Management report

ECONOMIC ENVIRONMENT

In 2018, the global economic developments were characterised by diverging monetary policies among the world's major central banks, trade disputes between the United States and its key trading partners, unresolved negotiations about the United Kingdom's withdrawal from the European Union, US sanctions against emerging countries such as Russia and Iran, and last but not least Italy's budget dispute with the European Union. Economic activity in advanced economies remained solid, with the United States outperforming both the euro zone and Japan. Although growth in Japan slightly decelerated in 2018, overall economic conditions remained favourable as the country benefitted from its lowest unemployment rate since the 1990s. Economic activity in emerging markets continued to show significant divergence across countries and regions. Growth in several emerging markets outside Asia, such as South Africa, Mexico, and Argentina fell short of expectation due to macroeconomic imbalances, domestic policy uncertainty and geopolitical developments. Argentina and Turkey were also impacted by currency turmoils and financial market weaknesses. By contrast, commodity exporting countries, like Russia, benefitted from higher average oil prices which boosted exports and improved current account balances and fiscal positions. China and India again outperformed other emerging markets due to their robust private consumption and firm investment activity. Within Europe, the Central and Eastern European (CEE) countries again outperformed the euro zone in terms of GDP growth, mainly driven by a robust domestic demand.

Among major central banks, policies continued to diverge. While the Swiss National Bank, the European Central Bank (ECB) and the Bank of Japan left key interest rates unchanged throughout the year, the Bank of England and the Federal Reserve (Fed) increased their key rates in by 0.25% and by 1.00%, respectively in 2018. Overall, global economic growth continued with 3.7%, in 2018.[1]

The United States' economy continued its good performance. Economic growth was significantly supported by an increased consumer and public spending and a strong labour market as well as the initial impact of personal income tax cuts. In addition, exports performed better than expected and also contributed to economic growth. Employment growth continued to strengthen, pushing the unemployment rate below 4%[2]. The budgetary impact of the fiscal stimulus, however, led to falling revenues and a deterioration in the fiscal position. Inflation increased mainly on the back of rising energy prices and higher wages which led to core inflation hitting the Fed's 2% target for the first time since 2012. Based on the strong economic performance, the Fed decided to raise its key rate in four steps by 100 basis points, to 2.50% during the year. Overall, the US economy grew by 2.9%[3] in 2018.

Economic growth in the euro zone slowed down after having grown at its fastest pace a year ago. This was mainly due to the weaker performance of exports which were impacted by the decline in global trade activity. In addition, several domestic factors such as strikes, extraordinary weather conditions, and higher tax burdens for consumers weighed on growth in some member states. Domestic demand and investment activity, on the other hand, remained supportive of growth. Despite the slower pace of economic growth, labour market conditions in the euro area continued to improve with employment having risen steadily throughout the year. Unemployment fell to the lowest level since 2008; however, it still varied substantially among the member states, with southern countries having significantly higher rates than those in the north. When looking at the bigger economies of the euro zone, Germany and Spain again outperformed France and Italy, and Italy's rising indebtedness led to a reduction of the country's credit ratings. The continued negotiations regarding the United Kingdom exiting the European Union did not significantly impact economic performance. The inflation rose slightly in the euro area, driven mainly by rising average energy prices. Despite higher wage growth, core inflation was rather muted throughout the year. The ECB maintained its expansionary monetary policy by keeping the base rate unchanged. In June 2018, the ECB announced to end its asset purchase programme by cutting its monthly asset purchases in half after September and phase them out entirely by the end of the year. Overall, similarly to the previous year, all euro zone member states saw growing economies in 2018 with an average real GDP growth of 1.8%[4].

The Austrian economy performed well with real GDP growth of 2.7%[5], the highest in seven years. With EUR 44,000 GDP per capita[6], Austria remained one of the most prosperous economies in the euro zone characterised by its well-educated workforce, stable institutional framework and strong international competitiveness. Economic growth was supported by all GDP components with domestic demand, particularly consumer spending, having been exceptionally strong. Growth in investment spending remained robust and exports to almost all important trade destinations accelerated significantly. In

[1] IMF: https://www.imf.org/en/Publications/WEO/Issues/2019/01/11/weo-update-january-2019 (Download on 20 February 2019)

[2] US Bureau of Labor Statistics: http://data.bls.gov/timeseries/LNS14000000 (Download am 26. Februar 2019)

[2] IMF: https://www.imf.org/en/Publications/WEO/Issues/2019/01/11/weo-update-january-2019 (Download on 20 February 2019)

[3] IMF: https://www.imf.org/en/Publications/WEO/Issues/2019/01/11/weo-update-january-2019 (Download on 20 February 2019)

[4] IMF: https://www.imf.org/en/Publications/WEO/Issues/2019/01/11/weo-update-january-2019 (Download on 20 February 2019)

[5] WIFO: https://www.wifo.ac.at/jart/prj3/wifo/resources/person_dokument/person_dokument.jart?publikationsid =61634&mime_type=application/pdf (Download on 20 February 2019)

[6] Statistik Austria: https://www.statistik.at/web_de/statistiken/wirtschaft/volkswirtschaftliche_gesamtrechnungen/ index.htmll (Download on 21 February 2019), adjusted for economic growth and inflation for 2018

addition, the traditionally strong service and tourism sectors continued to perform well. Austria also benefitted from the strong economic performance of Central and Eastern Europe. The favourable economic performance led to a significant decline of the unemployment rate, which dropped below 5%[7] for the first time since 2012. Average consumer prices remained well under control with an increase of the inflation rate of 2.0%[8.] The favourable economic performance led to a further improvement of the general government deficit to 0.3%[9]. Public debt as a percentage of GDP decreased further to 74.2%[10] (2017: 78.3%).

