Reasons to Authorize the Formation of a Horizontally Organized Group

The group of Austrian savings banks can look back on a long history, commencing with the formation of Erste österreichische Spar-Casse in 1819. Today, the group consists of Erste Group Bank AG, which is the sectoral central bank, of Erste Bank der oesterreichischen Sparkassen AG, of Zweite Sparkasse, and of the savings banks in the federal provinces.

In 2002, Erste Group Bank AG and most of the Austrian savings banks set up a **joint liability scheme** (*Haftungsverbund*). Meanwhile, Erste Group Bank AG is interconnected with all savings banks by virtue of liability agreements. The members of the joint-liability scheme relied on a more intensive and rapid implementation of the previous cooperation (uniform business and market policy, uniform market presence). In addition, an early-warning system was set up to identify economic difficulties of savings banks as early as possible, creating mutual liability of the banks as well as the obligation to provide professional and financial support within the group.

Over the course of time, that joint-liability scheme was extended in accordance with competition law, and cooperation between its members was simultaneously intensified. The joint liability company was granted far-reaching powers towards the members.

Thanks to the joint-liability scheme's early warning system, solutions are being devised in advance for vulnerable savings banks through the internal financial restructuring and participation measures. As a result, not a single savings bank had to rely on the deposit guarantee scheme to this very date.

Changes in banking regulations, expected to enter into force **as of 1 January 2013** in connection with **implementing the Basel III regulations in Austria,** have led to the proposal to reorganize the joint-liability scheme from a vertically organized group into a **horizontally organized group**.

At present, the members of the joint liability scheme and the subsidiaries of Erste Group Bank AG together form a uniform **banking group** for purposes of regulatory law. Erste Group Bank AG is required to maintain consolidated minimum capital requirements for that banking group. For that purpose, risk-weighted assets and off-balance sheet transactions are consolidated. Then, that consolidated risk-weighted assessment basis is compared with the group's consolidated own funds. Existing legislation allows for shares held by third parties in consolidated members of the group to be attributed to consolidated common equity. This applies also to shares held by third parties in the savings banks of the joint-liability scheme.

In the course of the implementation of the Basel III regulations - through the Capital Requirements Regulation (CRR) in the European Economic Area - according to information currently available, shares of third parties in consolidated members of the group are no longer fully eligible, because surplus capital attributable to those third parties (capital in excess of minimum own funds requirements) in consolidated members of the group can no longer be attributed to consolidated common equity Tier 1 capital. As a result, in view of the consolidation of the members of the joint-liability scheme, **Erste Group Bank AG** will lose about **EUR 1.5 bn of consolidated common equity Tier 1 capital compared to the status quo**, while being required at the same time to fully take into account the risk-weighted assets and off-balance sheet transactions without earning any revenues. Due to that asymmetrical treatment of own funds requirements against eligible own funds, the new banking regulations exert pressure on the group to adopt a structural change.

A **measure to avoid that loss of common equity would be to form a horizontally organized group**. For purposes of stock corporation law, a horizontally organized group is treated as a corporate group (*Konzern*); the intra-group exemption under cartel law would hence be safeguarded as before. For the purpose of accounting and banking regulations,

consolidation is presumably not mandatory for that horizontally organized group. That approach has the advantage of own funds requirements and eligible own funds again being treated symmetrically in the course of consolidation: Neither the risk-weighted assets and off-balance sheet transactions nor the savings banks' own funds need to be consolidated, thereby avoiding the above distortions. The joint-liability scheme is neutral to the consolidated ratio of common equity Tier 1 capital.

Within the scope of the savings banks' current joint liability scheme, Haftungsverbund GmbH may object to the proposed **appointment of new board members** for good cause relating to the relevant person's lack of suitability for the position. Furthermore, prior to its adoption by the supervisory board, the members of the joint-liability scheme shall obtain the consent of Haftungsverbund GmbH in respect of the **annual budget** (including investment plan and proposed capital measures). In addition, Haftungsverbund GmbH must approve the determination of new and changes in existing **principles of business policy and risk policy** of the members.

The approval rights referred to above are exercised by the **management** of **Haftungsverbund GmbH**. At present, Erste Group Bank AG may nominate two out of four managing directors of Haftungsverbund GmbH, including the chairman who has a casting vote (in case of a tie). By virtue of that casting vote, Erste Group Bank AG currently exercises a controlling influence over the decision-making process of Haftungsverbund GmbH and hence over the members of the joint-liability scheme.

A formation of and accession to a horizontally organized group from among the savings banks belonging to the joint-liability scheme **would not affect that structure**, yet Erste Group Bank AG would relinquish its casting vote in the management of Haftungsverbund GmbH and would no longer exercise **controlling influence**. Furthermore, Erste Group Bank AG would reduce its direct and indirect **participation** in Haftungsverbund GmbH from presently more than 50% **to just below 50%**.

The structural change entailed by forming a **horizontally organized group** has the following **advantages for the shareholders of Erste Group Bank AG**:

- it reduces pressure from the consolidated equity ratio for common equity Tier 1 capital;
- there is more flexibility in managing the equity ratio;
- the consolidated common equity Tier 1 capital will improve compared to maintaining the status quo under new conditions;
- the improvement of its equity ratio will allow Erste Group Bank AG to increase its business volume;
- the group's profitability will ultimately be increased.

As it is still uncertain whether the Basel III regulations will actually be implemented in the European Economic Area as currently proposed, the shareholders' meeting is invited to **authorize** the managing board, with the consent of the supervisory board, to accede to the horizontally organized group. The managing board will not exercise that authorization in case the regulations are implemented in any other manner which has no material adverse effect on the equity of Erste Group Bank AG. In that event, the current structure of the savings banks' joint liability scheme would be maintained.