9,883,694
Loans granted with funds from BCCR	141,433,591	177,090,616
Loans granted with other funds	43,313,062,195	40,879,267,471
Credit cards	2,727,402,948	2,350,168,175
Other loans	234,173	-
	<u>46,184,552,606</u>	<u>43,416,409,956</u>
	<u>¢ 403,941,137,471</u>	<u>351,653,217,587</u>

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BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

(30) Other finance income

For the year ended December 31, other finance income is as follows:

	2017	2016
Fees and commissions on letters of credit	¢ 73,454,058	54,287,331
Fees and commissions on guarantees granted	464,886,999	420,500,930
Fees and commissions on lines of credit	82,075,764	102,166,852
Gain on fair value hedge for item measured at cost	16,126,462,658	42,806,739,418
Other sundry finance income	4,782,243,818	4,012,419,170
	¢ <u>21,529,123,297</u>	<u>47,396,113,701</u>

(31) Finance expenses for obligations with the public

For the year ended December 31, finance expenses for obligations with the public are as follows:

	2017	2016
Demand deposits	¢ 37,370,082,469	28,214,133,494
Term deposits	111,896,091,731	77,352,761,160
Third-party repurchase agreements and securities lending	1,213,530,563	1,586,339,492
	¢ <u>150,479,704,763</u>	<u>107,153,234,146</u>

(32) Finance expenses for obligations with financial entities

For the year ended December 31, finance expenses for obligations with financial entities are as follows:

	2017	2016
Demand obligations	¢ 2,292,993,961	1,798,917,470
Term obligations	67,018,550,049	55,806,822,213
	¢ <u>69,311,544,010</u>	<u>57,605,739,683</u>

(Continued)

BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

(33) Other finance expenses

For the year ended December 31, other finance expenses are as follows:

	2017	2016
Fees and commissions on letters of credit obtained	¢ 78,631,720	81,692,990
Loss on hedged item measured at cost from fair value hedge on interest rate risk	14,664,767,883	27,421,960,479
Other sundry finance expenses	359,213,852	959,178,923
	¢ <u>15,102,613,455</u>	<u>28,462,832,392</u>

(34) Expenses for allowance for impairment of assets

For the year ended December 31, expenses for allowance for impairment of assets are as follows:

	2017	2016
Allowance for loan losses (note 7-c)	¢ 57,010,820,888	28,521,685,521
Allowance for impairment of other accounts receivable (note 8)	2,026,114,296	1,601,223,913
Allowance for stand-by credit losses (note 19)	18,050,000	130,000,001
General and counter-cyclical allowance for loan portfolio (note 7-c)	12,388,258,515	8,969,130,558
General and counter-cyclical allowance for stand-by credit losses (note 19)	58,207,000	55,335,019
Allowance for impairment of derivative financial instruments (note 5)	29,794,522	20,527,703
	¢ <u>71,531,245,221</u>	<u>39,297,902,715</u>

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BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

(35) Income from recovery of assets and decreases in allowances and provisions

For the year ended December 31, income from recovery of assets and decreases in allowances and provisions is as follows:

	2017	2016
Recovery of loan write-offs	¢ 11,290,264,850	8,540,789,494
Recovery of receivable write-offs	6,786,278	973,960
Decrease in allowance for loan losses (note 7)	720,000,000	-
Decrease in allowance for impairment of other accounts receivable (note 8)	767,042,270	3,229,204,400
Decrease in allowance for stand-by credit losses (note 19)	230,000,141	1,229,913,214
Decrease in general and counter-cyclical allowance for stand-by credit losses (note 19)	130,000,000	-
Decrease in allowance for impairment of investments in financial instruments (note 5)	17,716,855	97,495,429
	¢ <u>13,161,810,394</u>	<u>13,098,376,497</u>

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BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

(36) Operating income from service fees and commissions

For the year ended December 31, operating income from service fees and commissions is as follows:

	2017	2016
Drafts and transfers	¢ 8,458,568,610	7,822,913,773
Certified checks	5,936,946	4,755,849
Trusts	978,621,968	744,852,549
Custodial services	1,612,851,671	1,486,305,841
Banking mandates	231,919	279,577
Collections	32,139,006	34,685,858
Credit cards	55,057,266,543	47,048,860,334
Management services	3,470,572,705	3,656,010,308
Management of investment funds	4,903,577,312	5,147,534,227
Management of pension funds	7,392,864,342	8,635,957,365
Insurance underwriting	6,021,919,064	4,670,446,231
Brokerage operations (third parties in local market)	2,517,513,721	2,760,022,183
Brokerage operations (third parties in other markets)	89,624,207	174,148,773
Individual portfolio management	1,272,933	1,132,186
Other	41,063,239,483	40,333,903,337
	<u>¢ 131,606,200,430</u>	<u>122,521,808,391</u>

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BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

(37) Other operating income

For the year ended December 31, other operating income is as follows:

	2017	2016
Leasing of assets	¢ 54,690,391	41,960,194
Recovery of expenses	2,272,677,882	2,399,421,350
Net valuation of other assets (note 46-c)	414,076,427	371,907,290
Other income from accounts receivable	1,524,889	1,458,357
Sale of shares - VISA	-	11,877,381,401
Sundry operating income	5,065,197,788	5,313,955,420
Decrease in provisions	2,300,848,366	2,162,952,555
	¢ <u>10,109,015,743</u>	<u>22,169,036,567</u>

(38) Expenses for foreclosed assets

For the year ended December 31, expenses for foreclosed assets are as follows:

	2017	2016
Loss on sale of assets acquired in lieu of payment	¢ 2,262,926,272	1,581,436,186
Loss on sale of assets awarded in judicial auctions	7,116,546,951	6,353,617,713
Management of assets awarded in judicial auctions	5,678,480,407	8,275,437,770
Loss on impairment of foreclosed assets (note 9)	85,930,006	149,824,594
Loss on allowance for impairment of foreclosed assets and per legal requirements (note 9)	5,974,067,289	4,756,428,898
Other expenses for foreclosed assets	330,046,363	1,053,953,924
	¢ <u>21,447,997,288</u>	<u>22,170,699,085</u>

(Continued)

BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

(39) Expenses for provisions

For the year ended December 31, expenses for provisions are as follows:

	2017	2016
Severance benefits	¢ 1,338,573,809	7,122,139,577
Pending litigation	537,644,287	1,944,689,188
Other provisions	7,827,589,883	15,799,859,760
	¢ <u>9,703,807,979</u>	<u>24,866,688,525</u>

(40) Other operating expenses

For the year ended December 31, other operating expenses are as follows:

	2017	2016
Donations	-	500,000,000
Fines for noncompliance with legal regulatory provisions	¢ 374,531,989	28,077,206
Net valuation of other liabilities (note 46-c)	867,162,063	572,989,111
Income tax on foreign remittances	76,955,195	1,246,721,225
Income tax (8%) on interest on investments in financial instruments	2,939,100,615	2,742,921,270
Property tax	228,777,095	228,019,133
Licenses	558,278,348	429,130,865
Other local taxes	896,705,015	720,157,050
Transfer to FINADE	3,577,151,802	3,680,097,576
Sundry operating expenses	62,378,475,143	50,386,501,130
	¢ <u>71,897,137,265</u>	<u>60,534,614,566</u>

(Continued)

BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

(41) Personnel expenses

For the year ended December 31, personnel expenses are as follows:

	2017	2016
Salaries and bonuses, permanent staff	¢ 66,286,959,048	66,077,230,929
Salaries and bonuses, contractors	1,649,297,033	1,765,471,615
Compensation for directors and statutory examiners	188,014,533	176,173,391
Overtime	909,111,356	918,178,715
Travel expenses	612,637,821	712,741,437
Statutory Christmas bonus	6,966,280,073	7,458,001,402
Vacation	6,642,981,000	8,020,637,045
Other compensation	4,350,216,692	4,135,650,189
Severance benefits	4,227,195,279	4,470,283,031
Employer social security taxes	26,294,061,244	27,914,392,998
Refreshments	470,094,005	439,249,673
Uniforms	367,084,495	219,900,836
Training	706,234,618	886,548,604
Employee insurance	230,073,929	271,297,900
Back-to-school bonus	5,961,112,365	6,368,136,484
Mandatory retirement savings account	2,523,547,244	2,675,768,146
Other personnel expenses	555,555,391	580,695,202
	¢ <u>128,940,456,126</u>	<u>133,090,357,597</u>

(Continued)

BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

(42) Other administrative expenses

For the year ended December 31, other administrative expenses are as follows:

	2017	2016
Outsourcing	¢ 12,494,979,030	12,860,315,565
Transportation and communications	4,403,123,967	4,219,336,531
Infrastructure	36,136,543,165	35,049,737,893
Overhead	17,203,070,108	13,753,695,554
	¢ 70,237,716,270	65,883,085,543

(43) Statutory allocations

For the year ended December 31, statutory allocations are as follows:

	2017	2016
CONAPE 5%	¢ 2,394,220,408	3,809,281,191
CNE (3%)	1,547,256,681	2,397,001,050
INFOCOOP (10%)	4,253,491,805	6,279,305,016
Public capital pension operators	726,185,039	1,172,980,254
RIVM (15%) (2016: 7%)	4,766,379,763	3,494,837,874
	¢ 13,687,533,696	17,153,405,385

For the year ended December 31, statutory allocations decreased as follows:

	2017	2016
CNE (3%)	¢ 6,857,889	-
INFOCOOP (10%)	63,669,806	-
RIVM (15%) (2016: 7%)	30,585,366	-
	¢ 101,113,061	-

(Continued)

BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

(44) Fair value of financial instruments

As of December 31, carrying amounts and fair values of all financial assets and liabilities that are not carried at fair value are compared in the following table:

		2017	
		Carrying amount	Fair value
<i>Financial assets:</i>			
Cash and due from banks	¢	1,282,770,297,705	1,282,770,297,705
Investments in financial instruments		1,097,332,342,386	1,097,332,342,386
Loan portfolio		4,524,849,705,830	4,266,690,384,883
	¢	<u>6,904,952,345,921</u>	<u>6,646,793,024,974</u>
<i>Financial liabilities:</i>			
Demand deposits from the public and financial entities	¢	2,939,311,443,807	2,939,311,443,807
Other demand obligations with the public		26,763,791,694	26,763,791,694
Term deposits from the public and financial entities		3,254,760,690,320	3,285,295,781,289
Obligations for tri-party repurchase agreements		22,916,380,358	22,916,380,358
	¢	<u>6,243,752,306,179</u>	<u>6,274,287,397,148</u>
		2016	
		Carrying amount	Fair value
<i>Financial assets:</i>			
Cash and due from banks	¢	937,810,182,994	937,810,182,994
Investments in financial instruments		956,600,207,359	956,600,207,359
Loan portfolio		4,142,828,752,144	3,873,915,582,206
	¢	<u>6,037,239,142,497</u>	<u>5,768,325,972,559</u>
<i>Financial liabilities:</i>			
Demand deposits from the public and financial entities	¢	2,831,569,856,629	2,831,569,856,629
Other demand obligations with the public		12,810,540,801	12,810,540,801
Term deposits from the public and financial entities		2,607,387,462,867	2,620,399,593,453
Obligations for tri-party repurchase agreements		26,448,255,041	26,448,255,041
	¢	<u>5,478,216,115,338</u>	<u>5,491,228,245,924</u>

(Continued)

BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

*Fair value estimates*

The following assumptions were used by management to estimate the fair value of each class of financial instruments, both on and off the consolidated balance sheet:

- (a) Cash and due from banks, demand deposits from the public, and obligations from tri-party repurchase agreements

The carrying amounts approximate fair value due to the short-term nature of these instruments.

- (b) Loan portfolio

The fair value of loans is calculated by discounting future cash flows expected for principal and interest. Loan payments are assumed to be made on the contractually agreed payment dates. Future expected cash flows for loans are discounted at the interest rates offered for similar loans to new borrowers as of December 31, 2017 and 2016.

- (c) Term deposits

The fair value of term deposits is calculated by discounting cash flows at the interest rates in effect offered for term deposits with similar maturities.

- (d) Obligations with entities

The fair value of obligations with entities is calculated by discounting cash flows at the interest rates in effect.

BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

Fair value estimates are made at a specific date, based on market information and information concerning the financial instruments. These estimates do not reflect any premium or discount that could result from offering for sale a particular financial instrument at a given point in time. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and, therefore, cannot be determined with accuracy. Estimates could vary significantly if changes are made to those assumptions.

As of December 31, financial instruments measured at fair value by the level in the fair value hierarchy are as follows:

		2017			
		Level 1	Level 2	Level 3	Total
Available for sale	¢	980,863,830,905	74,248,381,800	5,931,735,202	1,061,043,947,907
Held to maturity		-	18,562,535,348	-	18,562,535,348
Derivative financial instruments		-	-	6,159,898,498	6,159,898,498
Term obligations with foreign financial entities		-	-	841,601,971,462	841,601,971,462
		2016			
		Level 1	Level 2	Level 3	Total
Available for sale	¢	781,783,683,133	125,232,881,081	5,629,455,571	912,646,019,785
Held to maturity		-	27,181,284,510	-	27,181,284,510
Derivative financial instruments		-	-	5,893,164,907	5,893,164,907
Term obligations with foreign financial entities		-	-	815,040,918,559	815,040,918,559

(Continued)



BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

The table above sets out information about financial instruments measured at fair value using a valuation method. The fair value hierarchy is as follows:

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

Financial instruments categorized as Level 3 in the fair value hierarchy are measured as follows:

December 31,						
2017			2016			
	Available for sale	Derivative financial instruments	Term obligations with foreign financial entities	Available for sale	Derivative financial instruments	Term obligations with foreign financial entities
Opening balance	¢ 5,676,680,839	5,893,164,907	815,040,918,559	5,594,435,115	12,835,716,456	539,553,389,165
Purchases	-	-	-	-	-	269,968,328,000
Valuation	63,384,957	89,782,668	39,811,482,772	(106,124,270)	(7,354,517,184)	(45,572,091,005)
Amortizations	-	-	863,192,777	-	-	724,094,677
Exchange differences	191,669,406	176,951,144	(14,113,622,646)	141,144,726	411,965,635	50,367,197,722
Closing balance	¢ 5,931,735,202	6,159,898,719	841,601,971,462	5,629,455,571	5,893,164,907	815,040,918,559

(Continued)

BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

(45) Segments

The Bank has defined its business segments based on the administrative and reporting structure, and on the structure of banking, stock brokerage, investment and pension fund management, and insurance brokerage services it provides.

As of December 31, profit or loss, assets, and liabilities of each segment are as follows:

As of December 31, 2017								
	Bank	Brokerage Firm	Investment Fund Manager	Pension Fund Manager	Insurance Brokerage Firm	Total	Eliminations	Consolidated
ASSETS								
Cash and due from banks	1,277,462,115,311	3,420,340,785	186,941,853	480,693,045	2,786,611,473	1,284,336,702,467	1,566,404,762	1,282,770,297,705
Investments in financial instruments	1,032,533,580,919	52,367,391,367	6,033,771,938	6,427,098,163	-	1,097,361,842,387	29,500,001	1,097,332,342,386
Loan portfolio, net	4,384,681,312,469	-	-	-	-	4,384,681,312,469	-	4,384,681,312,469
Accounts and fees and commissions receivable, net	606,391,517	330,208,090	62,734,784	698,085,476	453,180,919	2,150,600,783	14,167,274	2,136,433,509
Fees and commissions	169,681,180	26,518,183	56,953,401	671,719,251	347,477,920	1,272,349,935	11,153,968	1,261,195,967
Transactions with related parties	26,593,557	-	2,994,813	100,930	-	29,689,300	3,013,306	26,675,994
Deferred tax and income tax	134,516,249	302,475,534	2,418,194	15,084,947	105,689,743	560,184,667	-	560,184,667
Other	3,807,538,777	1,214,373	368,376	70,094,857	13,256	3,879,229,639	3	3,879,229,636
Accrued interest	1,724,156	-	-	-	-	1,724,156	-	1,724,156
Allowance for impairment of accounts and fees and commissions receivable	(3,533,662,402)	-	-	(58,914,509)	-	(3,592,576,911)	-	(3,592,576,911)
Foreclosed assets, net	18,784,905,854	-	-	-	-	18,784,905,854	-	18,784,905,854
Investments in other companies	93,954,215,527	30,000,000	-	-	-	93,984,215,527	32,201,517,060	61,782,698,467
Property and equipment, net	178,876,193,757	289,167,105	141,830,025	696,413,623	41,904,743	180,045,509,253	-	180,045,509,253
Other assets	47,078,879,187	216,335,261	548,140,077	223,267,141	146,080,734	51,700,127,681	19,068,771	48,193,633,629
TOTAL ASSETS	7,033,977,594,541	56,653,442,608	6,973,418,677	8,525,557,448	3,427,777,866	7,109,557,791,140	33,830,657,868	7,075,727,133,272
LIABILITIES AND EQUITY								
LIABILITIES								
Obligations with the public	4,831,290,315,009	23,034,864,247	-	-	-	4,854,325,179,256	29,500,000	4,854,295,679,256
Obligations with BCCR	125,644,412	-	-	-	-	125,644,412	-	125,644,412
Obligations with entities	1,311,009,191,006	16,078,096,011	-	-	-	1,327,087,287,017	1,566,404,766	1,325,520,882,251
Demand	208,155,264,673	-	-	-	-	208,155,264,673	1,566,404,766	206,588,859,906
Term	1,093,084,927,602	16,022,595,002	-	-	-	1,109,107,522,604	-	1,109,107,522,604
Finance charges payable	9,768,998,731	55,501,009	-	-	-	9,824,499,740	-	9,824,499,741
Accounts payable and provisions	93,638,596,234	2,008,418,072	356,495,203	1,177,564,974	723,241,038	97,904,315,521	33,236,048	97,871,079,473
Other liabilities	98,542,307,102	-	-	-	-	98,542,307,102	-	98,542,307,102
Subordinated obligations	75,136,063,242	-	-	-	-	75,136,063,242	-	75,136,063,242
TOTAL LIABILITIES	6,409,742,117,005	41,121,378,330	356,495,203	1,177,564,974	723,241,038	6,453,120,796,550	1,629,140,814	6,451,491,655,733

(Continued)

# BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

## Notes to the Consolidated Financial Statements

As of December 31, 2017								
	Bank	Brokerage Firm	Investment Fund Manager	Pension Fund Manager	Insurance Brokerage Firm	Total	Eliminations	Consolidated
EQUITY								
Share capital	172,237,030,102	6,600,000,000	3,000,000,000	4,648,886,328	369,700,000	186,855,616,430	14,618,586,328	172,237,030,102
Non-capitalized capital contributions	-	-	-	346,038,681	-	346,038,681	346,038,681	-
Equity adjustments	68,259,558,421	(581,602,093)	(28,951,265)	(17,445,341)	-	67,631,559,722	(627,998,699)	68,259,558,421
Capital reserves	311,121,806,369	1,344,948,321	452,648,063	300,000,000	73,940,000	313,293,342,753	2,171,536,384	311,121,806,369
Prior period retained earnings	12,741,841,466	6,391,977,086	1,451,488,345	1,344,327,767	-	21,929,634,664	9,187,793,198	12,741,841,466
Income for the period	32,763,283,164	1,776,740,964	1,741,738,331	726,185,039	2,260,896,828	39,268,844,326	6,505,561,162	32,763,283,164
FOFIDE	27,111,958,013	-	-	-	-	27,111,958,013	-	27,111,958,013
TOTAL EQUITY	624,235,477,536	15,532,064,278	6,616,923,474	7,347,992,474	2,704,536,828	656,436,994,590	32,201,517,054	624,235,477,535
TOTAL LIABILITIES AND EQUITY	7,033,977,594,541	56,653,442,608	6,973,418,677	8,525,557,448	3,427,777,866	7,109,557,791,140	33,830,657,868	7,075,727,133,272
Debit memoranda accounts	657,166,271,364	177,391,647	-	23,000,000	-	657,366,663,011	-	657,366,663,011
Trust assets	1,637,626,670,097	2,485,553,922	-	-	-	1,640,112,224,019	-	1,640,112,224,019
Trust liabilities	122,035,092,751	815,168	-	-	-	122,035,907,919	-	122,035,907,919
Trust equity	1,515,591,577,347	2,484,738,753	-	-	-	1,518,076,316,100	-	1,518,076,316,100
Other debit memoranda accounts	17,983,845,225,594	947,725,437,545	426,243,485,231	1,293,980,298,067	-	20,651,794,446,437	-	20,651,794,446,437