The economies of Central and Eastern Europe continued their robust performance and again outperformed the euro zone. Within the CEE countries, Poland, Hungary and the Czech Republic performed particularly well, and the rising convergence was demonstrated by a significant wage inflation across the region. Although investments and exports also contributed to growth, household consumption remained the main economic driver following higher wages and growing employment levels. In addition, European Union fund absorption rates improved further. The automobile industry, which was one of the main contributors to exports, again supported the Czech, Slovak, Romanian and Hungarian economies. Unemployment rates in the region declined further. The Czech Republic and Hungary were among the countries showing the lowest unemployment rates in the European Union. Although average consumer prices increased in most CEE countries, inflation remained well under control. CEE currencies remained relatively stable against the euro throughout the year. Among the region's central banks, policies continued to diverge. While the Czech Republic and Romania increased their key rates several times, other central banks kept the base rates at historic low levels. In addition, public deficits in the region remained low. While the underlying convergence trend continues, there are significant differences between the countries in the region. Standard & Poor's, for instance, rates the Czech Republic's long-term credit worthiness at AA- and that of Serbia at BB. Overall, CEE economies grew in 2018.

PERFORMANCE IN 2018

In the consolidated management report P&L data of 2018 is compared with data of 2017, balance sheet data as of 31 December 2018 is compared to data as of 31 December 2017.

[7] European Commission: https://ec.europa.eu/info/sites/info/files/economy-finance/2019_dbp_at_en.pdf, page 28, table 4 (Download on 21 February 2019)

[8] Statistik Austria: https://www.statistik.at/wcm/idc/idcplg?IdcService=GET_PDF_FILE&RevisionSelectionMethod=LatestReleased&dDocName=023344 (Download on 21 February 2019)

[9] European Commission: https://ec.europa.eu/info/sites/info/files/economy-finance/2019_dbp_at_en.pdf, page 29, table 6 (Download on 21 February 2019)

[10] European Commission: https://ec.europa.eu/info/sites/info/files/economy-finance/2019_dbp_at_en.pdf, page 28, table 4 (Download on 21 February 2019)

Acquisitions and disposals in Erste Group in 2018 did not have any significant impact and therefore had no effect on the rates of change stated below. Details are provided in the notes to the consolidated financial statements.

Overview

Net interest income increased – mainly in the Czech Republic and in Romania, but also in Austria – to EUR 4,582.0 million (EUR 4,353.2 million). **Net fee and commission income** rose to EUR 1,908.4 million (EUR 1,851.6 million), primarily on the back of significantly higher income from payment services and asset management Income from the securities business, from asset management and from brokerage was up substantially, while income from the lending business declined. While **net trading** result was down at EUR -1.7 million (EUR 222.8 million), the line item **gains/losses from financial instruments measured at fair value through profit or loss** improved to EUR 195.4 million (EUR -12.3 million). **Operating income** rose to EUR 6,915.6 million (EUR 6,669.0 million).

General administrative expenses were nearly stable at EUR 4,181.1 million (EUR 4,158.2 million). This was mostly attributable to the reduction of other administrative expenses to EUR 1,234.9 million (EUR 1,309.6 million). Payments to deposit insurance systems included in this line item amounted to EUR 88.6 million (EUR 82.8 million). This reduction almost fully compensated the rise in personnel expenses to EUR 2,474.2 million (EUR 2,388.6 million) and in depreciation and amortisation. Overall, the **operating result** improved to EUR 2,734.6 million (EUR 2,510.8 million). The **cost/income ratio** improved to 60.5% (62.4%).

Net impairment loss on financial assets amounted to EUR 59.3 million due to net releases on the back of improved asset quality or, adjusted for net allocation of provisions for commitments and guarantees given, -14 basis points of average gross customer loans (net allocations of EUR 132.0 million or 9 basis points). This was attributable to the substantial improvement in net allocations to risk provisions for the lending business across almost all segments, most notably in Croatia and Austria. The **NPL ratio** based on gross customer loans (see glossary for definition) improved again to 3.2% (4.0%). The **NPL cover ratio** (see glossary for definition) rose to 73.0% (68.8%).

Other operating result improved to EUR -304.5 million (EUR -457.4 million). It included expenses for the annual contributions to resolution funds in the amount of EUR 70.3 million (EUR 65.8 million). Banking and transaction taxes increased to EUR 112.2 million (EUR 105.7 million). Other taxes were positive at EUR 1.0 million (EUR -37.7 million) due to one-off effects. In the financial year 2017, other operating result had included EUR 45.0 million in provisions for losses from loans to consumers resulting from supreme court rulings regarding negative reference interest rates in Austria.

Taxes on income decreased significantly to EUR 332.4 million (EUR 410.1 million) as deferred tax assets were recognised, resulting in deferred tax income.

The minority charge increased to EUR 369.1 million (EUR 351.5 million). The **net result attributable to owners of the parent** rose to EUR 1,793.4 million (EUR 1.316.2 million).

Cash earnings per share (see glossary for definition) amounted to EUR 4.04 (reported EPS: EUR 4.02) versus EUR 2.96 (reported EPS: 2.94) in the previous year.

Cash return on equity (see glossary for definition), i.e. return on equity adjusted for non-cash expenses such as goodwill impairment and straight-line amortisation of customer relationships, stood at 13.5% (reported ROE: 13.4%) versus 10.2% (reported ROE: 10.1%) in the previous year.

