# Management report

## ECONOMIC ENVIRONMENT

In 2019, global economic growth decelerated to its slowest pace for more than a decade. Rising trade and geopolitical tensions increased uncertainty and adversely affected business confidence, investment decisions and global trade. Consequently, manufacturing activity weakened substantially. Private consumption, on the other hand, remained resilient and was supported by employment creation and higher wages. In advanced economies, GDP growth slowed down, with the United States outperforming both Japan and the euro zone. Economic performance in the euro zone was particularly impacted by weaker exports. In Japan, strong private consumption and public spending outweighed the weaker export performance. Among emerging and developing regions, China and India, the world's two most populated countries, continued to grow significantly with GDP reaching approx. 6.1%[1] and 4.8%[2], respectively. Declining commodity prices throughout the year impacted the development of Russia and Brazil, both countries grew at a significantly slower pace than in 2018. Central and Eastern Europe was again among the best performing regions of global economy. Most CEE countries, in particular Hungary and Poland, experienced very solid growth rates on the back of resilient domestic demand and rising wages. Overall, global economic growth stood at 2.9%[3].

Among major central banks monetary policies continued to diverge. To stimulate economic activity the US Federal Reserve (Fed) cut its key rate to 1.75%. The European Central Bank (ECB), the Bank of Japan, and the Swiss National Bank left their key interest rates unchanged throughout the year, the ECB at 0%, the Bank of Japan at -0.10% and the Swiss National Bank at -0.75%.

The United States' economy continued its solid economic performance. GDP growth, however, slowed down as business investment weakened against the backdrop of intensifying US-China trade tensions. Robust consumer spending was a stabilising factor for the economy. The labour market was again characterised by rising employment rates. The unemployment rate declined further to 3.5%[4] at year-end 2019. Both public spending and tax cuts supported economic growth, albeit at a lesser extent than 2018. Inflation declined and fell below the 2% target set by the Fed. In 2019, the budget deficit widened due to lower taxes and increased public spending. To reduce negative implications from the global economic slowdown on the US economy and also due to muted inflation pressure, the Fed decided to lower its key rate in three steps by a total of 75 basis points to 1.75%. Overall, the US economy grew by 2.3%[5].

At 1.2%[6], economic growth in the euro zone was weaker than that of other advanced regions of the world, mainly due to a decline in exports. Domestic demand stayed firm. Germany (particularly its manufacturing sector) and Italy weighed on growth, while France and Spain reported a solid performance. The growth momentum of consumer spending remained stable. The Brexit-related uncertainty did not significantly impact the economic performance in 2019. After more than three years of negotiations and two general elections the United Kingdom left the European Union at the end of January 2020. The ECB maintained its expansionary monetary policy. It kept the base rate unchanged, cut the interest rate on the deposit facility further by 10 basis points to -0.50% and restarted in November its asset purchase programme at a monthly volume of up to EUR 20 billion. The ECB also introduced a new series of longer-term refinancing operations (TLTRO III) to preserve bank lending conditions and further support the accommodative stance of monetary policy.

After posting solid GDP growth in the past two years, the Austrian economy slowed down in 2019. Domestic demand, especially consumer spending continued to be the main driver of growth, while manufacturing and investments declined. Exports also declined after the particularly strong development in 2018. The performance of the construction sector was again solid. In addition, the traditionally strong service and tourism sectors continued to perform well. Austria benefitted from the solid economic performance of Central and Eastern Europe. The average unemployment rate dropped further to a multiple year low of 4.5%[7]. Average consumer prices remained well under control, with an inflation rate of 1.5%[8]. The general government surplus stood at 0.3%[9]. Public debt as a percentage of GDP significantly decreased to 69.6%[10]. Overall, real GDP growth stood at 1.6%[11], with GDP per capita rising to EUR 45,000[12].

The economies of Central and Eastern Europe continued their robust performance and again outperformed the euro zone. Household consumption remained the main driver supported by higher wages and growing employment levels. Within the CEE countries, Poland, Hungary and the Czech Republic performed particularly well. The automotive industry, which was one of the

[1] IMF: https://www.imf.org/en/Publications/WEO/Issues/2020/01/20/weo-update-january2020 (Download on 19 February 2020)

[2] IMF: https://www.imf.org/en/Publications/WEO/Issues/2020/01/20/weo-update-january2020 (Download on 19 February 2020)

[3] IMF: https://www.imf.org/en/Publications/WEO/Issues/2020/01/20/weo-update-january2020 (Download on 19 February 2020)

[4] US Bureau of Labor Statistics: https://data.bls.gov/timeseries/LNS14000000 (Download on 19 February 2020)

[5] IMF: https://www.imf.org/en/Publications/WEO/Issues/2020/01/20/weo-update-january2020 (Download on 19 February 2020)

[6] IMF: https://www.imf.org/en/Publications/WEO/Issues/2020/01/20/weo-update-january2020 (Download on 19 February 2020)

[7] Statistik Austria: http://www.statistik.at/web_de/statistiken/menschen_und_gesellschaft/arbeitsmarkt/arbeitslose_arbeitssuchende/arbeitslose_int_definitionen_ms/055370.html (Download on 19 February 2020)

[8] Statistik Austria: http://www.statistik.at/web_de/statistiken/wirtschaft/preise/verbraucherpreisindex_vpi_hvpi/022835.html (Download am 19. Februar 2020)

[9] European Commission: https://ec.europa.eu/economy_finance/forecasts/2019/autumn/ecfin_forecast_autumn_2019_at_en.pdf (Download on 19 February 2020), adjusted for expected development until year-end 2019