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BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

For the year ended December 31, 2017

	Bank	Brokerage Firm	Investment Fund Manager	Pension Fund Manager	Insurance Brokerage Firm	Total	Eliminations	Consolidated
Finance income	481,062,452,651	4,033,887,635	501,430,635	492,928,481	67,657,337	486,138,356,738	56,938,254	486,101,418,484
Finance costs	239,122,593,563	1,872,493,868	101,994,016	32,024,486	3,949,243	241,133,055,173	56,938,254	241,076,116,919
Allowance expense	13,161,810,394	-	-	-	-	13,161,810,394	-	13,161,810,394
Income from recovery of assets	71,531,245,221	-	-	-	-	71,531,245,221	-	71,531,245,221
FINANCE INCOME	183,570,424,261	2,161,393,767	399,436,619	460,903,995	63,708,094	303,394,736,392	-	186,655,866,738
Other operating income	158,965,649,403	3,563,407,547	4,927,574,083	7,450,286,548	5,288,578,353	180,195,495,934	7,742,232,646	172,453,263,288
Other operating expenses	107,626,349,355	459,490,372	435,244,461	1,110,951,474	133,706,064	109,765,741,726	1,060,032,470	108,705,709,256
GROSS OPERATING INCOME	234,909,724,309	5,265,310,942	4,891,766,241	6,800,239,069	5,218,580,383	257,085,620,944	6,682,200,174	250,403,420,770
Personnel expenses	119,573,313,610	2,585,194,723	1,823,362,416	3,328,297,915	1,630,287,462	128,940,456,126	-	128,940,456,126
Other administrative expenses	67,612,059,618	764,200,282	626,751,373	1,167,771,766	243,572,242	70,414,355,281	176,639,011	70,237,716,270
Total administrative expenses	187,185,373,228	3,349,395,005	2,450,113,789	4,496,069,681	1,873,859,704	199,354,811,407	176,639,011	199,178,172,396
NET OPERATING INCOME BEFORE STATUTORY ALLOCATIONS AND TAXES	47,724,351,081	1,915,915,937	2,441,652,452	2,304,169,388	3,344,720,679	57,730,809,537	6,505,561,163	51,225,248,374
Income tax	4,110,475,565	119,537,919	627,636,238	825,956,431	983,482,231	6,659,431,201	-	6,659,431,201
Decrease in income tax	1,709,449,492	37,840,424	971,690	43,282,204	-	1,783,886,627	-	1,783,886,627
Statutory allocations	12,661,154,903	57,477,478	73,249,574	795,310,121	100,341,621	13,687,533,696	-	13,687,533,696
Decrease in statutory allocations	101,113,059	-	-	-	-	101,113,061	-	101,113,061
INCOME FOR THE PERIOD	32,763,283,164	1,776,740,964	1,741,738,330	726,185,040	2,260,896,827	39,268,844,328	6,505,561,163	32,763,283,165

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# BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

## Notes to the Consolidated Financial Statements

As of December 31, 2016

	Bank	Brokerage Firm	Investment Fund Manager	Pension Fund Manager	Insurance Brokerage Firm	Total	Eliminations	Consolidated
<b>ASSETS</b>								
Cash and due from banks	934,649,797,171	3,063,474,995	184,896,206	407,014,162	1,904,693,235	940,209,875,769	(2,399,692,750)	937,810,182,994
Investments in financial instruments	893,072,038,041	51,752,061,524	5,664,837,291	7,658,230,752	-	958,147,167,608	(1,546,960,250)	956,600,207,359
Loan portfolio, net	4,058,209,743,015	-	-	-	-	4,058,209,743,015	(845,850,191)	4,057,363,892,824
Accounts and fees and commissions receivable, net	828,306,210	134,771,589	94,281,405	903,994,768	394,656,193	2,356,010,124	(11,086,812)	2,060,363,518
Fees and commissions	126,378,316	24,817,893	36,290,993	745,901,450	368,231,193	1,301,619,845	(9,595,895)	1,292,023,010
Brokerage services	-	3,828,079	-	-	-	3,828,079	-	3,828,079
Transactions with related parties	18,524,503	71,263	-	3,089,689	571,851	22,257,306	(1,550,224)	20,707,082
Deferred tax and income tax	140,319,872	105,824,150	57,586,796	154,671,545	25,853,149	484,255,512	(284,559,811)	199,695,701
Other	3,933,633,959	230,204	403,616	59,008,455	-	3,993,276,234	59,307	3,993,335,555
Accrued interest	1,800,923	-	-	-	-	1,800,923	-	1,800,923
Allowance for impairment of accounts and fees and commissions receivable	(3,392,351,363)	-	-	(58,676,371)	-	(3,451,027,734)	-	(3,451,027,734)
Foreclosed assets, net	17,751,098,959	-	-	-	-	17,751,098,959	-	17,751,098,959
Investments in other companies	89,781,830,229	30,000,000	-	-	-	89,811,830,229	(32,620,628,246)	57,191,201,983
Property, furniture, and equipment, net	175,963,244,578	343,456,948	181,140,982	578,608,796	38,600,142	177,105,051,446	-	177,105,051,446
Other assets	37,921,909,641	108,968,784	497,338,719	143,244,205	141,127,368	38,812,588,717	8,995,540	38,821,584,257
<b>TOTAL ASSETS</b>	<b>6,208,177,967,844</b>	<b>55,432,733,840</b>	<b>6,622,494,603</b>	<b>9,691,092,683</b>	<b>2,479,076,938</b>	<b>6,282,403,365,867</b>	<b>(37,699,782,568)</b>	<b>6,244,703,583,340</b>
<b>LIABILITIES AND EQUITY</b>								
<b>LIABILITIES</b>								
Obligations with the public	4,165,156,725,291	26,526,637,552	-	-	-	4,191,683,362,843	(1,546,960,250)	4,190,136,402,593
Obligations with BCCR	125,644,412	-	-	-	-	125,644,412	-	125,644,412
Obligations with entities	1,219,539,230,255	8,559,576,304	-	-	-	1,228,098,826,558	(3,245,542,921)	1,224,853,283,638
Demand	217,838,981,195	-	-	-	-	217,838,981,195	(2,399,692,729)	215,439,288,466
Term	992,139,001,470	8,544,184,950	-	-	-	1,000,683,186,420	(844,184,950)	999,839,001,470
Finance charges payable	9,561,267,590	15,391,353	-	-	-	9,576,658,943	(1,665,242)	9,574,993,701
Accounts payable and provisions	114,805,824,473	2,785,899,704	676,663,523	2,396,687,260	659,305,471	121,324,380,431	(410,516,471)	121,037,729,284
Other liabilities	46,777,896,327	-	-	-	-	46,777,896,327	-	46,777,896,327
Subordinated obligations	72,675,778,397	-	-	-	-	72,675,778,397	-	72,675,778,397
<b>TOTAL LIABILITIES</b>	<b>5,619,081,119,155</b>	<b>37,872,113,560</b>	<b>676,663,523</b>	<b>2,396,687,260</b>	<b>659,305,471</b>	<b>5,660,685,888,969</b>	<b>(5,079,154,318)</b>	<b>5,655,606,734,651</b>

(Continued)

# BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

## Notes to the Consolidated Financial Statements

As of December 31, 2016									
	Bank	Brokerage Firm	Investment Fund Manager	Pension Fund Manager	Insurance Brokerage Firm	Total	Eliminations	Consolidated	
<b>EQUITY</b>									
Share capital	¢	118,130,303,482	6,600,000,000	3,000,000,000	4,307,463,024	369,700,000	132,407,466,506	(14,277,163,024)	118,130,303,482
Non-capitalized capital contributions		-	-	-	687,461,985	-	687,461,985	(687,461,985)	-
Equity adjustments		67,476,783,612	199,598,072	41,694,677	95,061,147	-	67,813,137,508	(336,353,897)	67,476,783,612
Capital reserves		274,614,308,392	1,262,017,387	452,648,062	300,000,000	73,940,000	276,702,913,841	(2,007,861,051)	274,614,308,392
Prior period retained earnings		54,106,726,619	7,075,514,723	836,600,372	731,439,013	-	62,750,280,727	(8,724,298,501)	54,106,726,619
Income for the period		53,018,907,264	2,423,490,097	1,614,887,969	1,172,980,254	1,376,131,467	59,606,397,052	(6,587,489,788)	53,018,907,264
FOFIDE		21,749,819,320	-	-	-	-	21,749,819,320	-	21,749,819,320
TOTAL EQUITY	¢	589,096,848,689	17,560,620,280	5,945,831,080	7,294,405,423	1,819,771,467	621,717,476,939	32,620,628,246	589,096,848,688
TOTAL LIABILITIES AND EQUITY	¢	6,208,177,967,844	55,432,733,840	6,622,494,603	9,691,092,683	2,479,076,938	6,282,403,365,908	37,002,614,946	6,244,703,583,340
Debit memoranda accounts	¢	606,880,388,509	109,558,264	-	288,110,324	-	607,278,057,097	-	607,278,057,097
Trust assets	¢	1,393,870,987,459	1,567,221,897	-	-	-	1,395,438,209,356	-	1,395,438,209,356
Trust liabilities	¢	51,558,117,672	800,420	-	-	-	51,558,918,092	-	51,558,918,092
Trust equity	¢	1,342,312,869,787	1,566,421,477	-	-	-	1,343,879,291,264	-	1,343,879,291,264
Other debit memoranda accounts	¢	17,119,227,249,789	939,715,141,866	358,238,446,450	1,156,558,855,191	-	19,573,797,402,675	-	19,573,797,402,675

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## BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

## Notes to the Consolidated Financial Statements

For the year ended December 31, 2016

	Bank	Brokerage Firm	Investment Fund Manager	Pension Fund Manager	Brokerage Firm	Total	Eliminations	Consolidated
€	443,588,752,826	4,683,161,819	551,504,091	650,406,174	40,069,651	449,487,697,616	(128,675,607)	449,385,218,954
Finance income	206,592,938,577	1,858,455,386	123,629,400	14,779,622	1,397,652	208,566,559,822	(128,675,605)	208,462,525,030
Finance costs	39,297,902,715	-	-	-	-	39,297,902,715	-	39,297,902,715
Allowance expense	13,098,376,497	-	-	-	-	13,098,376,497	-	13,098,376,497
Income from recovery of assets	210,796,288,031	2,824,706,433	427,874,691	635,626,552	38,671,999	214,721,611,576	-	214,723,167,706
FINANCE INCOME	165,060,972,400	3,963,231,015	5,164,536,173	8,852,903,448	4,099,544,227	187,142,743,391	(7,667,701,413)	179,473,485,850
Other operating income	113,751,927,767	604,750,473	650,314,031	1,139,049,707	143,002,809	116,282,820,706	(965,393,89)	115,323,651,698
Other operating expenses	262,105,332,664	6,183,186,975	4,942,096,833	8,349,480,293	3,995,213,417	285,581,534,261	(6,702,308,324)	278,873,001,858
GROSS OPERATING INCOME	122,975,147,348	2,753,678,860	1,959,590,209	3,666,145,840	1,735,795,340	133,090,357,597	-	133,090,357,597
Personnel expenses	62,944,561,488	885,582,257	696,136,088	1,246,610,664	225,013,582	66,004,128,159	(114,818,536)	65,883,085,543
Other administrative expenses	185,919,708,836	3,639,261,117	2,655,726,297	4,912,756,504	1,960,808,922	199,094,485,756	(114,818,536)	198,973,443,140
Total administrative expenses								
NET OPERATING INCOME BEFORE STATUTORY ALLOCATIONS AND TAXES	76,185,623,828	2,543,925,858	2,286,370,536	3,436,723,789	2,034,404,495	86,487,048,507	(6,587,489,788)	79,899,558,718
Income tax	10,170,950,461	138,534,280	658,317,097	1,056,044,605	623,094,042	12,646,940,485	-	12,646,940,485
Decrease in income tax	2,675,602,000	94,416,296	55,439,934	68,383,037	25,853,149	2,919,694,416	-	2,919,694,416
Statutory allocations	15,671,368,103	76,317,776	68,605,404	1,276,081,967	61,032,135	17,153,405,385	-	17,153,405,385
INCOME FOR THE PERIOD	€ 53,018,907,264	2,423,490,098	1,614,887,969	1,172,980,254	1,376,131,467	59,606,397,053	(6,587,489,788)	53,018,907,264

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BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

(46) Risk management

The Bank has exposure to the following risks from financial instruments:

- credit risk
- liquidity risk
- market risk:
  - interest rate risk
  - currency risk
- operational risk.

The Corporate Risk Division is responsible for identifying and measuring credit, market, liquidity, and operational risks. For such purposes, all types of risks to which the Bank is exposed are monitored by that Division on an ongoing basis using a mapping procedure to classify risks based on their severity or impact and their frequency or probability of occurrence.

Policies and procedures for managing market and liquidity risks are also being formalized in specific manuals for each type of risk that describe the methodologies used to manage those risks. This activity has been extended to the Bank's subsidiaries, i.e. Brokerage Firm, Investment Fund Manager, and Pension Fund Manager.

The Bank manages the above risks as follows:

a) Credit risk

i. Banco Nacional de Costa Rica

This is the risk that the borrower or issuer of a financial asset will fail to discharge an obligation, fully and on time, in accordance with the terms and conditions agreed upon at the time the financial asset was acquired. Credit risk is mainly related to the loan portfolio and investments in financial instruments. The exposure to credit risk on those assets is represented by the carrying amount of the assets in the consolidated balance sheet. The Bank also has exposure to credit risk for off-balance sheet credits, such as commitments, letters of credit, sureties, and guarantees.

(Continued)



## BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

### Notes to the Consolidated Financial Statements

The Bank monitors credit risk on an ongoing basis through reports on portfolio status and classification. Credit analyses include periodic assessments of the financial position of customers, an analysis of the country's economic, political, and financial environment, and the potential impact on each sector. For such purposes, a thorough understanding is obtained of customers on an individual basis and their capacity to generate cash flows that enable them to honor their debt commitments.

The Bank has established the following credit risk management procedures:

- The Bank has defined procedures for the monitoring, application of controls, and loan processing. The functions, tasks, and procedures performed by the Credit Risk Division have been documented with the support of the Quality Management Division. Consequently, the Bank has been able to optimize and standardize the process.
- The Bank has performed and reviewed the administrative loan follow-up procedures for branches and regional offices.
- The Bank is comprehensively evaluating the Loan Process and, based on that evaluation, the procedures performed through offices, shared service centers, trade zones, and the corporate center in accordance with the organizational structure project named "Reconquest."
- The work plan for loan follow-up includes an evaluation of main borrowers (higher balances in the loan portfolio), which involves continuous monitoring and visits to regional offices.

At the consolidated balance sheet date, there are no significant concentrations of credit risk. The maximum exposure to credit risk is represented by the carrying amount of each financial asset.

As of December 31, the Bank's financial instruments with credit risk exposure are as follows:

	Note	Direct		Note	Stand-by	
		2017	2016		2017	2016
Loan portfolio						
Principal	7-a	¢ 4,493,106,220,126	4,115,607,251,072		341,545,234,702	309,474,308,447
Accounts and accrued interest receivable		31,743,485,704	27,221,501,072		-	-
Carrying amount, gross		4,524,849,705,830	4,142,828,752,144		341,545,234,702	309,474,308,447
Allowance for loan losses (accounting records)		(134,030,406,147)	(82,909,492,079)		(265,681,489)	(540,840,567)
Net carrying amount		¢ 4,390,819,299,683	4,059,919,260,065		341,279,553,213	308,933,467,880

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BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

Set out below is an analysis of the gross and net (of allowance for loan losses) amounts of loans by risk rating according to SUGEF Directive 1-05:

		2017	
		Loans to customers	
		Gross	Net
0	¢	17,635,841,583	17,532,596,174
A1		3,561,582,919,978	3,538,623,193,907
A2		34,027,425,779	33,845,983,332
B1		390,309,401,449	386,938,024,903
B2		8,855,274,683	8,752,950,710
C1		110,371,269,122	107,118,082,175
C2		4,562,010,037	4,316,672,266
D		136,407,728,578	126,928,627,250
E		261,097,834,621	166,763,168,966
	¢	<u>4,524,849,705,830</u>	<u>4,390,819,299,683</u>

		2016	
		Loans to customers	
		Gross	Net
A1	¢	3,378,160,567,963	3,360,149,074,772
A2		34,871,377,144	34,753,588,529
B1		295,093,603,945	293,234,628,822
B2		9,985,360,361	9,896,790,037
C1		119,659,479,745	117,172,148,908
C2		4,690,615,409	4,430,315,563
D		115,582,103,273	108,548,234,893
E		184,785,644,304	131,734,478,541
	¢	<u>4,142,828,752,144</u>	<u>4,059,919,260,065</u>

As shown above, as of December 31, 2017, the gross portfolio amounts to ¢4,525 billion. Of that amount, 88.68% is classified in risk ratings “A + B” and 11.32% in risk ratings “C + D + E” (2016: ¢4,143 billion, of which 89.75% is classified in risk ratings “A + B” and 10.25% in risk ratings “C + D + E”).

(Continued)

## BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

### Notes to the Consolidated Financial Statements

#### Individually assessed loans with allowance:

Pursuant to SUGEF Directive 1-05, a risk rating is assigned to all borrowers. Applicable allowance percentages are determined based on that risk rating. Individually assessed loans with allowance are loan operations for which, after considering the guarantee for the loan, there is still a balance to which the applicable allowance percentage will be applied.

#### Past due loans without allowance:

Past due loans without allowance correspond to loan operations with a guarantee for at least the outstanding balance due to the Bank. Accordingly, no allowance is established.

#### Restructured loans:

Restructured loans are those for which the Bank has changed the original contractual terms due to deterioration in the borrower's financial position and where the Bank has made concessions that it would not otherwise consider. Once the loan is restructured, it remains in this category regardless of improvement in the borrower's position after restructuring. The various types of restructured loans are as follows:

- a. Extended loan: Loan operation in which at least one full or partial payment of principal or interest due under the current contractual terms has been postponed.
- b. Modified loan: Loan operation in which at least one of the current contractual repayment terms has been modified, excluding extensions, additional payments not included in the loan repayment schedule, additional payments to reduce the amount of installments, and a change in the currency used while respecting the original loan maturity date.

# BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

## Notes to the Consolidated Financial Statements

- c. Refinanced loan: Loan operation in which at least one payment of principal or interest is made fully or partially with another loan operation extended to the borrower or to an individual from its economic interest group by the same financial intermediary or any other company of the same financial group or conglomerate. In the event of full settlement of the loan, the new loan operation is considered to be refinanced. In the event of partial settlement, both the new and existing loan operations are considered to be refinanced.

### Loan write-off policy:

The Bank writes off a loan (and any allowance for loan losses) when it determines the loan to be uncollectible based on an analysis of significant changes in the financial conditions of the borrower preventing compliance with the payment obligation, or when it determines that the guarantee is insufficient to cover the entire amount of the loan facility. For standard loans with smaller balances, charge-offs are generally based on the level of arrears of the loan granted.

### Borrower classification

Pursuant to SUGEF Directive 1-05, borrowers are classified in two groups: Group 1, borrowers whose total outstanding balance exceeds ₡65,000,000; and Group 2, borrowers whose total outstanding balance is less than ₡65,000,000.