Total assets were up at EUR 236.8 billion (EUR 220.7 billion). On the asset side, cash and cash balances decreased to EUR 17.5 billion (EUR 21.8 billion), while loans and advances to credit institutions increased to EUR 19.1 billion (EUR 9.1 billion). **Loans and advances to customers** rose to EUR 149.3 billion (EUR 139.5 billion). On the liability side, deposits from banks increased to EUR 17.7 billion (EUR 16.3 billion) and **customer deposits** grew again – in all core markets – to EUR 162.6 billion (EUR 151.0 billion). The **loan-to-deposit ratio** stood at 91.8% (92.4%).

The **common equity tier 1 ratio** (CET1, CRR; see glossary for definition) remained stable at 13.5% (13.4%), the **total capital ratio** (CRR; see glossary for definition) at 18.2% (18.5%).

Dividend

A dividend distribution of EUR 1.40 per share will be proposed at the annual general meeting (2017: EUR 1.20 per share).

Outlook

Erste Group targets a return on tangible equity (ROTE) of above 11% in 2019. The expected solid macro-economic development in the core markets Czech Republic, Slovakia, Hungary, Romania, Croatia, Serbia and Austria, compared to 2018 only moderately rising interest rate levels in several of our markets and still historically low risk costs should be supportive factors to achieve this target. On the other hand, a global or regional slowdown of economic growth as well as potential – and as yet unquantifiable – political or regulatory risks might jeopardize achieving the target.

In 2019, the positive development of the economy should be reflected in growth rates (real GDP growth) of around 3% in Erste Group's CEE core markets. All other economic parameters are currently expected to be similarly robust. Unemployment rates should remain at historic lows – in the Czech Republic and in Hungary they are already among the lowest in the EU. Inflation is forecast to remain broadly stable. Strong competitive positions should again lead to current account surpluses in most countries. The fiscal situation and public debt levels are also projected to remain sound. Austria should see continued dynamic economic growth at a rate of above 2%. Overall, growth continues to be driven by domestic demand across all economies. The contribution of exports is forecast as neutral.

Against this backdrop, Erste Group expects mid-single digit net loan growth. Net interest income should thus increase further in 2019. The second key income component, net fee and commission income, is also expected to rise moderately. As in 2018, some positive momentum should again come from fund management and payment services. The other income components are expected to remain stable, by and large, despite the volatility of the net trading and fair value results. Consequently, operating income should continue to grow in 2019. Operating expenses are expected to rise in 2019, albeit not to the same extent as operating income, mostly due to anticipated further wage increases in all core markets of Erste Group. However, Erste Group will continue to invest in digitalisation and thereby its future competitiveness in 2019. The focus will be on product simplification, process standardisation as well as the group-wide implementation and expansion of the digital platform George. The roll-out of George will continue in Hungary and Croatia in 2019. Overall, the operating result is projected to rise in 2019.

Risk costs should remain low in 2019. Amid a stable low interest rate environment, risk costs should go up only slightly. Further improvements in asset quality, however, should have a dampening effect. Overall, Erste Group does not expect a recurrence of the historically low risk cost level of 2018 of -14 basis points of average gross customer loans. While precise forecasts are difficult in the current environment, Erste Group projects for 2019 risk costs of 10 to 20 basis points of average gross customer loans.

The Romanian banking tax will have a negative impact on other operating result in 2019, even though the magnitude remains as yet unclear.

Assuming a tax rate of below 20% and a similar level of minority charges, Erste Group aims to achieve a return on tangible equity (ROTE) of above 11%.

Due to its limited presence in the United Kingdom, Erste Group does not anticipate any material impact from Brexit at the current time.

Potential risks to the guidance are interest rate trends that differ from expectations, political or regulatory measures targeting banks as well as geopolitical and global economic developments.

ANALYSIS OF PERFORMANCE

Net interest income

Net interest income rose to EUR 4,582.0 million (EUR 4,353.2 million). The marked increase in the Czech Republic was attributable to the rising interest rate environment and robust growth in lending to customers. A significant rise in net interest income was also posted in Romania driven by higher market interest rates and in Austria on the back of stronger loan growth. In all other core markets interest income was largely stable. As interest-bearing assets, not least because of the doubling of interbank assets, rose faster than net interest income, the net interest margin (net interest income as a percentage of average interest-bearing assets) narrowed to 2.27% (2.40%).

Net fee and commission income

Net fee and commission income increased to EUR 1,908.4 million (EUR 1,851.6 million). Solid rises were seen in Austria, specifically in income from payment services, asset management and lending. In Slovakia, income from brokerage commissions was increased significantly. There was also a solid rise in Hungary, while net fee and commission income was largely stable in all other markets.

Net trading result& gains/losses from financial instruments measured at fair value through profit or loss

Net trading result declined substantially to EUR -1.7 million (EUR 222.8 million), due mostly to negative contributions from securities and derivatives trading. On the other hand, gains/losses from financial instruments measured at fair value through profit or loss amounted to EUR 195.4 million (EUR 12.3 million) on the back of positive valuation effects.

General administrative expenses

General administrative expenses amounted to EUR 4,181.1 million (EUR 4,158.2 million). **Personnel expenses** increased – mainly in Austria – to EUR 2,474.2 million (EUR 2,388.6 million) while **other administrative expenses** were reduced to EUR 1,234.9 million (EUR 1,309.6 million). Contributions to deposit insurance funds increased to EUR 88.6 million (EUR 82.8 million) on the back of continued strong deposit growth. This development was particularly visible in Austria with expenses rising to EUR 51.2 million (EUR 48.7 million) while in all other core markets contributions were up to a lesser extent. **Depreciation and amortisation** increased to EUR 472.0 million (EUR 460.0 million).

Operating result

Operating income rose to EUR 6,915.6 million (EUR 6,669.0 million) on the back of improved net interest and net fee and commission income. General administrative expenses were nearly stable at EUR 4,181.1 million (EUR 4,158.2 million) as the reduction of other administrative expenses offset the increase in personnel expenses and higher depreciation and amortisation. The operating result improved to EUR 2,734.6 million (EUR 2,510.8 million). The cost/income ratio improved likewise to 60.5% (62.4%).

Gains/losses from derecognition of financial instruments not measured at fair value through profit or loss

Gains from derecognition of financial instruments not measured at fair value through profit or loss (net) amounted to EUR 5.7 million (EUR 156.4 million). This item includes primarily gains from the sale of securities in Austria and Croatia.

Impairment result from financial instruments

Due to net releases, the impairment result from financial instruments amounted to EUR 59.3 million (net allocations of EUR 132.0 million) or, adjusted for net allocation of provisions for commitments and guarantees given, -14 basis points (9 basis points) of average gross customer loans and thus remained at a historically benign level. This was mostly attributable to the improvement in net allocations to risk provisions for the lending business, which offset the decline in income received from the recovery of loans already written off. From 1 January 2018, this line item also reflects the balance of allocations/releases for commitments and guarantees given in the amount of EUR 6.6 million (previously shown in the line item other operating result).

Other operating result

Other operating result improved to EUR -304.5 million (EUR -457.4 million). **Levies on banking** activities rose to EUR 112.2 million (EUR 105.7 million). While levies payable in Austria were unchanged at EUR 23.0 million (EUR 23.0 million), banking tax in Slovakia rose to EUR 30.3 million (EUR 27.4 million). Hungarian banking tax amounted to EUR 13.5 million (EUR 12.8 million). Including financial transaction tax of EUR 45.4 million (EUR 42.4 million), bank levies in Hungary totalled EUR 58.9 million (EUR 55.3 million). Allocation/release of other provisions improved to EUR 13.3 million (EUR 133.7 million). In the comparative period, this line item had included EUR 45.0 million in provisions for losses from loans to consumers resulting from supreme court rulings regarding negative reference interest rates in Austria. In addition, other operating result also reflects the annual contributions to resolution funds in the amount of EUR 70.3 million (EUR 65.8 million). In Austria, contributions increased to EUR 36.7 million

(EUR 26.7 million), but declined in Romania to EUR 5.5 million (EUR 14.3 million).

Profit/loss for the year

The pre-tax result from continuing operations amounted to EUR 2,495.0 million (EUR 2,077.8 million). Taxes on income decreased significantly to EUR 332.4 million (EUR 410.1 million) as deferred tax assets were recognised, resulting in deferred tax income. The minority charge rose to EUR 369.1 million (EUR 351.5 million). The net result attributable to owners of the parent improved to EUR 1,793.4 million (EUR 1,316.2 million).

Tax situation

Pursuant to section 9 of the Austrian Corporate Tax Act ("KStG"), Erste Group Bank AG and its main domestic subsidiaries constitute a tax group. Due to the high proportion of tax-exempt income – particularly income from participating interests – and tax payments for the permanent establishments abroad, no Austrian corporate income tax was payable for the financial year 2018. The current tax loss carried forward increased in 2018.

Taxes on income are made up of current taxes on income calculated in each of the Group companies based on the results reported for tax purposes, corrections to taxes on income for previous years, and the change in deferred taxes. The reported total income tax expense amounted to EUR 332.4 million (EUR 410.1 million).

Balance sheet development

The decline in **cash and cash balances** to EUR 17.5 billion (EUR 21.8 billion) was primarily due to smaller cash balances held at central banks.

Trading and investment securities held in various categories of financial assets increased to EUR 43.9 billion (EUR 42.8 billion).

Loans and receivables to credit institutions (net), including demand deposits other than overnight deposits, increased primarily in the Czech Republic and in the Holding to EUR 19.1 billion (EUR 9.1 billion).

Loans and receivables to customers (net) rose – mainly in the Czech Republic, but also in Austria and Slovakia – to EUR 149.3 billion (EUR 139.5 billion) driven by retail and corporate loan growth.

Credit loss allowances for loans to customers declined to EUR 3.6 billion (EUR 4.0 billion), mostly due to continuing asset quality improvement.

Intangible assets remained unchanged at EUR 1.5 billion (EUR 1.5 billion).

Miscellaneous assets amounted to EUR 5.4 billion (EUR 5.9 billion).

Financial liabilities – held for trading decreased to EUR 2.5 billion (EUR 3.4 billion).

Deposits from banks, primarily term deposits and overnight deposits, rose to EUR 17.7 billion (EUR 16.3 billion); **deposits from customers** increased to EUR 162.6 billion (EUR 151.0 billion), due to strong growth in overnight deposits in all markets. The **loan-to-deposit ratio** stood at 91.8% (92.4%).

Debt securities in issue increased to EUR 29.7 billion (EUR 25.1 billion). **Miscellaneous liabilities** amounted to EUR 5.4 billion (EUR 6.5 billion).