The loan portfolio by borrower classification is as follows:

Borrower classification	Direct		Stand-by	
	2017	2016	2017	2016
Group 1	₡ 2,748,857,867,558	2,507,279,865,361	68,576,315,183	54,593,528,042
Group 2	1,775,991,838,272	1,635,548,886,783	272,968,919,519	254,880,780,405
	₡ 4,524,849,705,830	4,142,828,752,144	341,545,234,702	309,474,308,447

### Risk ratings

The Bank individually classifies its borrowers in one of eight risk ratings, identified as A1, A2, B1, B2, C1, C2, D, and E, with rating A1 as the lowest credit risk and rating E as the highest credit risk.

(Continued)

## BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

### Notes to the Consolidated Financial Statements

For purposes of the analysis of creditworthiness, pursuant to SUGEF Directive 1-05, borrowers in Group 1 are classified based on arrears, historical payment behavior, and creditworthiness; whereas, pursuant to the Bank's internal policies and based on the credit web, borrowers in Group 2 are classified based on arrears and historical payment behavior:

<u>Risk rating</u>	<u>Arrears</u>	<u>Historical payment behavior</u>	<u>Creditworthiness</u>
A1	30 days or less	Level 1	Level 1
A2	30 days or less	Level 2	Level 1
B1	60 days or less	Level 1	Level 1 or Level 2
B2	60 days or less	Level 2	Level 1 or Level 2
C1	90 days or less	Level 1	Level 1 or Level 2 or Level 3
C2	90 days or less	Level 1 or Level 2	Level 1 or Level 2 or Level 3
D	120 days or less	Level 1 or Level 2	Level 1 or Level 2 or Level 3 or Level 4
E	More than 121 days	Level 1 or Level 2	Level 1 or Level 2 or Level 3 or Level 4

In all cases, borrowers without valid authorization for a credit check through SUGEF's Credit Information Center (CIC) cannot be classified in risk categories A1 to B2.

Likewise, borrowers with at least one loan operation purchased from a financial intermediary domiciled in Costa Rica and regulated by SUGEF must be classified for at least one month in the rating of higher risk between the rating assigned by the selling bank and the rating assigned by the buying bank at the time of the purchase.

Borrowers are to be assigned a risk rating of E if they fail to meet the conditions for any of the risk ratings defined above, are in a state of bankruptcy, meeting of creditors, court protected reorganization procedure, or takeover, or if the Bank considers assignment of such rating to be appropriate.

#### *Analysis of creditworthiness*

The Bank must define effective mechanisms to determine the creditworthiness of borrowers in Group 1. Based on whether the borrowers are individuals or legal entities, those mechanisms should permit an assessment of the following aspects:

- a. *Financial position and expected cash flows:* Analysis of the stability and continuity of main sources of income. The effectiveness of the analysis depends on the quality and timeliness of information.

(Continued)

## BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

### Notes to the Consolidated Financial Statements

- b. *Experience in the line of business and quality of management:* Analysis of the capacity of management to lead the business with appropriate controls and adequate support from the owners.
- c. *Business environment:* Analysis of the main sector variables that affect the borrower's creditworthiness.
- d. *Vulnerability to changes in interest rates and foreign exchange rates:* Analysis of the borrower's ability to confront unexpected adverse changes in interest rates and foreign exchange rates.
- e. *Other factors:* Analysis of other factors that affect the borrower's creditworthiness. In the case of legal entities, considerations include, but are not limited to, environmental issues, technological aspects, operating licenses and permits, representation of products or foreign offices, relationship with significant customers and suppliers, sales agreements, legal risks, and country risk (the latter for foreign-domiciled borrowers). In the case of individuals, the following borrower characteristics may be taken into consideration: marital status, age, level of education, profession, gender, etc.

When a borrower has been assigned a risk rating by a rating agency, that rating should be an additional consideration when assessing the borrower's creditworthiness.

The Bank must classify the borrower's creditworthiness into one of four levels: level 1 - has the ability to pay; level 2 - has minor weaknesses in the ability to pay; level 3 - has serious weaknesses in the ability to pay; and level 4 - has no ability to pay. For purposes of this classification, the borrower and co-borrower(s) must be assessed jointly. Joint classification of creditworthiness may only be used to determine the allowance percentage for operations in which the parties are borrower and co-borrower.

#### *Analysis of historical payment behavior*

The Bank must determine a borrower's historical payment behavior based on the level assigned to the borrower by SUGEF's CIC.

The Bank must classify historical payment behavior into one of three levels: level 1 - good historical payment behavior; level 2 - acceptable historical payment behavior; and level 3 - poor historical payment behavior.

BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

Structural allowance for loan losses

The specific allowance is calculated on the covered and uncovered balance of each loan operation. The allowance on the uncovered balance is equivalent to the total outstanding balance of each loan operation less the adjusted weighted value of the corresponding guarantee, multiplying the resulting amount by the allowance percentage corresponding to the risk rating of the borrower or co-borrower in the lowest risk rating. If the result of this calculation is negative or zero, the allowance is zero. If the total outstanding balance includes a stand-by principal balance, the credit equivalent should be used in accordance with Article 13 of SUGEF Directive 1-05.

The allowance for the covered portion of each loan operation is equivalent to the result of multiplying the covered amount by the corresponding allowance percentage pursuant to the aforementioned article. The adjusted value of the corresponding guarantee must be weighted at 100% when the borrower or co-borrower with the lowest risk rating is rated C2 or in another lower-risk rating, at 80% when rated D, and at 60% when rated E.

Weightings lower than 100% apply for all guarantees except for the guarantees mentioned in subsections d. through r. of Article 14 of SUGEF Directive 1-05. Weightings mentioned in subsection s. apply for trust assets whose nature corresponds to that of the assets mentioned in subsections a. through c. of Article 14 of SUGEF Directive 1-05.

Specific allowance percentages based on borrower risk rating are as follows:

<u>Risk rating</u>	<u>Specific allowance percentage -</u>	<u>Specific allowance percentage -</u>
	<u>Uncovered portion</u>	<u>Covered portion</u>
A1	0%	0.00%
A2	0%	0.00%
B1	5%	0.50%
B2	10%	0.50%
C1	25%	0.50%
C2	50%	0.50%
D	75%	0.50%
E	100%	0.50%

(Continued)



# BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

## Notes to the Consolidated Financial Statements

As an exception in the case of risk rating E, the minimum specific allowance for borrowers whose historical payment behavior is classified in level 3 should be calculated as follows:

<u>Arrears</u>	<u>Allowance percentage</u>
0 to 30 days	20%
31 to 60 days	50%
More than 61 days	100%

Pursuant to Articles 11 bis and 12 of SUGEF Directive 1-05, the calculations of the general allowance and the specific allowance for the covered portion of loan operations must consider the provisions of Transition Provision XII of such Directive. Accordingly, as of December 31, 2015, the Bank applied an allowance percentage of 0.32%, which will gradually increase on a quarterly basis to 0.5%, pursuant to the aforementioned Transition Provision.

Allowance percentages based on borrower risk rating are as follows:

<u>Risk rating</u>	<u>General allowance</u>	<u>Specific allowance percentage - Uncovered portion</u>	<u>Specific allowance percentage - Covered portion</u>
A1	0.5%	0%	0%
A2	0.5%	0%	0%
B1	N/A	5%	0.50%
B2	N/A	10%	0.50%
C1	N/A	25%	0.50%
C2	N/A	50%	0.50%
D	N/A	75%	0.50%
E	N/A	100%	0.50%

In accordance with Article 11 bis, *General allowance*, of CONASSIF Directive 1058/07 dated August 21, 2013, at each month-end, entities must book the general allowance for a minimum of 0.5% of the total outstanding balance for loan portfolios rated A1 and A2, without considering the effect of guarantees. The provisions of Article 13 of the aforementioned Directive are to be applied to stand-by credits.

(Continued)

BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

As an exception in the case of risk rating E, the minimum specific allowance for borrowers whose historical payment behavior is classified in level 3 should be calculated as follows:

<u>Arrears</u>	<u>Specific allowance percentage - Uncovered portion</u>	<u>Specific allowance percentage - Covered portion</u>	<u>Creditworthiness (Group 1 borrowers)</u>	<u>Creditworthiness (Group 2 borrowers)</u>
30 days or less	20%	0.50%	Level 1	Level 1
30 days or less	50%	0.50%	Level 2	Level 1
More than 60 days	100%	0.50%	Level 1 or Level 2 or Level 3 or Level 4	Level 1 or Level 2

If a borrower was rated E before subscribing a special loan operation, the borrower should remain in such rating during at least 180 days. During such period, the allowance percentage will be 100% and the aforementioned exception should not be applied.

In accordance with Articles 11 bis and 12 of SUGEF Directive 1-05, at each month-end, the Bank must book, as a minimum, the general allowance and the sum of the specific allowances for each loan operation subscribed.

Pursuant to the provisions of SUGEF Directive 1-05, as of December 31, the Bank must maintain a structural allowance, as follows:

	2017		
	Allowance booked	Structural allowance	Excess of allowance
Direct	¢ 134,030,406,147	(131,599,796,825)	2,430,609,322
Stand-by	265,681,489	(144,078,976)	121,602,513
	<u>134,296,087,636</u>	<u>(131,743,875,801)</u>	<u>2,552,211,835</u>
Counter-cyclical - SUGEF 19-16	6,137,987,214	(6,137,987,214)	-
	<u>¢ 140,434,074,850</u>	<u>(137,881,863,015)</u>	<u>2,552,211,835</u>
	2016		
	Allowance booked	Structural allowance	Excess of allowance
Direct	¢ 82,909,492,079	(77,227,248,420)	5,682,243,659
Stand-by	540,840,567	(19,203,816)	521,636,751
	<u>¢ 83,450,332,646</u>	<u>(77,246,452,236)</u>	<u>6,203,880,410</u>
Counter-cyclical - SUGEF 19-16	2,555,367,241	(2,555,367,241)	-
	<u>¢ 86,005,699,887</u>	<u>(79,801,819,477)</u>	<u>6,203,880,410</u>

(Continued)

BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

As of December 31, 2017, the balance of the Bank's allowance for loan losses (direct and stand-by), accrued interest receivable, and other receivables amounts to ₡144,026,651,761 (2016: ₡89,456,727,621).

*Counter-cyclical allowance*

As of December 31, 2016, the counter-cyclical allowance is valued pursuant to the provisions set forth in SUGEF Directive 19-16 *Regulations to Determine and Book Counter-cyclical Allowances*, approved by CONASSIF through Article 6 of minutes of meeting No. 1258-2016 held on June 7, 2016, published in Alcance No.100 of the Official Gazette No. 117, of June 17, 2016. Those provisions are summarized as follows:

Pursuant to SUGEF Directive 19-16, a counter-cyclical allowance is a generic-type allowance applied to the loan portfolio that has no current indication of impairment, determined by the expected level of allowances in economic recession periods. The purpose of the counter-cyclical allowance is mitigating the effects of the economic cycle on the financial results derived from the provision for loan losses. The purpose of this allowance is to reduce the pro-cyclical effect of specific allowances on the financial system and its consequences on the actual economic sector.

This allowance may be deactivated for the entire financial system or for an individual entity, whenever it is required to safeguard the stability of the financial system prior to a duly supported resolution. In that case, required entities must book the elimination of all of the counter-cyclical allowances made and stop making new ones until the Superintendency indicates that the requirement has been reactivated.

Transition Provision II of SUGEF Directive 19-16 indicates that starting July 2016 each entity must perform the monthly booking of the expense for the counter-cyclical component equivalent to a minimum of 7% of the difference between the balance of income accounts less expenses plus taxes and monthly statutory allocations, until the balance of the analytical account reaches the amount corresponding to the counter-cyclical allowance provided in the regulations (₡24,485,623,483 based on the calculation of the counter-cyclical allowance made by management as of December 31, 2017). Once the entity reach that level, it shall continue booking the counter-cyclical account as indicated by this Regulation.

BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

As of December 31, 2017, the counter-cyclical allowance booked amounts to ¢6,137,987,214 (2016: ¢2,555,367,241).

Credit equivalent

The following stand-by credit operations must be converted to credit equivalents based on the credit risk they represent. The credit equivalent is obtained by multiplying the balance of the stand-by principal by the corresponding credit equivalent conversion factor, as follows:

- a. bid bonds and export letters of credit without prior deposit: 0.05
- b. other sureties and guarantees without prior deposit: 0.25
- c. pre-approved lines of credit: 0.50.

Allowance for other assets

Allowances should be established for the following assets:

- a. Accounts and accrued interest receivable unrelated to loan operations, based on arrears calculated from the first day overdue or the date booked in the accounting records, as follows:

<u>Arrears</u>	<u>Allowance percentage</u>
30 days or less	2%
60 days or less	10%
90 days or less	50%
120 days or less	75%
More than 120 days	100%

(Continued)

BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

- b. Foreclosed assets acquired prior to May 2010 that have not been sold or leased within two years from the date of their acquisition, an allowance equivalent to 100% of their value. The booking of the allowance shall begin at the end of the month in which the assets were i) acquired, ii) produced for sale or lease, or iii) retired from use. After May 2010, an allowance must be established gradually by booking one-twenty-fourth of the value of the assets each month until the allowance is equivalent to 100% of the assets' carrying amount. The booking of the allowance shall begin at the end of the month in which the assets were acquired.

As of December 31, 2017, the carrying amount of the allowance for impairment of foreclosed assets and per legal requirements amounts to ₡62,466,054,133 (2016: ₡59,644,951,072).

As of December 31, the concentration of the loan portfolio by sector is as follows:

Sector	Direct		Stand-by	
	2017	2016	2017	2016
Trade	₡ 412,215,871,716	385,823,170,488	3,066,960	11,846,917
Services	929,716,008,520	890,488,809,393	60,958,147,070	46,704,888,190
Financial services	137,077,253,224	143,825,817,224	-	-
Mining	913,028,462	1,080,564,191	-	-
Manufacturing and quarrying	179,577,802,951	164,893,268,463	-	-
Construction	106,709,787,747	102,779,598,611	-	-
Agriculture and forestry	127,376,468,783	120,686,948,083	-	15,073,475
Livestock, hunting, and fishing	84,543,749,108	76,369,144,979	-	-
Electricity, water, sanitation, and other related sectors	440,807,243,205	399,236,286,171	-	-
Transportation and telecommunications	46,223,170,011	41,980,505,892	-	-
Housing	1,316,287,378,607	1,202,794,443,892	17,196,188	14,877,383
Personal or consumer	561,393,107,868	450,351,672,494	280,374,178,081	262,526,260,212
Tourism	182,008,835,628	162,518,522,263	192,646,404	201,362,270
	₡ <u>4,524,849,705,830</u>	<u>4,142,828,752,144</u>	<u>341,545,234,703</u>	<u>309,474,308,447</u>

(Continued)

BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

As of December 31, the concentration of the loan portfolio by geographic area is as follows:

	Direct		Stand-by	
	2017	2016	2017	2016
Central America	¢ 4,524,849,705,830	4,142,828,752,144	341,545,234,703	309,474,308,447

As of December 31, the loan portfolio by type of guarantee is as follows:

Type of guarantee	Direct		Stand-by	
	2017	2016	2017	2016
Back to back	¢ 44,538,351,577	13,829,691,479	1,078,696	1,236,793
Mortgage bond	329,841,726	484,547,012	-	-
Assignment of loans	372,439,090,207	462,803,451,395	-	219,272
Mortgage	1,825,152,619,518	1,710,541,594,795	171,227,876	190,663,081
Surety	874,822,084,146	762,062,136,046	1,599,874	23,274,642
Trust	382,507,943,648	368,369,817,770	19,821,732	86,004,322
Securities	1,061,598,736	28,416,281,573	-	-
Chattel mortgage	244,493,000,879	204,332,022,614	-	-
Other	779,505,175,393	591,989,209,460	341,351,506,525	309,172,910,337
	¢ 4,524,849,705,830	4,142,828,752,144	341,545,234,703	309,474,308,447

Guarantees:

Collateral: The Bank accepts collateral guarantees – usually mortgages, chattel mortgages, or securities – to secure its loans. The value of those guarantees is determined based on their fair value in the case of securities or, for mortgages and chattel mortgages, based on an appraisal made by an independent appraiser who determines the estimated fair value of land and buildings using comparable market offerings and prior appraisals.

Personal: The Bank also accepts sureties from individuals or legal entities. The Bank evaluates the guarantor's ability to honor the debt obligations on the borrower's behalf, as well as the integrity of the guarantor's credit history.

The Bank conducts strict credit analyses before granting loans and requires guarantees from its borrowers before disbursing loans. As of December 31, 2017 and 2016, 55.21% and 67.30%, respectively, of the loan portfolio is secured by collateral guarantees.

(Continued)

BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

The concentration of the loan portfolio by individual borrower is as follows:

Loan portfolio concentration		Direct		Stand-by	
		2017	2016	2017	2016
¢1 to ¢3,000,000	¢	164,701,590,388	150,144,009,432	103,660,719,263	97,654,393,260
¢3,000,001 to ¢15,000,000		630,696,858,704	563,931,355,672	175,793,736,125	163,377,395,761
¢15,000,001 to ¢30,000,000		474,923,823,398	452,926,633,531	6,522,609,211	5,694,833,794
¢30,000,001 to ¢50,000,000		480,160,993,326	445,924,835,557	2,506,185,273	2,013,695,688
¢50,000,001 to ¢75,000,000		389,300,510,481	336,037,598,434	1,900,742,296	1,852,516,239
¢75,000,001 to ¢100,000,000		192,387,223,209	151,304,177,727	1,621,318,004	1,490,718,663
¢100,000,001 to ¢200,000,000		243,112,076,993	225,986,006,480	4,427,307,836	3,462,597,036
More than ¢200,000,000		1,949,566,629,331	1,816,574,135,311	45,112,616,695	33,928,158,006
	¢	<u>4,524,849,705,830</u>	<u>4,142,828,752,144</u>	<u>341,545,234,703</u>	<u>309,474,308,447</u>

As of December 31, 2017 and 2016, the portion of the loan portfolio (direct and stand-by loans) corresponding to economic interest groups amounts to ¢481,020,452,451 and ¢470,646,093,550, respectively.

For credit risk management purposes, the Bank applies an internal model to estimate the loan portfolio's Expected Losses (EL) and Value at Risk (VaR) over a one-year holding period using the "Monte Carlo simulations" approach. Loan portfolio risks are assessed, controlled, and monitored on a monthly basis based on one-year projections (maximum loss with a confidence level of 99% over one year).

This approach is applied using a computational system developed in "Matlab" software. Also, the credit risk model takes into consideration the impact of changes in macroeconomic variables (endogenous and exogenous) on the loan portfolio when determining systemic factors. Results are compared with prior-month estimates and historical trends (for comparison purposes, loan portfolio information is available for 2003 and thereafter).

The Bank's loan portfolio is comprised of operations in various currencies, i.e. the Costa Rican colon, the U.S. dollar, and DU. Consequently, the VaR analysis is performed separately for each currency. The data is then consolidated to determine a maximum loss for the entire portfolio, expressed in colones. VaR is also calculated for each of the Bank's 13 economic activities, its credit card accounts, and the BN-Desarrollo portfolio.