Total assets grew to EUR 236.8 billion (EUR 220.7 billion). **Total equity** increased to EUR 18.9 billion (EUR 18.3 billion). Following two issuances in June 2016 and April 2017, this has included AT1 instruments in the amount of EUR 993 million. The transition to IFRS 9 as of 1 January 2018 resulted in a decline of Erste Group's total equity by EUR 0.7 billion due to the mandatory remeasurement of financial assets and the optional remeasurement of financial liabilities (own issues). After regulatory deductions and filtering according to the Capital Requirements Regulation (CRR) **common equity tier 1 capital** (CET1, CRR) rose to EUR 15.5 billion (EUR 14.7 billion). Total **own funds** (CRR) went up to EUR 20.9 billion (EUR 20.3 billion). Total risk **(risk-weighted assets)** including credit, market and operational risk, (CRR) increased to EUR 114.6 billion (EUR 110.0 billion).

Consolidated regulatory capital is calculated in accordance with CRR taking into consideration transitional provisions as defined in the Austrian CRR Supplementary Regulation and the Regulation (EU) 2016/445 of the European Central Bank on the exercise of options and discretions available in Union law. These transitional provisions define the percentages applicable to eligible capital instruments and regulatory deduction items as well as filters. The **total capital ratio** (CRR) total eligible qualifying capital in relation to total risk pursuant to CRR, was 18.2% (18.5%), well above the legal minimum requirement.

The **tier 1 ratio** (CRR) stood at 14.4% (14.0%), the **common equity tier 1 ratio** (CRR) at 13.5% (13.4%).

EVENTS AFTER BALANCE SHEET DATE

There were no significant events after the balance sheet date.

RISK MANAGEMENT

With respect to the explanations on substantial financial and non-financial risks at Erste Group as well as the goals and methods of risk management, we would like to draw the reader's attention to the information in Notes 54, 55 and 60 to the consolidated financial statements.

RESEARCH AND DEVELOPMENT

Erste Group does not engage in any research activities pursuant to section 243 (3) no. 3 UGB, but in 2018 development costs in the amount of EUR 61 million (EUR 139 million) were capitalised in connection with software developed in-house. In order to drive improvements for retail customers and in the ongoing services, Erste Group launched the Innovation Hub. Its purpose is to initiate and coordinate across-the-board initiatives with a strong focus on customer experiences. As a multi-disciplinary team consisting of marketing, product and IT as well as design experts, the Innovation Hub is tasked with creating innovations and managing new programme initiatives.

CAPITAL, SHARE, VOTING AND CONTROL RIGHTS

Additional disclosures pursuant to section 243a (1) UGB (Austrian Commercial Code)

With regard to the statutory disclosure requirements related to the composition of the capital as well as the class of shares, special reference is made to Note 46 in the consolidated financial statements.

As of 31 December 2017, together with its syndicate partners, DIE ERSTE oesterreichische Spar-Casse Privatstiftung (Privatstiftung), a foundation, controlled approximately 29.99% of the shares in Erste Group Bank AG and with 16.21% the most important shareholder. The Privatstiftung holds 6.49% of the shares directly, the indirect participation of the Privatstiftung amounts to 9.72% of the shares held by Sparkassen Beteiligungs GmbH & Co KG, which is an affiliated undertaking of the Privatstiftung. 0.78% is held directly by Austrian savings banks respectively saving banks foundations acting together with the Privatstiftung and affiliated with Erste Group Bank AG through the Haftungsverbund. 9.92% of the subscribed capital is controlled by the Privatstiftung on the basis of a shareholder agreement with Caixabank S.A. 3.08% are held by other partners to the shareholder agreement.

Furthermore, it should be noted that Erste Group Bank AG – just as nearly all Austrian savings banks – is a member of the Haftungsverbund of Sparkassengruppe. Sparkassengruppe sees itself as an association of independent, regionally established savings banks that strives to bolster its market position by strengthening common product development, harmonising its market presence and advertising concepts, pursuing a common risk policy, engaging in coordinated liquidity management and applying common controlling standards.

In addition, the purpose of this scheme is:

_ to identify any business issues of its member banks at an early stage and to provide effective assistance to its members in the resolution of business issues – this can range from offering technical assistance or giving guarantees to providing borrowed or qualifying capital and
_ to provide customers with a deposit guarantee system that goes beyond the legal deposit guarantee requirement (section 93 et seq. of the Austrian Banking Act (BWG)), which only guarantees certain types of customer deposits, by creating a suitable obligation to service the liabilities of other participating savings banks if the need arises.

Haftungsverbund GmbH is responsible for implementing such measures and analysing the business situation of every member bank of the Haftungsverbund. Overall, the participating savings banks hold a maximum stake of 49% (assuming all savings banks participate) in Haftungsverbund GmbH and Erste Group Bank AG always holds a minimum stake of 51%.

As required by the BWG, individual members of the Haftungsverbund may need to provide assistance to other members (by giving liquidity assistance, granting loans or guarantees and providing equity capital, for instance) and, in any other protection case (insolvency), to service the guaranteed customer deposits of a Haftungsverbund member. The scope of the individual services to be provided by individual Haftungsverbund members where needed is subject to an individual and general maximum limit. Any contributions made by Haftungsverbund members under the statutory deposit guarantee system pursuant to section 93 et seq. BWG are likewise counted. The corresponding amounts are determined by Haftungsgesellschaft and communicated to members liable for contributions.

In 2013, collaboration with savings banks was further strengthened by way of an additional agreement. The purpose of the agreement concluded in 2013 and effective as of 1 January 2014 is not only to broaden the regulatory options available to Erste Group Bank AG but also to ensure compliance with point 127 of Article 4 (1) CRR and Article 113 (7) CRR with a view to allowing recognition of minority interests at consolidated level in accordance with Article 84 (6) CRR. Savings banks that are party to the agreement concluded in 2013 also include Allgemeine Sparkasse Oberösterreich, which forms an institutional protection scheme as defined under Article 113 (7) CRR with the other members of the Haftungsverbund. Owing to the new legal and supervisory requirements, the maximum limits for support mechanisms of the individual members were raised and an ex ante fund was set up. Payments to the ex-ante fund are made on a quarterly basis over a period of 10 years. In the financial statements, the payments by the individual members are recognised as participations in IPS GesbR – which has been charged with managing the ex-ante fund. There was a shift in retained earnings from untied reserves to tied reserves. On the basis of the contractual provisions, these retained earnings represent a tied reserve. These tied retained earnings may be released only if the ex-ante fund is used due to a contingency. Internally, this reserve may therefore not be used to cover a loss and, at member level, it does not qualify as capital under the definition of CRR; on a consolidated level, however, the ex-ante fund qualifies as capital.

Additional disclosures pursuant to section 243a (1) UGB

All restrictions on voting rights or the transfer of shares, even if they are included in agreements between shareholders, insofar as they are known to the management board pursuant to section 243a (1) no. 2 UGB:

In shareholder agreements, the Privatstiftung agreed with its partners the following: Concerning the appointment of the members of the supervisory board, the partners are obliged to vote as required by the Privatstiftung. The partners can dispose of shares according to a predefined sale procedure and can purchase shares only within the quotas agreed with the Privatstiftung (of in total a maximum of 2% within 12 months); with this regulation an unwanted creeping-in according to the Takeover Act shall be prevented. In addition, the partners have committed themselves not to make a hostile takeover bid, nor to participate in a hostile takeover bid, nor to act together with a hostile bidder in any other way.

Under article 15.1 of the articles of association, for the duration of its assumption of liability for all current and future debts in the event of their default on payment, the Privatstiftung is entitled, pursuant to section 92 (9) of the Austrian Banking Act, to delegate up to one-third of the supervisory board members to be elected at the annual general meeting. Until now, the Privatstiftung has not exercised this right.

Article 15.4 of the Articles of Association concerning the appointment and dismissal of the supervisory board is not directly prescribed by statutory law: A three-quarters majority of valid votes cast and a three-quarters majority of the subscribed capital represented at the meeting considering the proposal are required to pass a motion for removal of supervisory board members.

The Articles of Association contain no restrictions in respect of voting rights or the transfer of shares. Article 19.9 of the Articles of Association concerning amendments to the Articles of Association contains a provision that is not prescribed directly by statutory law: Amendments to the Articles of Association, in so far as they do not alter the business purpose, may be passed by a simple majority of votes cast and a simple majority of the subscribed capital represented at the meeting considering the amendment. Where higher majority votes are required by individual provisions of the Articles of Association, these provisions can only be amended with the same higher majority vote. Moreover, amendments to Article 19.9 require a three-quarters majority of the votes cast and a three-quarters majority of the subscribed capital represented at the meeting considering the proposal.

Additional disclosures pursuant to section 243a (1) no. 7 UGB

Pursuant to the following provisions, members of the management board have the right to repurchase shares, where such a right is not prescribed by statutory law.

As per resolution of the annual general meeting of 17 May 2017:

_ The management board is entitled to purchase up to 10% of the subscribed capital in treasury shares for trading purposes according to section 65 (1) no. 7 Austrian Stock Corporation Act (AktG). However, the trading portfolio of these shares must not exceed 5% of the subscribed capital at the end of any calendar day. The consideration for the shares to be purchased must not be less than 50% of the closing price at the Vienna Stock Exchange on the last trading day prior to the purchase and must not exceed 20% of the closing price at the Vienna Stock Exchange on the last trading day prior to the purchase. This authorisation is valid for a period of 30 months, i.e. until 16 November 2019.
_ the Management Board is entitled, pursuant to section 65 (1) no. 8 as well as (1a) and (1b) Stock Exchange Act and for a period of 30 months from the date of the resolution, i.e. until 16 November 2019, to acquire own shares of up to 10% of the subscribed capital, subject to approval by the Supervisory Board, with the option of making repeated use of the 10% limit, either at the stock exchange or over the counter, likewise to the exclusion of the shareholders' right to tender proportional payment. The authorisation may be exercised in whole or in part or in several instalments and in pursuit of one or several purposes. The market price per share must not be below EUR 2.00 or above EUR 120.00. Pursuant to section 65 (1b) in conjunction with sec. 171 Stock Corporation Act, the Management Board is authorised, from the date of the resolution, i.e. until 16 May 2022, on approval by the Supervisory Board, to sell or use the company's own shares, also by means other than the stock exchange or a public offering for any purpose allowed by the law, particularly as consideration for the acquisition and financing of the acquisition of companies, businesses, business divisions or shares in one or several businesses in Austria or abroad to the exclusion of the shareholders' proportional purchase option. The authorisation may be exercised in whole or in part or in several instalments and in pursuit of one or several purposes. The Management Board

is authorised to redeem own shares subject to the Supervisory Board's approval without requiring the Annual General Meeting to adopt any further resolution.

The management board is authorised until 24 May 2023 and with the approval of the Supervisory Board, to issue convertible bonds (including conditional compulsory convertible bonds according to section 26 Austrian Banking Act (BWG)), which grant subscription or conversion rights to the acquisition of company shares, while paying due consideration or excluding the subscription right of shareholders. The terms of issue can also set out a conversion obligation at the end of the term or at another point in time in addition or instead of subscription or conversion rights. The issue of convertible bonds may only take place to the extent that guarantees the fulfilment of agreed conversion or subscription rights and, in the case of a conversion obligation set out in the conditions of issue, the fulfilment of the corresponding conversion obligations from the conditional capital increase. The issue amount, conditions or issue and the exclusion of shareholders' subscription rights are to be determined by the Management Board with consent of the Supervisory Board.