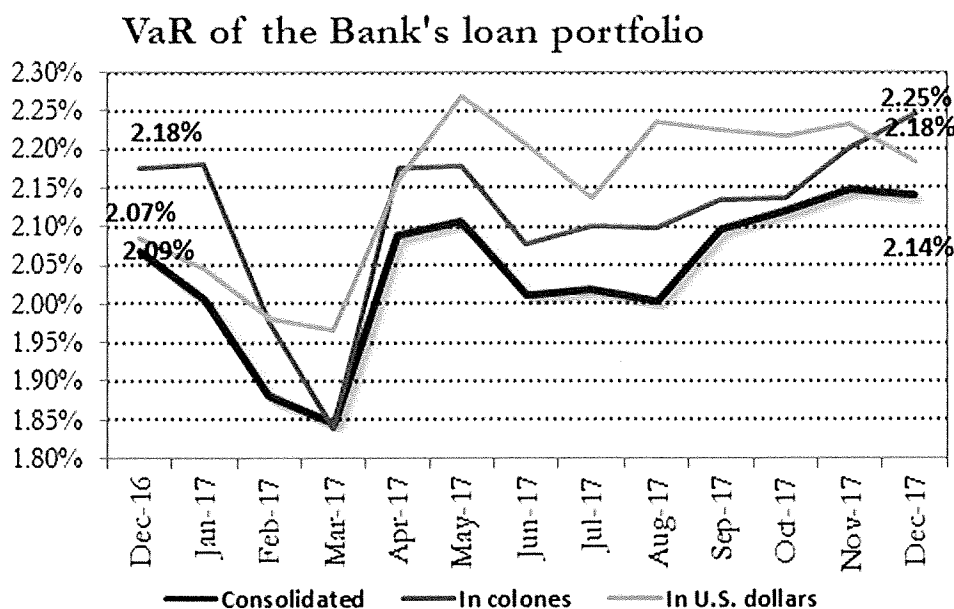
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## BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

### Notes to the Consolidated Financial Statements

Various technical tools are used to provide other angles for the analysis. Other types of estimates are made in addition to those obtained using the VaR methodology, such as the performance of the portfolio in legal collection, concentration of the portfolio by economic activity, vintage analysis, stress testing, transition matrixes, and sensitivity analyses for new loans, and/or follow-up. Accordingly, the Bank has developed specialized internal methodologies to model credit risk that quantify risk indicators and potential impacts on institutional development.

The quarterly increase of the VaR is due to the impairment of arrears more than 90 days in the entire loan portfolio between September and December 2017. Legal collection for the entire portfolio decreased from 5.82% in September 2017 to 5.15% in December 2017, while arrears more than 90 days increased from 2.29% to 2.44%. For that same period, by currency, portfolios also showed similar behaviors in arrears indicators for both legal collection and arrears more than 90 days. In colones, legal collection decreased from 6.29% to 5.65% and arrears more than 90 days increased from 2.16% to 2.46%. In U.S. dollars, legal collection decreased from 4.79% to 4.07% and arrears more than 90 days decreased from 2.48% to 2.35%. On a year-on-year basis, the consolidated VaR of the loan portfolio also increased during the period from December 2016 to December 2017. By currency, the VaR of the portfolios in colones, in U.S. dollars, and in DU increased.



(Continued)



BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

By economic activity, on a year-on-year basis, Agriculture, Energy, Services, and Construction show increases in VaR, while Industry and Tourism show decreases in VaR. In consolidated terms, VaR increased from 2.07% in December 2016 to 2.14% in December 2017.

VaR of the Bank's loan portfolio by economic activity is as follows:

Activity	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17
Agriculture	3.01%	3.38%	3.96%	4.10%	4.07%
Livestock	3.11%	2.65%	2.93%	3.07%	3.18%
Mining	9.11%	6.84%	10.35%	10.40%	9.15%
Industry	3.84%	3.08%	3.51%	3.61%	3.09%
Energy	3.65%	2.02%	3.66%	4.36%	4.30%
Housing	1.51%	1.45%	1.48%	1.51%	1.52%
Construction	3.94%	2.94%	3.07%	4.78%	4.19%
Trade	2.73%	2.61%	2.59%	2.51%	2.91%
Transportation	1.14%	1.02%	1.14%	1.33%	1.33%
Financial services	0.36%	0.22%	0.25%	0.26%	0.37%
Consumer	4.35%	4.10%	4.01%	4.33%	4.57%
Services	1.78%	1.56%	2.05%	2.06%	2.10%
Tourism	6.36%	5.05%	5.95%	5.65%	5.46%
BNCR	2.07%	1.85%	2.01%	2.10%	2.14%

Source: Credit Risk Division

ii. BN Sociedad Administradora de Fondos de Inversión, S.A.

Credit risk is the risk that the borrower or issuer of a financial asset will fail to discharge an obligation, fully and on time, in accordance with the terms and conditions agreed upon at the time the financial asset was acquired.

Credit risk is considered to be minimal since the Investment Fund Manager's portfolio is comprised of securities issued by BCCR and the Ministry of Finance. Such risk is measured and monitored using the Return on Risk-Adjusted Capital (RORAC) methodology.

(Continued)

## BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

### Notes to the Consolidated Financial Statements

To mitigate credit risk, the Investment Fund Manager monitors the issuers' risk, obtains ratings assigned to issuers by risk rating agencies, and maintains access to information necessary for following up on significant events for each issuer that could adversely affect its rating or outlook.

The Investment Fund Manager has established the following procedures to manage credit risk:

- formulation of credit policies;
- definition of concentration and exposure limits, which are included in the risk management and investment policy; and
- policy compliance reviews through analyses of the composition of the investment portfolio.

The Investment Fund Manager enters into repurchase agreements, which can lead to credit risk exposure if the counterparty to the transaction is unable to fulfill its contractual obligations. Repurchase agreements are secured by securities pledged by the counterparty, but are not directly secured by the Costa Rican National Stock Exchange. In the event of default, the Investment Fund Manager has recourse to the guarantee fund and to traditional recovery mechanisms such as termination of the agreement and foreclosure.

#### *iii. BN Valores Puesto de Bolsa, S.A.*

For the Brokerage Firm, credit risk is the risk of potential losses resulting from an issuer's failure to pay or from deterioration in the credit rating of the security or issuer.

To manage credit risk, the Brokerage Firm has identified risk factors, i.e. variables for which changes could affect the equity of the Brokerage Firm.

To mitigate credit risk, the Brokerage Firm's liquidity policy sets the following limits:

Pursuant to the requirements set out in the investment policy, the Brokerage Firm takes into consideration the ratings granted by rating agencies to local or international issues, in compliance with the provisions of current regulations.

The Brokerage Firm assesses the marketability of the instruments based on internally calculated indicators. In the case of investments in the local market, the Brokerage Firm considers those registered with the National Registry of Securities and Brokers, while for investments in international markets, the Brokerage Firm considers instruments that may be sold at any point in time.

## BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

### Notes to the Consolidated Financial Statements

Consequently, in order for the Brokerage Firm to acquire securities issued abroad, those securities must have been assigned a risk rating by a risk rating agency authorized by SUGEVAL or by a renowned international risk rating agency such as Standard & Poor's, Moody's, or Fitch. This requirement does not apply to securities issued abroad by the Government of Costa Rica, BCCR, and other Costa Rican public institutions.

The Brokerage Firm may acquire the following instruments:

- fixed income external debt securities issued by the Government of Costa Rica, BCCR, and other Costa Rican public institutions
- fixed income securities issued by the government or the central bank of countries that have been assigned an investment grade rating
- investment grade corporate bonds and fixed income securities issued by supranational entities
- structured notes issued by investment grade banks, provided that the underlying instrument is not related to commodities, stock indexes, or shares; has a risk rating that is not below the risk rating assigned to Costa Rica; and is available for public offering on a national or international stock exchange, subject to prior approval of General Management.

#### Local currency:

In local currency, the Brokerage Firm may invest in instruments issued by the Government of Costa Rica, BCCR, commercial State-owned banks, and local and foreign public or private entities authorized by SUGEVAL, which issue securities that meet the set criteria and investment limits and that may be freely transferred in the Costa Rican securities market.

The weighted average duration of the total portfolio based on Macaulay's duration and by weighing the carrying amount of each investment shall not exceed 2.75 years.

The Brokerage Firm's financial instruments are concentrated as follows:

For the December 2017 close, the accounting records showed investments in colones, investments in instruments issued by local issuers in U.S. dollars (\$CR), and investments in instruments issued by foreign issuers in U.S. dollars (\$USA). The Brokerage Firm holds no investments in DU. By currency, most of the Brokerage Firm's financial instruments (71.14%) is concentrated in the portfolio denominated in colones.

## BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

### Notes to the Consolidated Financial Statements

With respect to the consolidated portfolio, investments in instruments issued by the Government of Costa Rica (67.31%), BCCR (3.77%), and BNCR (0.06%) comprise the portfolio in colones, representing 71.14% of the consolidated portfolio. Investments in instruments issued by the Government of Costa Rica comprise the portfolio in U.S. dollars, representing 28.86% of the consolidated portfolio.

iv. *BN Vital Operadora de Planes de Pensiones Complementarias, S.A.*

For the Pension Fund Manager, since April 2008, the Bank's Credit Risk Division has applied a method based on the Merton model to quantify the VaR levels of the investment portfolio, replacing the Default model approach. The aforementioned method assumes a normal loss distribution and those exposures are perfectly correlated, which causes VaR to be overestimated.

The Merton model uses the following three basic inputs: the fair values of securities, the probability of default for each issuer, and the percentage of expected losses for each issuer. Fair values are obtained from the Oracle Financial Services Application (OFSA) and the remaining two inputs are obtained using estimates from international rating agencies (primarily Moody's).

Additionally, based on whether the issuer is a private or public issuer, a correlation table is calculated based on quarterly changes in equity prices or the government's creditworthiness.

Once the above information has been obtained, the Merton model uses the "Monte Carlo simulation" approach to generate loss scenarios (maximum loss with a confidence level of 99%).

The above method is used to generate monthly analyses of changes in the balances in the Pension Fund Manager's investment portfolio in each currency, by type of fund, and to quantify the corresponding VaR.

A yearly analysis of maximum and minimum VaR for the Pension Fund Manager by currency is also generated as required by SUPEN's Regulations on Investments. Those values are calculated for both the portfolio in colones and the portfolio in U.S. dollars, using the Merton model based on the limits set by SUPEN for investments per issuer.

As of December 31, 2017, the net assets managed by the Pension Fund Manager amount to ¢1,285,736.56 million (2016: ¢1,147,185.46 million), growing year-on-year by ¢138,551.1041 million in nominal terms, equivalent to a growth rate of 12.08%. These data do not include the Pension Fund Manager's own assets.

(Continued)

# BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

## Notes to the Consolidated Financial Statements

The pension fund with the highest relative share is ROP, which represents 81.37%, growing year-on-year by ¢116,482.53 million, an increase of 12.53% with respect to the same period in 2016.

As of December 31, 2017, the Pension Fund Manager's portfolio of own funds is represented by available-for-sale investments in the amount of ¢6,344.66 million (2016: ¢7,534.26 million) (see note 5). There is a decrease due to the maturity of principals and sales of such investments. An adjustment has been made to the price of assets that comprise the portfolio of investments of the Pension Fund Manager due to the increase in market's interest rates. This has a negative effect on the price of bonds, with a direct impact on gains on assets and a decrease in gains over the last year.

In September 2017, the VaR of credit in absolute terms is ¢32.21 million, equivalent to 0.47% (2016: ¢29.83 million, equivalent to 0.38%), showing a minimum increase.

Consolidated VaR - One year			
Fund	December 2017	December 2016	Variation
FCL	2.60%	2.06%	0.54%
FPC A	0.02%	0.16%	-0.14%
FPC B	3.75%	4.59%	-0.84%
FPD A	26.98%	35.10%	-8.12%
FPD B	29.19%	35.99%	-6.80%
NOT	0.00%	0.00%	0.00%
ROP	5.81%	6.66%	-0.85%
BN Vital (OPC)	0.47%	0.38%	0.09%
FCLE	5.08%	4.97%	0.11%
ROPE	4.14%	3.95%	0.19%

### v. BN Corredora de Seguros, S.A.

For the Insurance Brokerage Firm, credit risk is the risk that the borrower or issuer of a financial asset will fail to discharge an obligation, fully and on time, in accordance with the terms and conditions agreed upon at the time the financial asset was acquired. Credit risk arises mainly on cash and due from banks and investments in financial instruments and is represented by the carrying amount of the assets in the balance sheet.

At the consolidated balance sheet date, there are no significant concentrations of credit risk. The maximum exposure to credit risk is represented by the carrying amount of each financial asset and is based on parameters established by current regulations.

(Continued)

## BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

### Notes to the Consolidated Financial Statements

As of December 31, 2017 and 2016, exposure to credit risk is represented by the carrying amounts of cash and due from banks and available-for-sale investments. Cash and due from banks correspond to checking account deposits with a State-owned bank. As of December 31, 2017, investments in financial instruments correspond to the non-diversified investment fund in colones “*Fondo de Inversión BN FonDepósito Colones, No Diversificado*”, which is secured by term certificates of deposit from BNCR.

#### b) Liquidity risk

Liquidity risk arises when the financial entity is unable to honor its commitments or obligations with third parties due to insufficient cash flows, among other factors. It also represents the risk of potential losses due to forced sales of assets or forced acceptances of liabilities under unfavorable conditions.

#### i. Banco Nacional de Costa Rica

To support liquidity risk management, the Market Risk Division monitors indicators such as liability structure, daily changes and trends in demand and term account balances, volatility of deposit-taking from the public (duration by liability and currency), VaR of liquidity, levels of concentration of the Bank’s funding sources, liquidity coverage ratio (LCR), systemic liquidity indicators, and variables with the greatest impact on SUGEF’s term matching indicators.

Below is the LCR indicator, which remained stable in colones and increased in U.S. dollars with respect to December 2016, remaining above the risk appetite level in both currencies. The LCR indicator in colones presented variations during the first half of 2017 as a result of the accelerated placement of loans in colones, managed by means of measures to diversify profit-taking (through standardized issues), adjustments to deposit taking rates and loan rationalization during the second half of the year. In U.S. dollars, the LCR indicator has shown a significant upward tendency during 2017, influenced by the expectation and evolution of the exchange rate, which has decelerated the placement of loans and increased profit-taking.

<u>Indicador</u>	<u>December 2016</u>	<u>December 2017</u>	<u>Variation</u>	<u>Level</u>
LCR in colones	78.00%	110.00%	32.70%	Appetite
LCR in U.S. dollars	161.00%	278.00%	116.80%	Appetite

This information is communicated to management in a monthly report that is reviewed by the Corporate Risk Committee and subsequently presented to the board of directors.

(Continued)

# BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

## Notes to the Consolidated Financial Statements

As of December 31, 2017, the terms of the Bank's assets and liabilities denominated in local currency are matched as follows:

	Past due	Demand	Days						Total
			1 to 30	31 to 60	61 to 90	91 to 180	181 to 365	More than 365	
Cash and due from banks	¢ -	84,579,273,518	-	-	-	-	-	-	84,579,273,518
Minimum legal deposit in BCCR	-	323,563,751,725	25,393,150,720	35,772,718,849	25,895,395,415	57,743,568,550	60,614,088,948	24,298,583,588	553,281,257,795
Investments	-	-	112,551,341,206	29,835,624,817	44,076,040,113	35,202,952,338	49,535,472,295	235,224,476,290	506,425,907,059
Loan portfolio	144,568,723,210	-	46,892,391,275	42,121,884,476	35,005,298,609	106,622,738,480	132,633,716,014	2,485,448,469,783	2,993,293,221,847
Total recovery of assets	¢ 144,568,723,210	408,143,025,243	184,836,883,201	107,730,228,142	104,976,734,137	199,569,259,368	242,783,277,257	2,744,971,529,661	4,137,579,660,219
Obligations with the public	¢ -	1,819,782,210,980	276,084,916,895	160,449,282,424	156,912,286,465	334,709,008,383	360,782,278,962	137,895,491,130	3,246,615,475,239
Obligations with BCCR	-	-	-	-	-	-	-	125,644,412	125,644,412
Obligations with financial entities	-	87,053,086,275	12,359,127,691	18,570,517,452	20,809,400,000	41,982,956,360	1,369,332,729	30,082,347,628	212,226,768,135
Charges payable	-	9,308,146,296	9,338,930,845	3,230,900,435	2,894,751,515	3,826,367,413	1,339,344,906	225,771,967	30,164,213,377
Total maturity of liabilities	¢ -	1,916,143,443,551	297,782,975,431	182,250,700,311	180,616,437,980	380,518,332,156	363,490,956,597	168,329,255,137	3,489,132,101,163
Difference	¢ 144,568,723,210	(1,508,000,418,308)	(112,946,092,230)	(74,520,472,169)	(75,639,703,843)	(180,949,072,788)	(120,707,679,340)	2,576,642,274,524	648,447,559,056

(Continued)

BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

As of December 31, 2016, the terms of the Bank's assets and liabilities denominated in local currency are matched as follows:

	Past due	Demand	Days							Total
			1 to 30	31 to 60	61 to 90	91 to 180	181 to 365	More than 365		
Cash and due from banks	¢	-	-	-	-	-	-	-	-	56,185,829,148
Minimum legal deposit in BCCR	-	269,901,461,244	24,889,860,801	27,831,268,268	22,814,602,264	51,681,513,817	31,232,422,636	8,642,783,446	436,993,912,476	
Investments	-	-	48,819,837,623	6,615,051,602	102,916,265,683	26,822,219,168	93,979,093,152	221,818,781,013	500,971,248,241	
Loan portfolio	116,170,017,460	-	45,159,439,281	35,574,116,173	46,783,109,348	92,607,781,282	113,931,559,982	2,159,523,812,331	2,609,749,835,857	
Total recovery of assets	¢	326,087,290,392	118,869,137,705	70,020,436,043	172,513,977,295	171,111,514,267	239,143,075,770	2,389,985,376,790	3,603,900,825,722	
Obligations with the public	¢	-	1,786,844,782,555	208,359,076,157	158,238,514,512	129,800,193,032	322,316,860,180	254,975,566,075	59,069,402,606	2,919,604,395,117
Obligations with BCCR	-	-	-	-	-	-	-	-	125,644,412	125,644,412
Obligations with financial entities	-	97,674,940,416	8,597,395,146	98,359,644	18,000,000	498,582,837	952,617,295	6,245,949,138	114,085,844,476	
Charges payable	-	7,287,448,490	4,340,579,327	2,949,570,566	1,192,522,676	1,616,146,244	456,099,091	108,652,073	17,951,018,467	
Total maturity of liabilities	¢	-	1,891,807,171,461	221,297,050,630	161,286,444,722	131,010,715,708	324,431,589,261	256,384,282,461	65,549,648,229	3,051,766,902,472
Difference	¢	116,170,017,460	(1,565,719,881,069)	(102,427,912,925)	(91,266,008,679)	41,503,261,587	(153,320,074,994)	(17,241,206,691)	2,324,435,728,561	552,133,923,250

(Continued)



BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

As of December 31, 2017, the terms of the Bank's assets and liabilities denominated in foreign currency, expressed in local currency, are matched as follows:

	Past due	Demand	Days							Total
			1 to 30	31 to 60	61 to 90	91 to 180	181 to 365	More than 365		
¢	-	84,579,273,518	-	-	-	-	-	-	84,579,273,518	
Cash and due from banks	-	323,563,751,725	25,393,150,720	35,772,718,849	25,895,395,415	57,743,568,550	60,614,088,948	24,298,583,588	553,281,257,795	
Minimum legal deposit in BCCR	-	-	112,551,341,206	29,835,624,817	44,076,040,113	35,202,952,338	49,535,472,295	235,224,476,290	506,425,907,059	
Investments	-	-	46,892,391,275	42,121,884,476	35,005,298,609	106,622,738,480	132,633,716,014	2,485,448,469,783	2,993,293,221,847	
Loan portfolio	144,568,723,210	-	184,836,883,201	107,730,228,142	104,976,734,137	199,569,259,368	242,783,277,257	2,744,971,529,661	4,137,579,660,219	
Total recovery of assets	¢	144,568,723,210	184,836,883,201	107,730,228,142	104,976,734,137	199,569,259,368	242,783,277,257	2,744,971,529,661	4,137,579,660,219	
Obligations with the public	-	1,819,782,210,980	276,084,916,895	160,449,282,424	156,912,286,465	334,709,008,383	360,782,278,962	137,895,491,130	3,246,615,475,239	
Obligations with BCCR	-	-	-	-	-	-	-	125,644,412	125,644,412	
Obligations with financial entities	-	87,053,086,275	12,359,127,691	18,570,517,452	20,809,400,000	41,982,956,360	1,369,332,729	30,082,347,628	212,226,768,135	
Charges payable	-	9,308,146,296	9,338,930,845	3,230,900,435	2,894,751,515	3,826,367,413	1,339,344,906	225,771,967	30,164,213,377	
Total maturity of liabilities	¢	1,916,143,443,551	297,782,975,431	182,250,700,311	180,616,437,980	380,518,332,156	363,490,956,597	168,329,255,137	3,489,132,101,163	
Difference	¢	1,508,000,418,308	(112,946,092,230)	(74,520,472,169)	(75,639,703,843)	(180,949,072,788)	(120,707,679,340)	2,576,642,274,524	648,447,559,056	

(Continued)

BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

As of December 31, 2016, the terms of the Bank's assets and liabilities denominated in foreign currency, expressed in local currency, are matched as follows:

			Days							
	Past due	Demand	1 to 30	31 to 60	61 to 90	91 to 180	181 to 365	More than 365	Total	
¢	-	192,095,757,966	-	-	-	-	-	218,978,305	192,314,736,271	
Cash and due from banks										
Minimum cash reserve in										
BCCR	-	152,984,418,282	10,299,210,214	12,461,736,132	6,170,924,617	20,725,007,141	5,895,404,578	43,779,004,169	252,315,705,133	
Investments	-	-	18,225,546,902	7,688,361,496	2,181,240,935	77,409,225,718	151,461,231,846	198,722,785,897	455,688,392,794	
Loan portfolio	69,290,102,302	-	28,086,322,352	21,401,230,034	19,576,446,335	72,683,603,360	64,274,872,582	1,257,766,339,322	1,533,078,916,287	
Total recovery of assets	¢	345,080,176,248	56,611,079,468	41,551,327,662	27,928,611,887	170,817,836,219	221,631,509,006	1,500,487,107,693	2,433,397,750,485	
Obligations with the public	¢	819,962,286,026	99,887,979,325	44,754,793,979	41,051,718,097	144,543,692,263	72,880,372,523	34,514,700,331	1,257,595,542,544	
Obligations with financial entities	-	120,164,040,779	855,160,800	7,510,066	16,445,400	8,239,145,400	58,134,489,000	913,775,654,015	1,101,192,445,460	
Charges payable	-	1,410,480,672	977,820,660	1,643,324,066	227,368,962	9,001,341,528	314,005,543	185,339,428	13,759,680,859	
Total maturity of liabilities	¢	941,536,807,477	101,720,960,785	46,405,628,111	41,295,532,459	161,784,179,191	131,328,867,066	948,475,693,774	2,372,547,668,863	
Difference	¢	69,290,102,302	(596,456,631,229)	(45,109,881,317)	(4,854,300,449)	(13,366,920,572)	90,302,641,940	552,011,413,919	60,850,081,622	

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BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

ii. BN Sociedad Administradora de Fondos de Inversión, S.A.