Concerning the authorised and conditional capital we refer to the information given in Note 46 to the consolidated financial statements.

All sales and purchases were carried out as authorised at the annual general meeting.

Significant agreements pursuant to section 243 a (1) no. 8 UGB

The following paragraphs list important agreements to which the company is party and which become effective, are amended or are rendered ineffective when there is a change in the control of the company as a result of a takeover bid, as well as their effects:

Agreement in principle of the Haftungsverbund

The agreement in principle of the Haftungsverbund provides for the possibility of early cancellation for good cause. Good cause allowing the respective other contracting parties to cancel the agreement is deemed to exist if

- one contracting party harms grossly the duties resulting from present agreement
- the ownership structure of a party to the contract changes in such a way – particularly by transfer or capital increase – that one or more third parties from outside the savings banks sector directly and/or indirectly gain a majority of the equity capital or voting rights in the contracting party or
- one contracting party resigns from the savings banks sector irrespective of the reason.

The Haftungsverbund agreement in principle and supplementary agreement expire if and as soon as any entity that is not a member of the savings bank sector association acquires more than 25% of the voting power or equity capital of Erste Group Bank AG in any manner whatsoever and a member savings bank notifies the Haftungsverbund steering company and Erste Group Bank AG by registered letter within 12 weeks from the change of control that it intends to withdraw from the Haftungsverbund.

Directors and officers insurance

Changes in controlling interests

In the event that any of the following transactions or processes occur during the term of the insurance policy (each constituting a "change of control") in respect of the insured party:

- the insured party ceases to exist as a result of merger or consolidation, unless the merger or consolidation occurs between two insured parties, or
- another company, person or group of companies or persons acting in concert who are not insured parties, acquire more than 50% of the insured party's outstanding equity or more than 50% of its voting power (giving rise to the right to control the voting power represented by the shares, and the right to appoint the management board members of the insured party), then the insurance cover under this policy remains in full force and effect for claims relating to unlawful acts committed or alleged to have been committed before this change in control took effect. However, no insurance cover is provided for claims relating to unlawful acts committed or allegedly committed after that time (unless the insured party and insurer agree otherwise). The premium for this insurance cover is deemed to be completely earned.

In the event that a subsidiary ceases to be a subsidiary during the insurance period, the insurance cover under this policy remains in full force and effect for that entity for the remainder of the insurance period or (if applicable) until the end of the extended discovery period but only in respect of claims brought against an insured party in relation to unlawful acts committed or alleged to have been committed by the insured party during the existence of this entity as a subsidiary. No insurance cover is provided for claims brought against an insured party in relation to unlawful acts committed or allegedly committed after this entity ceased to exist.

Cooperation between Erste Group Bank AG and Vienna Insurance Group ("VIG")

With respect to banking and insurance products, Erste Group Bank and Vienna Insurance Group AG Wiener Versicherung Gruppe ("VIG") are contractual partners of a general sales agreement regarding the sales cooperation between Erste Group Bank AG and VIG in Austria and CEE. The contract, which was originally entered into in 2008 (between Erste Bank der österreichischen Sparkassen AG and Vienna Insurance Group der WIENER STÄDTISCHE Versicherung AG), was renewed and extended in 2018 until the end of 2033. The objective of the renewal and extension was the modification of the agreement to fit the company restructurings of the original parties, the change to several business parameters and the adaptation of the agreement to the legal framework. The parties already determined in the first agreement that each party had the right to terminate the agreement in the case of a takeover. Regarding Erste Group Bank, a takeover is deemed to occur if 50% plus one share of voting capital of Erste Group Bank AG is acquired by a third party (except DIE ERSTE oesterreichische Spar-Casse Privatstiftung or the Austrian savings banks). Regarding VIG, a takeover is deemed to occur if 50% plus one share of voting capital of VIG is acquired by a third party (except Wiener Städtische Wechselseitiger Versicherungsverein Vermögens-verwaltung - Vienna Insurance Group). Aside from this contract termination agreement, upon extension of this contract the parties agreed upon an additional termination for good cause if the continuation of the contract is no longer reasonable for one or both parties based upon new statutory or regulatory requirements.

Furthermore, Erste Group Bank AG and VIG are parties to an Asset Management Agreement, pursuant to which Erste Group Bank AG undertakes to manage certain parts of VIG's and its group companies' securities assets. In case of a change of control (as defined above), each party has a termination right. The Asset Management Agreement was extended until 2033 at the same time as the renewal of the aforementioned contract.

INTERNAL CONTROL AND RISK MANAGEMENT SYSTEM FOR THE GROUP FINANCIAL REPORTING PROCEDURES

Control environment

The management board is responsible for the establishment, structure and application of an appropriate internal control and risk management system that meets the company's needs in its group accounting procedures.

The management in each group unit is responsible for implementing group-wide instructions. Compliance with group rules is monitored as part of the audits performed by internal and local auditors.

Consolidated financial statements are prepared by the Group Consolidation department. The assignment of powers, the process description and the necessary control procedure are defined in the operating instructions.