For the Investment Fund Manager, liquidity risk is the risk that it will be unable to liquidate its investments on a timely basis and for an amount that approximates fair value in order to meet its liquidity needs.

Liquidity risk management is closely related to credit risk management since they both involve facilitating the trading of securities in the financial market.

iii. BN Valores Puesto de Bolsa, S.A.

For the Brokerage Firm, liquidity risk is the risk of potential losses due to premature or forced sales of assets at unusual discounts in order to fulfill commitments, or the risk that a position cannot be liquidated, acquired, or hedged in a timely manner by offsetting it with an equivalent position.

To manage liquidity risk, the Brokerage Firm has established its liquidity levels based on its cash needs, diversified its funding sources, and formulated policies to monitor risk exposures.

Liquidity risk is also the risk that the Brokerage Firm will be unable to meet all of its obligations due to an unexpected withdrawal of funds from creditors or customers, a decrease in the value of investments, the excessive concentration of liabilities in a single creditor, a mismatch of assets and liabilities, the lack of liquid assets, or the financing of long-term assets with short-term liabilities, etc. The Brokerage Firm's approach to managing liquidity is to ensure that it will always have sufficient liquidity to meet its liabilities when due under normal conditions.

Risk management has become essential for most entities that operate in financial markets since successful investment portfolio management is directly linked to good risk management practices. These entities have increasingly become aware of the importance of having an adequate system in place to measure and monitor positions assumed in order to manage risk exposures.

The Brokerage Firm has been compelled to increasingly diversify its investments in response to the development of the securities market, which has given rise to the need for a mechanism for making timely decisions to take advantage of investment opportunities in domestic and international markets.

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BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

In light of that situation, the Brokerage Firm must have sufficient tools for measuring and monitoring the risks on its investments in order to maximize return while minimizing risk. For such purposes, the Brokerage Firm has documented liquidity risk policies aimed at limiting liquidity risk exposures.

The Brokerage Firm's liquidity policies establish that the trader of the Brokerage Firm's own portfolio is responsible for executing investments and making any investment decisions related to that portfolio, in accordance with the provisions set forth in the guidelines for management of the Brokerage Firm's own portfolio and in compliance with current legal regulations and with the Brokerage Firm's internal and corporate rules, regulations, and procedures.

Marketability of instruments is determined based on indicators calculated by the Brokerage Firm for such purposes and on whether they are registered in the National Registry of Securities and Brokers. The Brokerage Firm must comply with maximum and minimum maturity concentrations, which require that a minimum of 20% of the total portfolio correspond to investments with maturities of 12 months or less. The investment portfolio should not include investments in equity instruments or investments in publicly-offered real estate funds.

iv. BN Vital Operadora de Planes de Pensiones Complementarias, S.A.

The liquidity level of the Pension Fund Manager corresponds to the nature of its operations. The entity holds a portfolio of short-term assets as well as liquid investments to ensure it has sufficient liquidity. As part of liquidity controls, cash flows are monitored on a daily basis, taking into consideration checking account balances and projected cash needs for up to three days after the calculation. Accordingly, the entity could sell financial assets or invest surpluses that will not be used in the short term, if necessary.

As of December 31, 2017, a change in the methodology is presented in relation to liquidity risk. The calculation of a liquidity ratio that shows the number of times that cash covers expected withdrawals. For the ROP, FCL, FPC B, and NOT, the methodology considers cash plus liquid investments (in the issuers BCCR and the government, with maturities of less than one month). Therefore, a comparison using the same date of the prior period is not made, but there must be an indication that as of the period-end the following liquidity ratio is kept for the funds:

BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

<u>Historical VaR of liquidity</u>	
<u>Fund</u>	<u>December 2017</u>
ROP	10.21%
FCL	14.50%
NOT	76.97%
FPCA	9.74%
FPCB	10.07%
FPDA	4.01%
FPDB	4.85%
FCL-E	11.75%
ROP-E	68.27%

Liquidity risk management

Risk management policies establish a liquidity limit which determines that a sufficient liquidity level will be maintained to address the investment needs and operations of the company and the characteristics of the pension plan, according to the need arising from the nature of the Pension Fund Manager itself.

All policies and procedures are subject to review and approval by the Risk Committee and the Investment Committee. The board of directors has established minimum liquidity levels on the minimum portion of funds available to meet the fund requirements.

The liquidity level of the Pension Fund Manager corresponds to the nature of its operations. The entity holds a portfolio of short-term assets as well as highly-liquid investments to ensure it has sufficient liquidity. As part of liquidity controls, cash flows are monitored on a daily basis, taking into consideration checking account balances and projected cash needs for up to 4 days after the calculation. Accordingly, the entity could sell financial assets or invest surpluses that will not be used in the short term, if necessary.

Exposure to liquidity risk:

Additionally, according to the portfolio's nature, the Pension Fund Manager has established limits to manage liquidity risk that allow determining liquidity levels. To assess liquidity risk, indicators are used, such as the market index of investment instruments.

v. BN Corredora de Seguros, S.A.

For the Insurance Brokerage Firm, liquidity risk is the risk that the entity will be unable to honor its commitments or obligations with third parties due to insufficient cash flows, resulting from a mismatch of the terms of assets and liabilities.

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BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

c) Market risk

i. Banco Nacional de Costa Rica

To assess market risk, the Bank analyzes the probability that the value of its own investments will decrease as a result of changes in interest rates, foreign exchange rates, prices of instruments, and other economic and financial variables as well as the economic impact of those changes, which could expose the Bank to market risk. The objective of market risk management is to follow-up on and control market risk exposures within acceptable parameters (risk limits approved by the board of directors), while optimizing the return.

The main indicator used is the market VaR of the Bank's investments, which is quantified by means of an internal methodology and determined for each currency in which the Bank holds positions. That indicator is complemented with the duration and return, which show the Bank's risk-return profile derived from holding an investment portfolio.

The Market Risk Division periodically analyzes and follows-up on the investment portfolio on a periodic basis through the Comprehensive Risk Assessment Report, which is submitted to the Corporate Risk Committee and the board of directors.

Below is the variation of the portfolios in each currency between December 2016 and December 2017.

<u>Currency</u>	<u>Face value of investments by currency</u>		<u>Variation</u>
	<u>December 2016</u>	<u>December 2017</u>	
Colones	402,018,100,000	425,852,400,000	23,834,300,000
U.S. dollars - local	375,303,064	426,017,729	50,714,665
U.S. dollars - intl	389,023,923	557,607,036	168,583,112
Euros	27,650,000	11,000,000	(16,650,000)
DU	34,823,795	24,282,530	(10,541,265)

The duration for each currency has presented variations according to portfolio management, with a decrease during the last year in colones, euros, and DU and an increase in dollars.

<u>Duration</u>	<u>December 2016</u>	<u>December 2017</u>	<u>Variation</u>
Colones	0.79	0.32	(0.47)
U.S. dollars - local	0.88	0.99	0.10
U.S. dollars - intl	1.28	1.32	0.04
Euros	1.06	0.94	(0.12)
DU	1.86	1.29	(0.57)

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BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

ii. BN Sociedad Administradora de Fondos de Inversión, S.A.

For the Investment Fund Manager, market risk is the risk of potential losses in the fair value of its financial instrument portfolio before they are derecognized. The loss is equivalent to the difference between the fair value when the instrument was acquired and the fair value at the date the instrument was derecognized. The degree of risk depends on the settlement period and market volatility and liquidity.

As a systemic risk, market risk depends on a series of factors that are strongly linked to macroeconomic performance and is inherent to the market environment, thereby affecting all participants in a given market.

Market risk management

Market risks have been calculated since late 2003 and a database of those calculations is available for consultation when setting the corresponding risk limits.

Potential losses arising from changes in risk factors, such as changes in interest rates, which affect the valuation of positions, are calculated daily.

For such purposes, the RiMeR methodology is used, which was internally developed by the Mathematical Modeling and Market Risk Divisions of the Bank. This methodology permits calculating the VaR of portfolios comprised of fixed income instruments. The model considers yield curves, rate model parameter estimation, scenario simulations, and calculation of VaR. This methodology uses a two-factor rate model (G2++ model), which involves decomposing the short rate into two processes and a deterministic function to be selected.

VaR of price risk and fair value is calculated on a daily basis, and all results are reported to the Investment Fund Manager's Financial Resources Investment Committee each month.

The Investment Fund Manager uses the above methods and calculations to analyze the risk on its portfolios and the correlation between risk and return over a given period of time. The Sharpe ratio measures the risk-adjusted return based on the relationship between return and risk-free assets and the volatility of returns.

BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

Market risk exposure – trading portfolio:

The Investment Fund Manager sets VaR limits for all identified market risks. The structure of those limits is subject to review and approval by the Investment Committee and Board of Directors, respectively, and is based on the local VaR limits of the trading portfolio. VaR is calculated at each month-end, with reports on the usage of VaR limits submitted to the Investment Committee.

The VaR of the Investment Fund Manager's portfolio is as follows:

	<u>December 2017</u>	<u>December 2016</u>
VaR (99% confidence level)	0.24%	0.26%

Fair values

Fair value estimates are made at a specific date, based on relevant market information and information concerning the financial instruments. These estimates do not reflect any premium or discount that could result from offering for sale a particular financial instrument at a given point in time.

These estimates are subjective in nature and involve uncertainties and matters of significant judgment and, therefore, cannot be determined with precision.

As of December 31, 2017 and 2016, the carrying amount of the following financial instruments approximates fair value: cash, investments in financial instruments, interest receivable, obligations under repurchase agreements, interest payable, fees and commissions, and other accounts payable. Investments are carried at the fair value determined using the method described above.

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BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

iii. BN Valores Puesto de Bolsa, S.A.

For the Brokerage Firm, market risk is the potential losses due to changes in risk factors that affect the valuation of positions, such as interest rates, foreign exchange rates, and price indices, which can result in either loss or gain for the Brokerage Firm. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimizing the return on risk.

All derivatives and available-for-sale investments are recognized at fair value, and therefore, any changes in market conditions directly affect the Brokerage Firm's net income. Market risk is the risk that the fair value of those instruments will fluctuate as a result of changes in interest rates, foreign exchange rates, or equity prices.

Management of the Brokerage Firm controls market risk exposures on a daily basis by applying VaR analyses and other methods supported by the investment parameters under which the Brokerage Firm operates.

Additionally, the Brokerage Firm's approach to market risk management is to identify risk factors, monitor any such factors identified using market analyses, and assess positions that are subject to price risk using models that measure potential losses on those positions as a result of changes in equity prices, interest rates, or foreign exchange rates.

Price risk exposure:

The Brokerage Firm mainly measures and controls price risk exposure using VaR, which estimates possible losses in a portfolio over a predetermined time period ("holding period"). Because the portfolio may be affected by adverse changes in the market, a specific probability is quantified and used as the confidence level applied in the VaR calculation. Price risk exposure is low and has been controlled through investments.

The Brokerage Firm uses the historical method to calculate VaR, as established in the risk regulations issued by SUGEVAL, based on a confidence level of 95% and a 22-day holding period. As a complement to determine price risk exposure, the Brokerage Firm uses the consolidated VaR model, provided by the Bank's Risk Division, which assumes a 99% confidence level and a 30-day holding period, based on the Monte Carlo approach.

# BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

## Notes to the Consolidated Financial Statements

### iv. BN Vital Operadora de Planes de Pensiones Complementarias, S.A.

The Pension Fund Manager manages market risk for each of its funds by applying a VaR model pursuant to Section 41 of IFRS 7. The calculation of market risk indicators are mainly performed using the RiMeR software, which estimates the VaR of the portfolios managed by the Bank. VaR is determined by adjusting the portfolio and calculating its duration and price. The total portfolio duration is the average amount-weighted durations. The RiMeR methodology applies daily parameters (modeling rising volatility curves) and efficiently captures market movements. Such parameters are denominated G2++ and are an extension of the Hull-White model.

Currently, the Pension Fund Manager's funds are comprised of funds in various currencies, i.e. the Costa Rican colon, the U.S. dollar (local issuers and international portfolio), and DU, for which the Corporate Risk Division performs separate VaR analyses in respect of each currency. Subsequently, those analyses are consolidated using a model that includes interest rate and currency risks. Also, a VaR of investment funds is included to calculate the possible loss of the total investment portfolio over a holding period with a specific confidence level.

### v. BN Corredora de Seguros, S.A.

For the Insurance Brokerage Firm, market risk is the risk of changes in market prices, such as foreign exchange rates and interest rates. The objective of market risk management is to manage and control market risk exposures within acceptable parameters.

#### • Market risk of investments

### i. Banco Nacional de Costa Rica

The Bank's consolidated VaR regarding the market value of investments is at the risk appetite level, showing a slight increase in the last year. Increases in the monetary policy rate and a higher pressure on the liquidity in colones may give rise to higher pressure on local interest rates, increasing VaR due to movements in the curves.

<u>Type of risk</u>	<u>December 2016</u>	<u>December 2017</u>	<u>Variation</u>	<u>Level</u>
Consolidated VaR	0.12%	0.24%	0.12%	Appetite

BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

The individual VaR by currency and its variation with respect to the prior year is also included.

<u>Currency</u>	<u>VaR by currency</u>		<u>Variation</u>
	<u>December 2016</u>	<u>December 2017</u>	
Colones	0.15%	0.07%	(0.08%)
U.S. dollars - local	0.08%	0.35%	0.27%
U.S. dollars - intl	0.25%	0.55%	0.30%
Euros	0.03%	0.01%	(0.02%)
DU	0.26%	0.06%	(0.21%)

- Interest rate risk

Interest rate risk is the risk of losses in the value of a financial asset or liability arising from fluctuations in interest rates, when changes in interest rates for the asset and liability portfolios are mismatched and when the Bank does not have the necessary flexibility to make a timely adjustment.

The Market Risk Division monitors this risk regularly and reports on its performance monthly to the Bank's Corporate Risk Committee. A summary is provided below:

<u>Type of risk</u>	<u>December 2016</u>	<u>December 2017</u>	<u>Variation</u>	<u>Level</u>
Interest rate risk in colones	1.63%	0.14%	(1.49%)	Normal
Interest rate risk in foreign currency	0.48%	0.70%	0.22%	Normal

Both indicators closed considerably below SUGEF's regulatory maximum limit. The decrease in the interest rate risk in colones is due improvements in the source of data, which makes better use of the distribution of credit by time band based on the interest rate renegotiated starting June 2017.

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BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

As of December 31, 2017, the interest rate terms for the Bank's assets and liabilities (differences between the recovery of assets and the maturity of liabilities) are matched as follows:

	1 to 30 days	31 to 90 days	91 to 180 days	181 to 360 days	361 to 720 days	More than 720 days	Total
<i>Local currency (LC)</i>							
Investments	112,509,834,994	73,776,846,339	35,118,105,652	40,253,520,467	69,788,316,382	155,458,541,380	486,905,165,214
Loan portfolio	2,565,056,362,078	103,136,230,043	98,705,850,847	16,237,894,212	17,827,018,976	69,033,666,086	2,869,997,022,242
Total recovery of rate-sensitive assets in LC (A)	2,677,566,197,072	176,913,076,382	133,823,956,499	56,491,414,679	87,615,335,358	224,492,207,466	3,356,902,187,456
Obligations with the public	287,073,097,286	361,877,505,555	379,228,579,456	361,856,489,734	117,853,166,515	26,386,847,813	1,534,275,686,359
Obligations with BCCR	-	-	-	-	-	125,644,412	125,644,412
Obligations with financial entities in LC	11,803,944,224	284,957,555	431,114,246	901,229,134	1,852,649,947	26,876,594,198	42,150,489,304
Total maturity of rate-sensitive liabilities in LC (B)	298,877,041,510	362,162,463,110	379,659,693,702	362,757,718,868	119,705,816,462	53,389,086,423	1,576,551,820,075
Difference in LC, recovery of assets less maturity of liabilities (A - B)	2,378,689,155,562	(185,249,386,728)	(245,835,737,203)	(306,266,304,189)	(32,090,481,104)	171,103,121,043	1,780,350,367,381
<i>Foreign currency (FC)</i>							
Investments	37,219,488,692	50,491,679,901	90,267,262,864	147,981,191,473	101,150,799,996	157,603,704,503	584,714,127,429
Loan portfolio	1,302,177,235,933	48,468,965,584	28,347,786,928	3,116,546,562	26,038,902,776	72,292,589,480	1,480,442,027,263
Total recovery of rate-sensitive assets in FC (C)	1,339,396,724,625	98,960,645,485	118,615,049,792	151,097,738,035	127,189,702,772	229,896,293,983	2,065,156,154,692
Obligations with the public	112,531,385,354	196,034,488,852	232,106,788,355	108,375,623,814	44,094,385,417	872,773,706,255	1,565,916,378,047
Obligations with entities	4,296,312,806	1,097,438,750	2,130,854,810	2,722,236,763	5,619,145,656	84,836,931,091	100,702,919,876
Total maturity of rate-sensitive liabilities in FC (D)	116,827,698,160	197,131,927,602	234,237,643,165	111,097,860,577	49,713,531,073	957,610,637,346	1,666,619,297,923
Difference in FC, recovery of assets less maturity of liabilities (C - D)	1,222,569,026,465	(98,171,282,117)	(115,622,593,373)	39,999,877,458	77,476,171,699	(727,714,343,363)	398,536,856,769
Total recovery of rate-sensitive assets 1/ (A + C)	4,016,962,921,697	275,873,721,867	252,439,006,291	207,589,152,714	214,805,038,130	454,388,501,449	5,422,058,342,148
Total maturity of rate-sensitive liabilities 2/ (B + D)	415,704,739,670	559,294,390,712	613,897,336,867	473,855,579,445	169,419,347,535	1,010,999,723,769	3,243,171,117,998
LC + FC difference, recovery of assets less maturity of liabilities (item 1 - item 2)	3,601,258,182,027	(283,420,668,845)	(361,458,330,576)	(266,266,426,731)	45,385,690,595	(556,611,222,320)	2,178,887,224,150

(Continued)

BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

As of December 31, 2016, the interest rate terms for the Bank's assets and liabilities (differences between the recovery of assets and the maturity of liabilities) are matched as follows:

	1 to 30 days	31 to 90 days	91 to 180 days	181 to 360 days	361 to 720 days	More than 720 days	Total
<i>Local currency (LC)</i>							
Investments	48,812,693,591	109,317,565,716	26,800,503,393	84,761,333,218	161,141,334,136	43,764,668,956	474,598,099,010
Loan portfolio	151,925,287,550	69,418,330,158	77,845,769,583	103,985,699,379	177,271,191,938	1,928,393,980,922	2,508,840,259,530
Total recovery of rate-sensitive assets in LC (A)	200,737,981,141	178,735,895,874	104,646,272,976	188,747,032,597	338,412,526,074	1,972,158,649,878	2,983,438,358,540
Obligations with the public	213,237,921,355	291,461,974,865	323,978,413,537	255,259,599,514	50,516,603,627	12,405,715,871	1,146,860,228,769
Obligations with BCCR	-	-	-	-	-	125,644,412	125,644,412
Obligations with financial entities in LC	7,942,886,645	186,942,968	282,919,617	437,488,536	647,271,846	6,470,621,117	15,968,130,729
Total maturity of rate-sensitive liabilities in LC (B)	221,180,808,000	291,648,917,833	324,261,333,154	255,697,088,050	51,163,875,473	19,001,981,400	1,162,954,003,910
Difference in LC, recovery of assets less maturity of liabilities (A - B)	(20,442,826,859)	(112,913,021,959)	(219,615,060,178)	(66,950,055,453)	287,248,650,601	1,953,156,668,478	1,820,484,354,630
<i>Foreign currency (FC)</i>							
Investments	18,225,547,063	9,869,605,239	77,122,591,690	151,026,799,586	93,463,236,274	100,045,134,095	449,752,913,947
Loan portfolio	48,010,615,534	33,136,957,685	66,292,171,514	62,723,058,826	104,104,023,879	1,171,674,486,769	1,485,941,314,207
Total recovery of rate-sensitive assets in FC (C)	66,236,162,597	43,006,562,924	143,414,763,204	213,749,858,412	197,567,260,153	1,271,719,620,864	1,935,694,228,154
Obligations with the public	101,956,582,694	86,191,499,811	158,443,079,045	72,376,065,490	13,895,928,098	829,205,488,048	1,262,068,643,186
Obligations with entities	1,452,003,566	1,062,098,750	5,282,584,837	61,239,515,093	5,764,761,915	87,426,410,429	162,227,374,590
Total maturity of rate-sensitive liabilities in FC (D)	103,408,586,260	87,253,598,561	163,725,663,882	133,615,580,583	19,660,690,013	916,631,898,477	1,424,296,017,776
FC difference, recovery of assets less maturity of liabilities (C - D)	(37,172,423,663)	(44,247,035,637)	(20,310,900,678)	80,134,277,829	177,906,570,140	355,087,722,387	511,398,210,378
Total recovery of rate-sensitive assets 1/ (A + C)	266,974,143,738	221,742,458,798	248,061,036,180	402,496,891,009	535,979,786,227	3,243,878,270,742	4,919,132,586,694
Total maturity of rate-sensitive liabilities 2/ (B + D)	324,589,394,260	378,902,516,394	487,986,997,036	389,312,668,633	70,824,565,486	935,633,879,877	2,587,250,021,686
LC + FC difference, recovery of assets less maturity of liabilities (item 1 - item 2)	(57,615,250,522)	(157,160,057,596)	(239,925,960,856)	13,184,222,376	465,155,220,741	2,308,244,390,865	2,331,882,565,008

(Continued)

BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

ii. BN Sociedad Administradora de Fondos de Inversión, S.A.

For the Investment Fund Manager, interest rate risk in respect of cash flows and fair value are the risks that the future cash flows and the fair value of a financial instrument will fluctuate as a result of changes in market interest rates.

iii. BN Vital Operadora de Planes de Pensiones Complementarias, S.A.

In general, the Pension Fund Manager sought to maintain the average term to maturity for investments in colones in order to receive the highest real returns, which were unusually high during the year (due to relatively low inflation).

The consolidated VaR of the Pension Fund Manager's own funds presents a downward trend with a maximum of 0.38% and a minimum of 0.00%, for an average of 0.22%, equivalent to ₡15.29 million. As of December 31, 2017, the indicator closes at 0.29%, compared to the indicator at the 2016 close at 0.18%, showing an increase resulting from the proportional decrease in the size of both the total investment portfolio and the portfolio of fixed-rate instruments. For the 2016 period, 0.18% is equivalent to ₡14.18 million.

The volatility observed mid-year caused a considerable increase in VaR levels. However, sales were made, materializing capital gains in the portfolio and decreasing the probability of losses due to movements in interest rates.

iv. BN Corredora de Seguros, S.A.

For the Insurance Brokerage Firm, interest rate risk is the risk of losses in the value of a financial asset or liability arising from fluctuations in interest rates, when interest rates for financial assets and liabilities are mismatched, and when the Insurance Brokerage Firm does not have the necessary flexibility to make a timely adjustment.

- Currency risk

Pursuant to SUGEF Directive 24-00, an entity faces currency risk when the value of its assets and liabilities in foreign currency is affected by exchange rate variations and the amounts of the corresponding assets and liabilities are mismatched.

(Continued)

BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

Starting May 2009, the Bank's Asset and Liability Committee (ALCO) decided to take a neutral foreign currency position with the purpose of protecting the Bank from any changes in the exchange rate, which has been ratified annually by the Bank's Corporate Risk Committee. The Bank's foreign currency position is monitored daily by the Market Risk Division.

Due to the amendments to BCCR's Foreign Exchange Operations and the new regulations of SUGEF Directive 23-17 on market risk, interest rates, and exchange rate, the Bank will eventually modify its appetite in the foreign currency position to a higher level (a long position).

The Bank calculates the SUGEF currency risk indicator on a monthly basis, which remains at a normal level for both years, as follows:

<u>Type of risk</u>	<u>December 2016</u>	<u>December 2017</u>	<u>Variation</u>	<u>Level</u>
Currency risk	0.12%	0.08%	(0.04%)	Appetite

i. Banco Nacional de Costa Rica

The Bank is exposed to currency risk when the value of its assets and liabilities in U.S. dollars is affected by variations in the exchange rate, which is recognized in the consolidated statement of comprehensive income.

(Continued)

BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

As of December 31, assets and liabilities denominated in foreign currency are as follows:

		U.S. dollars	
		2017	2016
<u>Assets:</u>			
Cash and due from banks	US\$	1,102,241,128	787,278,782
Investments in financial instruments		1,029,740,828	801,084,440
Loan portfolio		2,683,160,687	2,742,960,429
Accounts and accrued interest receivable		474,096	555,045
Investments in other companies		108,986,397	104,236,891
Other assets		6,237,828	6,595,807
	US\$	4,930,840,964	4,442,711,394
<u>Liabilities:</u>			
Obligations with the public	US\$	2,740,286,322	2,232,819,607
Obligations with entities		1,962,477,461	2,024,886,784
Accounts payable and provisions		31,163,608	34,199,464
Other liabilities		46,941,196	36,575,840
Subordinated obligations		132,650,795	132,576,487
	US\$	4,913,519,382	4,461,058,182
Excess (deficit) of assets over liabilities in U.S. dollars	US\$	17,321,582	(18,346,788)
		Euros	
		2017	2016
<u>Assets:</u>			
Cash and due from banks	€	30,409,852	22,789,474
Investments in financial instruments		11,312,826	28,775,701
Other assets		1,007	-
	€	41,723,685	51,565,175
<u>Liabilities:</u>			
Obligations with the public	€	39,281,032	50,131,849
Obligations with entities		792,201	1,102,038
Accounts payable and provisions		138,795	131,176
Other liabilities		994,789	509,588
	€	41,206,817	51,874,651
Excess (deficit) of assets over liabilities in euros	€	516,868	(309,476)

(Continued)



BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

		DU	
		2017	2016
<u>Assets:</u>			
Investments in financial instruments	UD	24,293,913	34,822,825
Loan portfolio		14,691,220	22,951,719
	UD	38,985,133	57,774,544
<u>Liabilities:</u>			
Accounts payable and provisions	UD	692,698	818,804
Other liabilities		3,151	4,486
	UD	695,849	823,290
Excess of assets over liabilities in DU	UD	38,289,284	56,951,254

The Bank's net position is not hedged. However, the Bank considers its position to be acceptable and in compliance with the internal policy limits established by ALCO.

The valuation in colones of monetary assets and liabilities in foreign currency gave rise to foreign exchange gains or losses, as follows:

	2017	2016
Foreign exchange gain	¢ 191,058,338,305	118,087,779,312
Foreign exchange loss	(191,945,965,828)	(119,706,015,540)
Net (loss) gain	¢ (887,627,523)	(1,618,236,228)

Additionally, the valuation of other assets and other liabilities for the year ended September 30 gave rise to gains and losses, respectively, which are booked in "Other operating income" and "Other operating expenses", respectively, as follows:

	2017	2016
Gain on net valuation of other assets (see note 37)	¢ 414,076,427	371,907,290
Loss on net valuation of other liabilities (note 40)	(867,162,063)	(572,989,111)
Net gain (loss)	¢ (453,085,636)	(201,081,821)

(Continued)

BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

The value of financial assets and liabilities includes future interest to be earned in the corresponding time band.

ii. BN Sociedad Administradora de Fondos de Inversión, S.A.

For the Investment Fund Manager, currency risk is the risk of a decrease in an investor's purchasing power due to unexpected variations in foreign exchanges rates for the currencies in which the investor holds positions.

The investment funds managed by the Investment Fund Manager are currency specific, i.e. the assets and liabilities of the investment portfolios are denominated in the same currency. Additionally, the investment funds are managed as memoranda accounts rather than as liabilities.

The risk of capital requirement due to currency risk corresponds to the amount resulting from multiplying the absolute value of the total net position in foreign currency by 10%.

iii. BN Valores Puesto de Bolsa, S.A.

A significant change in the devaluation rate, depending on the magnitude of such change, could adversely impact the local market and, to a certain degree, counterparty risk in the stock market. Business units, together with the risk management department, monitor market changes on a daily basis and measure the impact of positions acquired on the Brokerage Firm's liquidity and equity based on simulations of extreme conditions.

The Brokerage Firm incurs currency risk mainly on cash and investments in U.S. dollars.

In respect of its assets and liabilities denominated in U.S. dollars, the Brokerage Firm aims to ensure that its net exposure is maintained at an acceptable level by holding sufficient assets in U.S. dollars to be able to settle its liabilities in that currency.

iv. BN Vital Operadora de Planes de Pensiones Complementarias, S.A.

For each of the funds managed, the Comprehensive Risk Management Unit (UAIR) performs simulations of exchange rate variations and their effect on changes in the value of the assets managed, the share value, and accordingly, the portfolio yield.

(Continued)

BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

As of December 31, 2017, 3.22% of the Pension Fund Manager's portfolio of own funds is represented by investments in U.S. dollars. By adding cash and due from banks denominated in foreign currency, the percentage increases to 3.44%, which in nominal terms represents ₡234.78 million compared to the close as of December 31, 2016 at 2.72% (₡216.32 million), considering cash and due from banks and bonded debt, which is a relatively low currency risk for the size of the managed portfolio.

v. BN Corredora de Seguros, S.A.

The Insurance Brokerage Firm is exposed to currency risk when the value of its assets and liabilities in U.S. dollars is affected by exchange rate variations. The effect of this risk is recognized in the consolidated statement of comprehensive income.

For the Insurance Brokerage Firm, currency risk is the risk that the fair value or the future cash flows of a financial instrument may fluctuate as a result of variations in foreign exchange rates. The effect of this risk is recognized in the consolidated statement of comprehensive income.

d) Operational risk

i. Banco Nacional de Costa Rica

Operational risk is the risk of losses resulting from inadequate or failed internal processes, personnel, information systems, and controls or from external events. This definition includes legal risk but excludes strategic, business, or reputational risks. In addition, the existing methodologies incorporate the criteria and best practices regarding the taxonomy and classification of operational risks established as recommendations and best practices by the Basel Committee.

The policy adopted by the Bank stipulates that all of the Bank's employees are inherently responsible for managing operational risk. The Bank's employees are also required at all times to comply with the policies, regulations, procedures, and controls applicable to their positions and to ensure that the Bank's institutional values, code of conduct, and ethics are adopted across all levels of the organization.

BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

That policy is implemented through a comprehensive model with roles and responsibilities assigned to each level:

- Business areas with the primary functions of execution and supervision.
- Support areas that have functions including surveillance, internal guideline generation, monitoring and control of key indicators, and regulatory compliance.
- Independent audits, both internal and external, that perform control testing and validation in conformity with that set forth by senior management and the applicable regulations.

Furthermore, the Bank has defined operating policies related to the implementation of new products, services, and operations and to fraud management and the reporting of operating risk events.

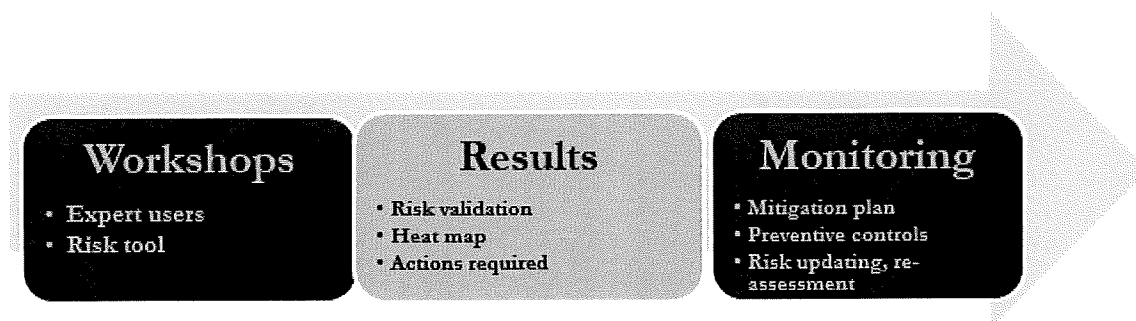
The Information Security and Business Continuity functions are part of the scope of the operational risk in conformity with SUGEF Directive 18-16 *Regulations on operating risk management*.

One of the Bank's fundamental operational risk management principles is transparency, which refers to the following:

All events should be identified, documented, and reported in order to allow the Bank to adequately measure risk events and carry out any necessary corrective, preventive, and mitigation measures in a timely manner, including insurance where this is effective.

All potential events must be identified and assessed so as to establish preventive controls and mitigating actions.

Operational risk management is the assessment and analysis of risk in institutional processes by applying a specific methodology that controls the frequency, impact, and quality of identified potential risks. The diagram below shows how such methodology is applied to institutional processes:



(Continued)

BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

Once the risks of the processes, areas, and operations are assessed, control activities are established in order to implement operating and prudential mitigation mechanisms, so that preventive controls are included in the day-to-day tasks and functions performed.

Senior management has defined operational risk limits that specifically measure the performance of risk management and total operating losses. These measurements are performed and reported to the upper levels on a monthly basis. Risk management also entails a qualitative assessment through the calculation of indicators and specific risk models, which reflect behaviors and trends on a periodic basis that are used as inputs for decision-making.

For legal risk, the Bank applies a model that enables estimating the EL and VaR of legal actions, considering the subject matter of the cases when calculating the likelihood of loss and a continuous model for the duration of the legal actions. Such model provides a direct estimate of the duration of each legal action in the corresponding court and the possible outcomes. The results thereof are used to address possible losses from unfavorable rulings.

For IT risk, the critical systems supporting the business are identified. System availability is measured on a monthly basis, while risk maps are updated annually based on a methodology established for such purposes. Events affecting normal operations are identified, classified, and reported to the Bank's upper management through a periodic information system that determines risk exposure.

ii. BN Sociedad Administradora de Fondos de Inversiones, S.A.

For the Investment Fund Manager, operational risk is the risk of possible direct or indirect loss arising from Investment Fund Manager's processes, personnel, technology, and infrastructure, in addition to external factors other than credit, market, and liquidity risks such as those arising from legal and regulatory requirements and generally accepted standards of corporate behavior. Also, the Institutional Risk Assessment System (SEVRI) measures operational risk activities, which are weighted with other risk categories to determine a global rating for institutional risk.

The Investment Fund Manager aims to manage operational risk so to avoid financial losses and damage to its reputation.

(Continued)

BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

The Investment Fund Manager has worked in the following six areas related to operational risk:

- Identification: Tools have been developed to accurately identify the different risks associated with each of the Investment Fund Manager's fundamental processes. Each process was analyzed together with any related processes to formulate a risk portfolio for the entire company. As a first step, the risks included in that portfolio were grouped by type and by class.
- Analysis: Using tools defined by international methods, the Investment Fund Manager analyzed the risks identified for each business unit and determined the degree of impact, the probability of occurrence, and the origin of each risk. In addition to this analysis, the Investment Fund Manager assesses aspects of the business that can affect risk such as its image, operations, income, human resources, etc.
- Measurement: Similar to the analysis mentioned above, each risk identified was assessed from two perspectives (its probability of occurrence and its potential impact) in order to determine which risks require the most attention and the formulation of action plans to be carried out in the event that the risk materializes. Such information is included in the Business Continuity Plan (BCP).
- Follow-up: Periodic assessments are made of the institutional risk map to identify changes that could increase or decrease the probability that risk events will occur in order to adapt the Investment Fund Manager's strategies to address areas in which risk exposures are considered unacceptable.
- Control: The Investment Fund Manager's strategies to control and mitigate the potential impact of different operational risks include contingent computer hardware, a redundant power infrastructure, personnel turnover, documentation of the activities performed by each position, specialized training, varied and continually open channels of communication, development of a general culture focused on operational controls, etc.
- Communication: Senior management informs employees of risk management trends and strategies as well the results of assessments through meetings with employees or announcements.

iii. BN Valores Puesto de Bolsa, S.A.

For the Brokerage Firm, operational risk is the risk of losses resulting from inadequate or failed internal processes, personnel, information systems, and internal controls or from external events.

(Continued)

BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

Management of this risk is the responsibility of all business units within the Brokerage Firm and considers the following:

- identification of risk factors;
- mapping of the Brokerage Firm's operational risks;
- operational risk database of information on risk events, including type, description, and number of events, business unit in which the event originated, date, and monetary loss incurred;
- compliance with corporate governance practices and established conduct guidelines;
- compliance with regulatory and other legal or contractual requirements applicable to the Brokerage Firm; and
- integrity, security, and availability of the Brokerage Firm's information technology (IT).

Fair value of financial instruments

Fair value estimates are made at a specific date, based on relevant market information and information concerning the financial instruments. These estimates do not reflect any premium or discount that could result from offering for sale a particular financial instrument at a given point in time.