Risks relating to the financial reporting procedures

The main risk in the financial reporting procedures is that errors or deliberate action (fraud) prevent facts from adequately reflecting the company's financial position and performance. This is the case whenever the data provided in the financial statements and notes is essentially inconsistent with the correct figures, i.e. whenever, alone or in aggregate, they are apt to influence the decisions made by the users of financial statements. Such a decision may incur serious damage, such as financial loss, the imposition of sanctions by the banking supervisor or reputational harm.

Furthermore, especially estimates for the determination of the fair value of financial instruments for which no reliable market value is available, estimates for the accounting of risk provisions for loans and advances and for provisions, complex measurement requirements for accounting as well as a difficult business environment bear the risk of significant financial reporting errors.

Controls

Group Accounting and Group Performance Management are responsible for group reporting and report to Erste Group's CFO. Erste Group issues group policies used for preparation of consolidated financial statements in accordance with IFRS. A summary description of the accounting process is provided in Erste Group's IFRS Accounting Manual. All transactions have to be recorded, posted and accounted for in accordance with the accounting and measurement methods set out in this manual. The management of each subsidiary is responsible for the implementation of group policies.

The basic components of the internal control system (ICS) at Erste Group are:

_ Controlling as a permanent financial/business analysis (e.g. comparison of target and actual data between Accounting and Controlling) and control of the company and/or individual corporate divisions.
_ Systemic, automatic control systems and measures in the formal procedure and structure, e.g. programmed controls during data processing.
_ Principles of functional separation and checks performed by a second person (the four-eye principle).
_ Internal Audit – as a separate organisational unit – is charged with monitoring all corporate divisions in an independent yet proximate manner, particularly with regard to the effectiveness of the components of the internal control system. The Internal Audit unit is monitored and/or checked by the management board, the audit committee/supervisory board, by external parties (bank supervisor, in individual cases also by an external auditor) as well as through audit's internal quality assurance measures (self-assessments, peer reviews).

Group Consolidation

The data provided by the group entities is checked for plausibility by the Group Consolidation department. The subsequent consolidation steps are then performed using the consolidation system (TAGETIK). These include consolidation of capital, expense and income consolidation, and debt consolidation. Lastly, possible intragroup gains are eliminated.

At the end of the consolidation process, the notes to the financial statements are prepared in accordance with IFRS, BWG and UGB.

The consolidated financial statements and the group management report are reviewed by the audit committee of the supervisory board and are also presented to the supervisory board for approval. They are published as part of the annual report, on Erste Group's website and in the Official Journal of Wiener Zeitung and finally filed with the Commercial Register.

Information and communication

Each year, the annual report shows the consolidated results in the form of a complete set of consolidated financial statements. In addition, the management summary provides verbal comments on the consolidated results in accordance with the statutory requirements.

Throughout the year, the group produces consolidated monthly reports for group management. Statutory interim reports are produced that conform to the provisions of IAS 34 and are also published quarterly in accordance with the Austrian Stock Corporation Act. Before publication, the consolidated financial statements are presented to senior managers and the Chief Financial Officer for final approval and then submitted to the supervisory board's audit committee.

Reporting is almost fully automated, based on source systems and automated interfaces, and guarantees up-to-date data for controlling, segment reporting and other analyses. Accounting information is derived from the same data source and is reconciled monthly for reporting purposes. Close collaboration between accounting and controlling permits continual target/actual comparisons for control and reconciliation purposes. Monthly and quarterly reports to the management board and the supervisory board ensure a regular flow of financial information and monitoring of the internal control system.

Responsibilities of Internal Audit

Internal Audit is in charge of auditing and evaluating all areas of the bank based on risk-oriented audit areas (according to the annual audit plan as approved by the management board and reported to the audit committee). The main focus of audit reviews is to monitor the completeness and functionality of the internal control system. Internal Audit has the duty of reporting its findings to the group's management board, supervisory board and audit committee several times within one year.
According to section 42 BWG, Internal Audit is a control body that is directly subordinate to the management board. Its sole purpose is to comprehensively verify the lawfulness, propriety and expediency of the banking business and banking operation on an on-going basis. The mandate of Internal Audit is therefore to support the management board in its efforts to secure the bank's assets and promote economic and operational performance and thus in the management board's pursuit of its business and operating policy. The activities of Internal Audit are governed in particular by the currently applicable Rules of Procedure, which were drawn up under the authority of all management board members and approved as well as implemented by them. The Rules of Procedure are reviewed on a regular basis and whenever required and adapted should the need arise.

Audit activities of Internal Audit

In its auditing activities, Internal Audit puts a special focus on:
- Operating and business areas of the bank;
- Operating and business processes of the bank;
- Internal bank standards (policies, guidelines, operating instructions), also with regard to their compliance and up-to-dateness;
- Audit areas stipulated by the law as they inter alia result from the rules of the Austrian Banking Act (BWG) and the Capital Requirements Regulation (CRR).

Internal Audit performs its responsibilities based on its own discretion and in compliance with the annual audit plan as approved by the management board. Once approved, the audit plan is also reported to the audit committee.

CORPORATE GOVERNANCE

The (consolidated) corporate governance report is part of the annual report of Erste Group (www.erstegroup.com/investor-relations).

(CONSOLIDATED) NON-FINANCIAL DECLARATION

Erste Group decided to prepare and publish a separate non-financial report – integrated in the annual report – in line with an option provided for in the Austrian Sustainability and Diversity Improvement Act (NaDiVeG).

Management board	
Andreas Treichl mp, Chairman	**Peter Bosek mp, Member**
Petr Brávek mp, Member	**Willibald Cernko mp, Member**
Gernot Mittendorfer mp, Member	**Jozef Síkela mp, Member**

Vienna, 28 February 2019