Estimates could vary significantly if changes are made to those assumptions. The following methods and assumptions were used by the Brokerage Firm to estimate the fair value of financial instruments:

- (a) The carrying amounts of cash and cash equivalents, accounts receivable, and accounts payable approximate fair value because of the short-term nature of these instruments.
- (b) Available-for-sale investments are booked at fair value. The fair values are based on quoted market prices or prices quoted by brokers. The fair values of held-to-maturity investments are estimated using discounted cash flow techniques.

iv. BN Vital Operadora de Planes de Pensiones Complementarias, S.A.

For the Pension Fund Manager, operational risk is the risk of possible direct or indirect loss arising from the Pension Fund Manager's processes, personnel, technology, and infrastructure, in addition to external factors other than credit, market, and liquidity risks. Operational risk is an inherent risk for the sector in which the Pension Fund Manager operates and for all of its main activities. It manifests as failures, errors, business interruptions, or inappropriate employee behavior, and may cause financial loss, penalties from regulatory authorities, or damage to the reputation of the Pension Fund Manager.

(Continued)

BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

The primary responsibility for the development and implementation of controls to address operational risk is assigned to management in each business area. This responsibility is supported by the development of standards for the management of operational risk in the following areas:

- appropriate segregation of duties, including the independent authorization of transactions
- requirements for effective reconciliation and monitoring of transactions
- compliance with regulatory and other legal requirements
- communication and application of conduct guidelines or ethical standards
- monitoring of risks using measurement tools
- reporting of operational losses and proposed remedial actions
- comprehensive planning for resuming activities, including plans to restore key operations and internal and external support to ensure services are not interrupted
- personnel training.

At the financial conglomerate level, the UAIR furnishes necessary operational risk results. Compliance with the standards established by the Bank at the financial conglomerate level is supported by a program of periodic reviews undertaken by General and Internal Audit. The results of such reviews are discussed with the personnel of the Pension Fund Manager.

Legal risk: This risk focuses on the legal contingencies that result from the nature and operation of the industry when applying and interpreting pension legislation and regulations. The Pension Fund Manager is provided with legal advice and agreements authorized by SUPEN.

Risk management is comprised of three types of risk, namely:

Contract risk: This risk is assumed when the Pension Fund Manager makes investments with its own funds or the funds it manages. Accordingly, the contracts must comply with the regulations in effect and the performance bond signed by the parties. To ensure that these actions are executed from a legal standpoint, measures are coordinated and backed by the Bank.

Regulatory compliance risk: This risk refers to the scope and adoption of regulations in effect of the Pension Fund Manager. For such purposes, a Compliance Officer is in charge of reviewing in a systematic and comprehensive manner any departure from regulations. The UAIR analyzes and verifies the limits established by SUPEN in the Investment Regulations of the regulated entities.

(Continued)



BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

Litigation risk: The UAIR follows up monthly on the legal actions filed against the Pension Fund Manager. The legal actions must be timely communicated and fed by management into the database of the Bank's Legal Department. Mathematical models are then applied to estimate the amounts of EL and VaR.

As of December 31, 2017, the Bank's General Risk Division presented the results of the VaR by legal risk for the Pension Fund Manager, which indicate that the amount to be provisioned is the EL of ¢23.0 million that covers the main lawsuits against the Pension Fund Manager out of six pending lawsuits, most of which are in first instance.

v. BN Corredora de Seguros, S.A.

For the Insurance Brokerage Firm, operational risk is the possibility of incurring losses arising from deficient, failed, or inadequate processes, personnel, technology, infrastructure, or related external events. This risk includes legal risk and reputational risk.

For the Insurance Brokerage Firm, operational risk is related to the quality of the information in the systems, since an error in entering the information may lead to failed processing or renewal of individual insurance policies.

Information systems are being purchased, which implies a risk since the current information system process is not appropriate.

Capital management

Costa Rican banking legislation requires the financial conglomerate to maintain a capital surplus at all times (i.e. a ratio of one or higher obtained by dividing the sum of total transferable surpluses of each company in the conglomerate and the individual surplus of the controlling company by the absolute value of the sum of individual deficits).

The capital surplus or capital deficit of the financial group or conglomerate is calculated as the individual surplus or deficit of the controlling company plus the transferable surpluses and minus the individual deficits of each company in the financial group or conglomerate.

The individual surplus of each company in the financial conglomerate is calculated as the excess of the capital base over the respective minimum capital requirement for each type of company stipulated in the CONASSIF prudential standard.

(Continued)

BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

Regulatory capital is analyzed with consideration for the following three areas:

Tier I capital: ordinary and preferred paid-in capital plus reserves.

Tier II capital: calculated as the sum of equity adjustments revaluation of property up to a maximum of 75% of the balance of the corresponding equity account, unrealized gains on investments in available-for-sale financial instruments, non-capitalized contributions, prior period retained earnings, and profit or loss for the period, less statutory deductions.

Deductions: Investments in other companies and loans granted to the controlling entity of the same financial group or conglomerate are to be deducted from the sum of Tier I and Tier II capital.

Risk-weighted assets: Assets and contingent liabilities are weighted according to the risk level established by regulations plus a price risk adjustment per capital requirements.

The Bank's policy is to maintain a strong capital base so as to maintain a balance between share capital and return on investment. Throughout the year, the Bank has complied with capital requirements and no significant changes were made to its capital management.

As of December 31, 2017 and 2016, the Group's risk rating is at a normal level since its capital adequacy ratio is above the required 10% ratio.

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BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

(47) Contingencies

As of December 31, the Bank, Pension Fund Manager, and Investment Fund Manager are defendants in ordinary, labor, and criminal lawsuits, as follows:

	Number of cases		Phase	Total estimated amount	
	2017	2016		2017	2016
Bank	234	251	First instance	¢ 237,497,530,073	235,166,531,230
	21	19	Second instance	20,207,132,825	19,363,100,060
	7	3	Appeal	3,615,000,000	3,600,000,000
	1	1	Administrative proceedings (note 48)	38,458,424,266	38,458,424,266
	263	274		299,778,087,164	296,588,055,556
Pension Fund Manager	1	1	First instance	23,000,000	288,110,324
	1	1		23,000,000	288,110,324
Investment Fund Manager	1	1	First instance	177,391,648	109,558,263
	1	1		177,391,648	109,558,263
	265	276	Total estimated amount (note 22)	¢ 299,978,478,812	296,985,724,143

As of December 31, 2017 and 2016, the legal actions filed against the Bank are booked in memoranda accounts under “Other contingencies - pending litigation and lawsuits”.

As of December 31, 2017 and 2016, the Bank is a claimant in ordinary, labor, and criminal lawsuits for which the outcome is uncertain and are not booked in the accounting records, as follows:

Number of cases		Phase	Total estimated amount	
2017	2016		2017	2016
161	542	First instance	¢ 721,160,935,180	971,611,945,366
1	14	Second instance	375,839,600	21,284,650,067
-	6	Appeal	-	4,624,706,759
162	562		¢ 721,536,774,780	997,521,302,192

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Additionally, the Bank is a defendant in three lawsuits related to the payment of SEDI. The files for such proceedings are as follows: File No. 15-001477-0166-LA notified by the Labor Court of the Second Judicial Circuit of San José, at 11:25 hours of November 18, 2015, received on December 7, 2015; file No. 15-000780-0166-LA of the Labor Court of the Second Judicial Circuit of San José, at 13: 54 hours of March 29, 2016, received on April 15, 2016, and File No. 5-008666-1027-CA of the Administrative Court, at 10:45 hours of November 20, 2015, received on December 15, 2015.

As of December 31, 2017, the Bank does not book a provision for litigation because a reliable estimate for the proceedings has not been determined by the legal counsel and the probability of a loss is remote.

The following lawsuits can also be mentioned:

- File No. 14-003379-1027-CA
  - ✓ Statement of facts: The plaintiffs seek that the Bank be ordered to pay damages caused to all the plaintiffs and to pay compensation for pain and suffering caused due to the inability to acquire decent housing, as a result of apparent anomalies regarding the management of credits to Grupo Zion, S.A. to build the Bariloche Real condominium. Additionally, it has had media coverage.
  - ✓ Current status: In ruling issued at 14:46 hours of July 3, Nancy Rodríguez Cruz was appointed as expert witness, who must accept this position within a term of three days and issue the corresponding expert opinion within 15 business days.
- File No. 08-000388-0419-AG
  - ✓ Court: Agrarian Court of Corredores
  - ✓ Statement of facts: The proceedings seek to declare the liability of CORBANA, as Trustee of a banana plantation Management Trust, in which the Bank was the Trust Beneficiary.
  - ✓ Current status: An appeal was filed and is being discussed by the Agrarian Court of the Second Judicial Circuit of San José, Goicoechea. No judicial records exist for this case. It seems clear that, since the case relates to a contractual commercial liability, it has lapsed.

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Notes to the Consolidated Financial Statements

- File No. 08-000232-0419-AG
  - ✓ Court: Agrarian Court of Corredores
  - ✓ Statement of facts: This process was filed by the Bank against Surcoop R.L. It seeks to nullify the auction, awarding, and registration of lots of the Agrarian Court of Corredores processed through file No. 97-010656-1701 AG.
  - ✓ Current status: First instance ruling 56-2014 in favor of the Bank upheld the objection due to lack of legal grounds given that no damages caused by the defendants were demonstrated since there is no direct relationship between the factual substance of the complaint and the legal claims. No background exists regarding issues like this. A motion for appeal was filed and is under consideration by the Agrarian Court of the Second Judicial Circuit of San José, Goicoechea.
- File No. 08-001455-1027-CA
  - ✓ Court: Administrative Litigation Court and Civil Litigation Court of the Public Treasury
  - ✓ Statement of facts: External notaries that filed a lawsuit against the Bank due to the termination of their contracts for professional services, since they consider that their contracts were for indefinite terms and they had an acquired right.
  - ✓ Current status: The appeal for annulment filed by the Bank was admitted, and the judgment of first instance sentencing the Bank was revoked. A decision was made on the merits of the case, rejecting the lawsuit against the Bank in all respects.
- File No. 08-000382-0419-AG
  - ✓ Statement of facts: Lawsuit for breach of contract and fiduciary responsibility.
  - ✓ Current status: The plaintiff is filing an appeal.

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Notes to the Consolidated Financial Statements

(48) Significant events

a) Review by the Tax Authorities - 2010, 2011, 2012, and 2013

On May 21, 2014, the Bank was informed that the Tax Authorities would perform a review in respect of the 2010, 2011, 2012, and 2013 periods. Through Notice No. 1-10-015-14-077-011-03 and Notice No. 1-10-015-14-078-111-03 issued by the Large Taxpayer Administration, the Bank received the "Notification of the Start of the Tax Audit and Initial Information Requirements" for the 2012 and 2013 periods, which involved confirming the veracity of the tax returns filed.

Additionally, on June 27, 2014, the periods to be audited were extended to include 2010 and 2011 through the "Notification of the Extension to the Tax Audit and Initial Information Requirements" (Notice No. 1-10-015-14-025-012-03 and Notice No. 1-10-015-14-016-121-03).

On November 13, 2014, the National Large Taxpayer Audit Area issued "Proposed Sanctioning Ruling Based on Article 81 of the Tax Code of Standards and Procedures" for periods 2010-2013 No. 2-10-015-14-116-511-03 and No. 2-10-015-14-022-512-03, claiming that the income tax returns filed by the Bank for the indicated periods were inaccurate and, thus, detrimental to the treasury.

On November 27, 2014, the Bank's management issued Document No. SGRF-397-2014 presenting the technical and legal criteria that support its disagreement with the adjustments determined by the Large Taxpayer Administration, as a response to the "Provisional Regularization Proposal" and the "Proposed Sanctioning Ruling Based on Article 81 of the Tax Code of Standards and Procedures".

On December 11, 2014, the National Large Taxpayer Audit Area presented a report on the claims against the proposed sanctioning ruling for the mentioned periods, through documents No. 2-10-015-14-072-513-3 and No. 2-10-015-14-055-033-3, indicating for each period its valuation and whether it rules in favor of the Bank or partially admits the claims presented by the Bank.

On January 9, 2015, the National Large Taxpayer Audit Area issued document No. 1-10-015-14-091-341-03, "Regularization Proposal", detailing the required tax adjustments or corrections to the tax base included in the tax returns filed by the Bank for fiscal years 2010, 2011, 2012, and 2013. The total tax liability and interest amount to ₡29,089,100,723 and ₡9,036,647,719, respectively.

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BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

On January 16, 2015, the Bank presented Official Letter SGR-012-2015 expressing its disagreement with the "Regularization Proposal". Also, the Tax Authorities issued Notice No. 2-10-015-14-044-03 "Postponement of the Sanctioning Ruling", whereby the issue of the sanctioning ruling is suspended until the Tax Authorities present the supporting jeopardy assessment of taxes. Additionally, Notice No. 1-10-015-14-038-03 "Postponement of the Jeopardy Assessment of Taxes" suspends the assessment process until the Constitutional Chamber issues a decision on the appeal claiming violation of constitutional rights against Article 144 of the *Code of Tax Standards and Procedures* (CNPT) (File No. 14-011798-0007-CO).

On January 19, 2015, the National Large Taxpayer Audit Area issued Document No. SFGCN-020-15, notified to the Bank on January 21, 2015, whereby it maintained its decision and confirmed the actions taken, stating the following:

(...) In this regard, it is inadmissible in this procedural stage to resolve motions for dismissal or assess arguments concerning merits or the correction of errors since those claims were already examined and the reports on the claims filed against provisional regularization proposal No. 1-10-015-14-055-033-03 and on the claims filed against proposed sanctioning ruling No. 2-10-015-14-072-513-03 were already issued; therefore, this Audit Area has fully complied with the regulated process, and the claims filed by your company were already resolved in a timely manner, and were partially admitted.

Notification No. D.J. 176-2015 ref. 365 of the Legal Department, dated February 3, 2015, reads as follows:

Therefore, in response to the inquiries made, no legally-binding tax liability has been established for the Bank. For such purposes, an administrative act must be issued on the jeopardy assessment of taxes, which is subject to the decision of the Constitutional Chamber of the Supreme Court of Justice regarding the appeal against Article 144. If the appeal is dismissed by the Constitutional Chamber, the debt will become immediately applicable, final, and a present obligation, due to the issue of the jeopardy assessment of taxes.

On February 5, 2015, in response to Official Letter SFGCN-020-15, management of the Bank filed Note SGR-044-2015 before the Large Taxpayer Division claiming that it is defenseless since it does not know the arguments and additional evidence provided and this infringes the right to defend oneself.

On August 31, 2016, the Constitutional Chamber resolved the constitutional motion filed against Article 144 of the *Code of Tax Standards and Procedures* (CNPT), declaring unconstitutional Articles 144 and 192 of CNPT (Vote No. 12496-16).

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BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

- On October 12, 2016, the National Large Taxpayer Audit Area issued Notice of Deficiency and Observations No. 1-10-15-14-009-041-03, which details the tax payment in accordance with the tax base declared by the Bank for tax periods 2010, 2011, 2012, and 2013, assessing a tax liability in the amount of ¢29,089,100,723 and interest calculated as of that date in the amount of ¢9,369,323,543, for a total of ¢38,458,424,266.
- On November 28, 2016, the Bank filed before the Large Taxpayer Administration Official Letter GG-395-16 “Administrative Claim and Appeal for Annulment” against Notice of Deficiency and Observations No. 1-10-15-14-009-041-03, presenting the considerations of fact and of law and its claims.
- On March 28, 2017, the National Large Taxpayer Audit Area issued Determination Ruling DT10R-030-17 rejecting the annulment of the actions and rejecting the claim filed by the Bank against Notice of Deficiency and Observations No. 1-10-15-14-009-041-03, Regularization Proposal No. 1-10-015-14-091-341-03, and the official letter of the National Large Taxpayer Audit Area No. SFGCN 020-15. Additionally, taxes updated as of January 29, 2017 result in a tax liability of ¢29,089,100,723 and interest calculated as of that date in the amount of ¢10,453,749,273, for a total of ¢39,542,849,996.
- On April 19, 2017, the National Large Taxpayer Audit Area issues “Sanctioning Ruling Based on Article 81 of the Tax Code of Standards and Procedures” No. 2-10-15-14-5178-03 and No. 2-10-15-14-03-582-03, applying to the tax assessment in the amount of ¢29,089,100,723 the corresponding fines: 25% for 2010-2011 and 50% for 2012-2013, for a total of ¢11,286,519,808.
- On May 18, 2017, through file No. GC-02/10, management of the Bank filed an appeal for reversal against Ruling No. DT10R-030-17 before the Large Taxpayer Administration in accordance with Article 145 of the *Code of Tax Standards and Procedures* and in light of the considerations of fact and of law and claims filed, to admit the appeal and annul the aforementioned ruling, and accept the claims for annulment due to procedural defects and statute of limitations described in the aforementioned file and declare the annulment of the administrative-tax procedure and the statute of limitations of tax periods already closed to the tax audit.
- On May 23, 2017, through file No. 2-10-015-14 management of the Bank filed an appeal for reversal against Sanctioning Ruling No. 2-10-15-14-5178-03 and 2-10-15-14-03-582-03 to annul the sanction imposed to the Bank.
- On June 7, 2017, as a supplement to file No. GC-02/100, management presented the documentation required according to DTR-030-17 to be analyzed together with the arguments developed by the Bank.

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Notes to the Consolidated Financial Statements

On July 26, 2017, ruling AUR-066-17 of June 23, 2017 rejects the objection of statute of limitations on the motion for dismissal and motion for reconsideration against determination ruling DT-R-030-17 filed by the Bank on May 18, 2017.

On August 31, 2017, an appeal was filed before the Large Taxpayer Administration against sanctioning rulings No. 2-10-15-14-1-5178-03 and No. 2-10-15-14-03-582-03 dated April 5, 2017, notified to the Bank on April 19, 2017.

On November 10, 2017, an appeal is filed before the Tax Court against Ruling No. AU10R-066-17 (which was confirmed by Official Letter No. DT10R-030-17, both issued by the Large Taxpayer Administration) in accordance with file No. 1-10-050-14 (No. GC-02/10 in accordance with the final resolution).

b) Tax audit process – Costa Rican Tax Administration - 2014, 2015 and 2016

The Bank faces a new tax audit process by the Tax Authorities for the 2014, 2015, and 2016 tax periods. On August 14, 2017, through documents No. DGCN-SF-PD-18-2017-17-11-03 and No. DGCN-SF-PD-18-2017-18-111-03 issued by the National Large Taxpayer Administration, the Bank received the “Notification of the Start of the Tax Audit for Verification and Investigation and Initial Information and Documentation Requirements,” which involves confirming the veracity of the tax returns filed.

On November 15, 2017, the National Large Taxpayer Audit Area issued “Provisional Regularization Proposal” No. DGCN-SF-PD-18-2017-28-31-03 and “Proposed Sanctioning Ruling Based on Article 81 of the Tax Code of Standards and Procedures” No. DGCN-SF-PS-18-2017-20-31-03, for periods 2014-2016, claiming that the income tax returns filed by the Bank for the indicated periods were inaccurate and, thus, detrimental to the treasury.

On November 29, 2017, the Bank’s management presented the technical and legal criteria that support its disagreement with the adjustments determined by the Large Taxpayer Administration as a response to the “Provisional Regularization Proposal” and the “Proposed Sanctioning Ruling Based on Article 81 of the Tax Standards and Procedures Code”.

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c) Dividends paid to the Bank

As of December 31, dividends of the subsidiaries are as follows:

Subsidiary	Board of Directors' Agreement		Amount	
	2017	2016	2017	2016
BN Corredora de Seguros, S.A.	Article 4, Meeting No. 12,172 held on May 29, 2017	Article 4, Meeting No. 12,127 held on December 5, 2016	¢ 1,376,131,467	826,027,662
BN Sociedad Administradora de Fondos de Inversión, S.A.	Article 4, Meeting No. 12,171 held on May 29, 2017	Article 3, Meeting No. 12,120 held on November 21, 2016	1,000,000,000	1,000,000,000
BN Valores Puesto de Bolsa, S.A.	Article 2, Meeting No. 12,161 held on April 24, 2017	Article 2, Meeting No. 12,119 held on November 21, 2016	3,024,096,802	2,404,923,470
BN Vital Operadora de Planes de Pensiones Complementarias, S.A.	Article 2, Meeting No. 12,163 held on April 24, 2017	Article 2, Meeting No. 12,121 held on November 21, 2016	560,091,499	550,231,826
			¢ 5,960,319,768	4,781,182,958

(49) Transition to International Financial Reporting Standards (IFRSs)

Through various resolutions, CONASSIF agreed to partial adoption starting January 1, 2004 of IFRSs published by the International Accounting Standards Board (IASB).

In order to regulate application of those Standards, CONASSIF issued the terms of the *Accounting Regulations Applicable to Entities Regulated by SUGEF, SUGEVAL, SUPEN, and SUGESE and to Non-financial Issuers* (the Regulations) and approved a comprehensive revision of those Regulations on December 17, 2007.

On May 11, 2010, CONASSIF issued official letter C.N.S. 413-10 to revise the Regulations, whereby regulated entities adopted IFRSs and the corresponding Interpretations issued by the IASB in effect as of January 1, 2008, except for the special treatment indicated in Chapter II of the aforementioned Regulations.

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Notes to the Consolidated Financial Statements

Subsequently, through official letter C.N.S. 1034-08 dated April 4, 2013, CONASSIF published a number of amendments to SUGEF Directive 31-04 *Regulations on the Financial Reporting of Financial Entities, Groups, and Conglomerates* in respect of the presentation of annual financial statements, unaudited interim consolidated and separate financial statements prepared by the entity, and audited consolidated and separate financial statements. Also, CONASSIF amended SUGEF Directive 34-02 *Accounting Regulations Applicable to Entities Regulated by SUGEF, SUGEVAL, SUPEN, and SUGESE and to Non-financial Issuers* to adopt IFRSs in effect as of January 1, 2011, except for the special treatments indicated in Chapter II of the Regulations. These amendments are effective for annual reporting periods beginning on or after January 1, 2014.

When the regulations issued by CONASSIF differ from IFRSs, noncompliance with such IFRSs and the nature of the specific departure applicable to the entity must be disclosed for each reporting period.

Pursuant to the Regulations, adoption of new IFRSs or interpretations issued by the IASB, as well as any other revisions of IFRSs adopted will require the prior authorization of CONASSIF.

A summary of some of the main differences between the accounting regulations issued by CONASSIF and IFRSs, as well as the IFRSs or Interpretations of the International Financial Reporting Interpretations Committee (IFRICs) yet to be adopted, is presented below:

a) IAS 1: Presentation of Financial Statements

The presentation of financial statements required by CONASSIF differs in many respects from presentation under this Standard. Following are some of the most significant differences:

SUGEF regulations do not allow certain transactions, such as clearing house balances, gains or losses on the sale of financial instruments, gains or losses on foreign exchange differences, income taxes, etc. to be presented on a net basis. Given their nature, IFRSs require those balances to be presented net to prevent assets and liabilities or profit or loss from being overstated.

Interest receivable and payable is presented in the main asset or liability account rather than as other assets or other liabilities.

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BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

b) IAS 7: Statement of Cash Flows

CONASSIF has only authorized preparation of the cash flow statement using the indirect method. The direct method is also acceptable under this Standard. In addition, this Standard requires disclosure of the changes in the liabilities that arise from financing activities derived from cash flows as well as those that do not entail cash flows, for example exchange rate variations.

c) IAS 12: Income Taxes

SUGEF's Chart of Accounts presents deferred income tax assets, liabilities, income, and expenses separately. IAS 12 permits the presentation of assets and liabilities on a net basis if the taxes are levied on the same taxable entity. In accordance with this Standard, income or expenses must be presented on a net basis as part of total income tax.

d) IAS 16: Property, Plant and Equipment

The regulations issued by CONASSIF require the revaluation of property through appraisals made by independent appraisers at least once every five years, eliminating the option to carry these assets at cost or to revalue other types of assets.

Additionally, SUGEF has allowed certain regulated entities to convert (capitalize) revaluation surplus into share capital. This Standard only permits realization of revaluation surplus through the sale or depreciation of the asset. As a result of this treatment, regulated entities must recognize the effect of any impaired fixed assets in profit or loss, since the effect cannot be charged against equity. Under this Standard, impairment is charged to revaluation surplus and any difference is recognized in profit or loss. The amendments to SUGEF Directive 31-04 and SUGEF Directive 34-02 eliminate the option of capitalizing the surplus derived from revaluation of assets for financial statements as of December 31, 2014.

Moreover, under this Standard, depreciation continues on property, plant and equipment, even if the asset is idle. The regulation issued by CONASSIF allows entities to suspend the depreciation of idle assets and reclassify them as foreclosed assets.

e) IAS 18: Revenue

CONASSIF has allowed regulated financial entities to recognize loan fees and commissions collected prior to January 1, 2003 as revenue. Additionally, CONASSIF has permitted the deferral of 25%, 50%, and 100% of loan fees and commissions for transactions completed in 2003, 2004, and 2005, respectively. IAS 18 prescribes deferral of 100% of those fees and commissions over the loan term.

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Until December 31, 2013, CONASSIF allowed deferral of the net excess of loan fee and commission income minus expenses incurred for activities such as assessment of the borrower's financial position, evaluation and recognition of guarantees, sureties, or other collateral instruments, negotiation of the terms of the instrument, preparation and processing of documents, and settlement of the operation. IAS 18 does not allow deferral on a net basis of such income. Instead, it prescribes deferral of 100% of loan fee and commission income and permits the deferral of only certain incremental transaction costs, rather than all direct costs.

Accordingly, loan fee and commission income originating prior to December 31, 2013 may not be deferred in full. This treatment does not conform to IAS 18 and IAS 39. With the amendments to SUGEF Directive 31-04 and SUGEF Directive 34-02, CONASSIF adopted the accounting treatment prescribed by IAS 18 and IAS 39 for fees and commissions and transaction costs as of January 1, 2014. However, the following differences remain between the accounting regulations issued by CONASSIF and IAS 18 and IAS 39, as follows:

- CONASSIF requires that fee and commission income be recognized as a liability and booked under "Deferred income" (liability) and incremental direct costs be amortized in "Deferred charges" (asset). Under IAS 39, fees and commissions and incremental costs are part of the amortized cost of financial instruments, rather than separate assets and liabilities.
- CONASSIF requires that fee and commission income be deferred in "Other income" and costs be amortized in "Other expenses". Under IAS 18 and IAS 39, income and costs must be booked as part of "Finance income on financial instruments".
- Under SUGEF regulations, the effective interest rate must be calculated over the financial instrument's contractual life. Under IAS 39, the effective interest rate for financial instruments is calculated over their expected life (or over a shorter period, if appropriate).
- Under SUGEF regulations, in the event of issuance of a credit-related guarantee, deferred income and incremental costs pending deferral or amortization as of the issue date are not included in the instrument's amortized cost or the calculation of the foreclosed asset's carrying amount. As a result, upon issuance, fees and commissions pending deferral and costs pending amortization are booked in profit or loss for the year.

f) IAS 21: The Effects of Changes in Foreign Exchange Rates

CONASSIF requires that the financial statements of regulated entities be presented in colones as the functional currency.

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g) IAS 27: Consolidated and Separate Financial Statements

CONASSIF requires that the financial statements of a parent be presented separately, measuring its investments by the equity method. Under IAS 27, effective as of 2011 (replaced by IFRS 10, effective as of 2012), a parent is required to present consolidated financial statements. A parent need not present consolidated financial statements when the ultimate or any intermediate parent of the parent produces consolidated financial statements available for public use, provided certain other requirements are also met. However, IAS 27, effective as of 2011, requires that investments be accounted for at cost. With the amendments to IAS 27 effective starting 2014, in the preparation of separate financial statements investments in subsidiaries and associates can be measured at cost according to IFRS 9, or using the equity method described in IAS 28. However, the amendments to IAS 27 have not been adopted by CONASSIF.

In the case of financial groups, the holding company must consolidate the financial statements of all of the companies of the group in which it holds an ownership interest of twenty-five percent (25%) or more, irrespective of control. For such purposes, proportionate consolidation should not be used, except in the consolidation of investments in joint arrangements.

Amended IAS 27 (2008) requires accounting for changes in ownership interests in a subsidiary, while maintaining control, to be recognized as an equity transaction. When a Group loses control of a subsidiary, any ownership interest retained in the former subsidiary is to be measured at fair value with the gain or loss recognized in profit or loss. The amendments to this standard became mandatory for 2010 financial statements. These amendments have not been adopted by CONASSIF.

With the amendments to SUGEF Directive 31-04 and SUGEF Directive 34-02, savings and credit cooperatives and the Education Savings and Loan Association, as holding companies, are not required to consolidate the interim and annual audited financial statements of their investees, such as funeral homes and other entities not related to the financial and stock market sector, except for entities that own or manage the cooperatives' personal and real property, which must be consolidated.

h) IAS 28: Investments in Associates

CONASSIF requires consolidation of investments in companies in which an entity holds twenty-five percent (25%) or more ownership interest, irrespective of any considerations of control. Such treatment does not conform to IAS 27 and IAS 28.

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Notes to the Consolidated Financial Statements

i) Revised IAS 32: Financial Instruments - Presentation

The revised Standard provides new guidelines clarifying the classification of financial instruments as liabilities or equity (e.g. preferred shares). SUGEVAL determines whether issues fulfill the requirements of share capital.

j) Amendments to IAS 32: Financial Instruments - Presentation and IAS 1: Presentation of Financial Statements - Puttable Financial Instruments and Obligations Arising on Liquidation

The amendments to the Standards require puttable instruments and instruments that impose on the entity an obligation to deliver to another party a *pro rata* share of the net assets of the entity only on liquidation to be classified as equity if certain conditions are met. These amendments have not been adopted by CONASSIF.

k) IAS 37: Provisions, Contingent Liabilities and Contingent Assets

SUGEVAL prescribes recognition of a provision for possible losses on contingent assets. This type of provision is prohibited under IAS 37.

l) IAS 38: Intangible Assets

The commercial banks listed in Article 1 of IRNBS (Law No. 1644) may present organization and installation expenses as an asset in the balance sheet. However, those expenses must be fully amortized using the straight-line method over a maximum of five years. Also, under SUGEVAL regulations, intangible assets must be amortized over five years. This is not in accordance with IAS 38.

m) IAS 39: Financial Instruments: Recognition and Measurement

CONASSIF requires that the loan portfolio be classified pursuant to SUGEVAL Directive 1-05 and that the allowance for loan losses be determined based on that classification. It also allows excess allowances to be booked. Furthermore, on June 17, 2016, through Official Letter SGF-1729-2016, CONASSIF approved SUGEVAL Directive 19-16, "Regulations to Determine and Book Counter-cyclical Allowances", which requires entities supervised by SUGEVAL to book a general allowance for the loan portfolio with no current indications of impairment, in order to mitigate the effects of the economic cycle on the profit or loss derived from the allowance for the loan portfolio.

IAS 39 requires that the allowance for loan losses be determined based on a financial analysis of actual losses. This Standard also prohibits the booking of provisions for contingent accounts. Any excess allowance must be reversed in the income statement.

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Notes to the Consolidated Financial Statements

The revised Standard introduced changes with respect to classification of financial instruments, which have not been adopted by CONASSIF. Those changes include the following:

- The option of classifying loans and receivables as available for sale was established.
- Securities quoted in an active market may be classified as available for sale, held for trading, or held to maturity.
- The “fair value option” was established to designate any financial instrument to be measured at fair value through profit or loss, provided a series of requirements are met (e.g. the instrument has been measured at fair value since the original acquisition date).
- The category of loans and receivables was expanded to include purchased loans and receivables that are not quoted in an active market.

Regular purchases and sales of securities are to be recognized using settlement date accounting only.

Depending on the type of entity, financial assets are to be classified as follows:

a) Pooled portfolios

Investments in pooled investment funds, pension and mandatory retirement saving funds, similar trusts, and Demand Cash Management Accounts (OPABs) are to be classified as available for sale.

b) Own investments of regulated entities

Investments in financial instruments of regulated entities are to be classified as available for sale.

Own investments in open investment funds are to be classified as trading financial assets. Own investments in closed investment funds are to be classified as available for sale.

Entities regulated by SUGEVAL and SUGEF may classify other investments in financial instruments as trading instruments, provided there is an express statement of intent to trade them within 90 days from the acquisition date.

Banks regulated by SUGEF may not classify investments in financial instruments as held to maturity.

The above classifications do not necessarily adhere to the provisions of IAS 39.

The amendment to this Standard clarifies the existing principles that determine whether specific risks or portions of cash flows are eligible for designation in a hedging relationship. The amended Standard became mandatory for 2010 financial statements with retrospective application required. These amendments have not been adopted by CONASSIF.

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Notes to the Consolidated Financial Statements

n) IAS 40: Investment Property

This Standard allows entities to choose between the fair value model and the cost model to measure their investment property. The regulation issued by CONASSIF only allows entities to use the fair value model to measure this type of assets except in the cases for which no clear evidence is provided to determine their fair value.

o) Revised IFRS 3: Business Combinations

This Standard establishes that a business combination between entities under common control can be performed at cost or at fair value. CONASSIF only permits booking of these transactions measuring the assets and liabilities at fair value.

p) IFRS 5: Non-current Assets Held for Sale and Discontinued Operations

CONASSIF requires booking an allowance of one-twenty-fourth of the value of non-current assets classified as available for sale each month, so that if they are not sold within two years from acquisition, an allowance is recognized equivalent to 100% of the assets' carrying amount. IFRS 5 requires that these assets be recorded at the lower of the carrying amount or fair value less costs to sell, discounted to the present value of the assets that will be sold in periods greater than one year. Accordingly, assets could be understated, with excess allowances.

q) IFRS 9: Financial Instruments

This Standard replaces IAS 39, "*Financial Instruments: Recognition and Measurement*". IFRS 9 amends the classification and measurement requirements for financial instruments, including a new financial instrument impairment model based on the premise of providing for expected credit losses and the new guidelines on hedge accounting. IFRS 9 does not change the principles for financial instrument recognition and derecognition provided for under IAS 39. The Standard is effective for annual periods beginning on or after January 1, 2018. Early application is permitted. This Standard has not been adopted by CONASSIF.

r) IFRS 10: Consolidated Financial Statements

This Standard provides a revised control definition and application guidance therefor. This Standard supersedes IAS 27 (2008) and SIC 12, "*Consolidation - Special Purpose Entities*", and is applicable to all investees.

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Notes to the Consolidated Financial Statements

Early application is permitted. Entities that apply this Standard early must disclose that fact and simultaneously apply IFRS 11, IFRS 12, IAS 27 (as amended in 2011), and IAS 28 (as amended in 2011).

An entity is not required to make adjustments to the accounting for its involvement with an investee when entities that were previously consolidated or unconsolidated in accordance with IAS 27 (2008), SIC 12, and this Standard continue to be consolidated or continue not to be consolidated.

The Standard is effective for annual periods beginning on or after January 1, 2013. Early application is permitted. This Standard has not been adopted by CONASSIF.

s) IFRS 11: Joint Arrangements

This Standard was issued in May 2011 with an effective date of January 1, 2013. The Standard addresses the inconsistencies in the accounting for joint arrangements and requires a single accounting treatment for interests in jointly controlled entities. This Standard has not been adopted by CONASSIF.

t) IFRS 12: Disclosure of Interests in Other Entities

This Standard was issued in May 2011 with an effective date of January 1, 2013. This Standard requires an entity to disclose information that enables users of financial statements to evaluate the nature and financial effects of its ownership interests in other entities, including joint arrangements, associates, structured entities, and “off-balance-sheet” activities. This Standard has not been adopted by CONASSIF.

u) IFRS 13: Fair Value Measurement

This Standard clarifies the definition of fair value, establishes a single procedure for measuring fair value and defines the measurements and applications required or permitted in IFRSs. This Standard is effective for annual periods beginning on or after January 1, 2013. Early application is permitted. This Standard has not been adopted by CONASSIF.

v) IFRS 14: Regulatory Deferral Accounts

This Standard was approved in January 2014. It specifies the accounting policies for regulatory deferral account balances arising from a rate regulation. This Standard is effective for annual periods beginning on or after January 1, 2016. Early application is permitted. This Standard has not been adopted by CONASSIF.

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BANCO NACIONAL DE COSTA RICA AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

w) IFRS 15: Revenue from Contracts with Customers

This Standard was approved in May 2014. It provides a global framework for the recognition of revenue from contracts with customers and establishes the principles to report useful information to users of financial statements about the nature, amount, timing, and uncertainty of revenue and cash flows arising from a contract with a customer. This Standard replaces IAS 11, IAS 18, IFRS 13, IFRIC 13, IFRIC 15, IFRIC 18, and SIC 31. This Standard is effective for annual periods beginning on or after January 1, 2018. Early application is permitted. This Standard has not been adopted by CONASSIF.

x) IFRS 16: Leases

This Standard was approved in January 2016. It establishes the guidelines for recognition, measurement, presentation, and disclosure of leases. This Standard replaces IAS 17, IFRIC 4, SIC 15, and SIC 27. This Standard is effective for annual periods beginning on or after January 1, 2019. Early application is permitted for those entities that will perform the early adoption of IFRS 15. This Standard has not been adopted by CONASSIF.

y) IFRS 17: Insurance Contracts

This Standard was approved in March 2017. It establishes the guidelines for recognition, measurement, presentation, and disclosure of insurance contracts issued. It also requires similar principles to be applied by to reinsurance contracts held and investment contracts with discretionary participation features issued. The objective of IFRS 17 is to ensure that an entity provides relevant information that faithfully represents those contracts. This Standard replaces IFRS 4 Insurance Contracts. It is effective for annual periods beginning on or after January 1, 2021. Early application is permitted for those entities that will perform the early adoption of IFRS 9 and IFRS 15. This Standard has not been adopted by CONASSIF.

z) IFRIC 10: Interim Financial Reporting and Impairment

This Interpretation prohibits the reversal of an impairment loss recognized in a previous interim period in respect of goodwill. CONASSIF permits the reversal thereof.

aa) IFRIC 21: Levies

This Interpretation addresses the accounting of liabilities related to the payment of levies imposed by governments. This Interpretation is effective for annual periods beginning on or after January 1, 2014. Early application is permitted. This Interpretation has not been adopted by CONASSIF.

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Notes to the Consolidated Financial Statements

bb) IFRIC 22: Foreign currency transactions and advance considerations

The Interpretation covers foreign currency transactions (or a portion thereof) when an entity recognizes a non-monetary asset or non-monetary liability arising from the payment or receipt of advance consideration before the entity recognizes the related asset, expense or income (or the corresponding portion thereof). This Interpretation is effective for annual periods beginning on or after January 1, 2018, with early adoption permitted. IFRIC 22 has not been adopted by CONASSIF.

cc) IFRIC 23: Uncertainty over Income Tax Treatments

The Interpretation clarifies application of recognition and measurement requirements in IAS 12 Income Taxes when there is uncertainty over income tax treatments. In these circumstances, an entity shall recognize and measure its current or deferred tax assets or liabilities applying the requirements of IAS 12 on the taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates determined applying this Interpretation. This Interpretation is effective for annual periods beginning on or after January 1, 2019, with early adoption permitted. This Interpretation has not been adopted by CONASSIF.

(50) Disclosure of economic impact of departure from IFRSs

Since the basis of accounting used by the Bank's management described in note 1-b differs from IFRSs, discrepancies may arise related to certain account balances.

The Bank's management has chosen not to determine the economic impact of those differences since it considers such determination impractical.