[10] European Commission: https://ec.europa.eu/economy_finance/forecasts/2019/autumn/ecfin_forecast_autumn_2019_at_en.pdf (Download on 19 February 2020), adjusted for expected development until year-end 2019

[11] WIFO: https://www.wifo.ac.at/jart/prj3/wifo/resources/person_dokument/person_dokument.jart?publikationsid=65634&mime_type=application/pdf (Download on 19 February 2020)

[12] Statistik Austria: https://www.statistik.at/web_de/statistiken/wirtschaft/volkswirtschaftliche_gesamtrechnungen/index.html (Download on 19 February 2020), adjusted for economic growth and inflation for 2019

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 inflation rates rose towards the upper bounds of the central banks' targets in most of the CEE economies, the average increase of inflation was rather moderate. CEE currencies remained on average fairly stable against the euro throughout the year. Among the region's central banks, policies varied in 2019 with the Czech National Bank further increasing its key rate while the Serbian National Bank cut its policy rate. Public deficits in the region remained low. The favourable economic performance was also recognised by the rating agencies which upgraded the Czech, Hungarian, Croatian and Serbian credit ratings during the year. Overall, CEE economies grew in 2019 between 4.9%[13] in Hungary and 2.3%[14] in Slovakia.

## PERFORMANCE IN 2019

P&L data of 2019 is compared with data of 2018, balance sheet data as of 31 December 2019 is compared to data as of 31 December 2018.

### Overview

**Net interest income** increased – mainly in the Czech Republic, but also in Romania and Hungary – to EUR 4,746.8 million (+3.6%; EUR 4,582.0 million). **Net fee and commission income** rose to EUR 2,000.1 million (+4.8%; EUR 1,908.4 million), driven mainly by higher payment fees, insurance brokerage fees and asset management fees. While **net trading result** improved significantly to EUR 318.3 million (EUR -1.7 million), the line item **gains/losses from financial instruments measured at fair value through profit or loss** declined to EUR -24.5 million (EUR 195.4 million). The development of both line items was driven by valuation effects due to market interest rate volatility. **Operating income** increased to EUR 7,255.9 million (+4.9%; EUR 6,915.6 million). The increase in **general administrative expenses** to EUR 4,283.3 million (+2.4%; EUR 4,181.1 million) was mainly attributable to a rise in personnel expenses to EUR 2,537.1 million (+2.5%; EUR 2,474.2 million). Payments to deposit insurance systems included in other administrative expenses rose to EUR 104.8 million (EUR 88.6 million). The increase in amortisation and depreciation to EUR 541.0 million (EUR 472.0 million) is attributable to the first-time application of the new financial reporting standard for leases (IFRS 16) as of 1 January 2019, while a corresponding positive effect was recorded in other administrative expenses. Overall, the **operating result** increased to EUR 2,972.7 million (+8.7%; EUR 2,734.6 million) and the **cost/income ratio** improved to 59.0% (60.5%).

Due to net allocations in Austria and Slovakia in both the retail and the corporate segments, the **impairment result from financial instruments** amounted to EUR -39.2 million or, adjusted for net allocations to provisions for commitments and guarantees given, 7 basis points of average gross customer loans (net releases of EUR 59.3 million or -3 basis points). Positive effects came from substantial income from the recovery of loans already written off, primarily in the Czech Republic, Hungary and Romania, as well as from releases of provisions for commitments and guarantees given in Austria, the Czech Republic and Romania.

The **NPL ratio** based on gross customer loans improved again to 2.5% (3.2%), the **NPL coverage ratio** to 77.1% (73.4%).

**Other operating result** amounted to EUR -628.2 million (EUR -304.5 million). The deterioration is attributable to a provision in the amount of EUR 153.3 million set aside for losses expected from a supreme court decision concerning the business activities of a Romanian subsidiary as well as goodwill impairment in Slovakia in the amount of EUR 165.0 million. The expenses for the annual contributions to resolution funds included in this line item rose – in particular in the Czech Republic – to EUR 75.3 million (EUR 70.3 million). Levies on banking activities increased to EUR 128.0 million (EUR 112.2 million), including a EUR 11.0 million banking tax payable in Romania for the first time in the reporting year.

The minority charge rose due to significantly better results from the savings banks to EUR 440.9 million (EUR 369.1 million). The **net result attributable to owners of the parent** declined to EUR 1,470.1 million (-18.0%; EUR 1,793.4 million) due to the one-off effects.

**Cash earnings per share** (see glossary for definition) amounted to EUR 3.25 (reported EPS: EUR 3.23) versus EUR 4.04 (reported EPS: 4.02) 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 10.1% (reported ROE: 10.1%) versus 13.5% (reported ROE: 13.4%) in the previous year.

**Total assets** rose to EUR 245.7 billion (EUR 236.8 billion). On the asset side, cash and cash balances decreased substantially to EUR 10.7 billion (EUR 17.5 billion), while loans and advances to credit institutions increased to EUR 23.1 billion (EUR 19.1 billion). On the back of continuing loan growth in all core markets, **loans and advances to customers** rose to EUR 160.3 billion (+7.3%; EUR 149.3 billion).

[13] Központi Statisztikai Hivatal: https://www.ksh.hu/docs/hun/xftp/gyor/gde/gde1912.html (Download on 19 February 2020)

[14] Štatistický úrad Slovenskej republiky: http://statdat.statistics.sk/cognosext/cgi-bin/cognos.cgi?b_action=cognosViewer&ui.action=run&ui.object=storeID(%22iC20449D1FEFE41C0B10E2AC7A4F5A4E4%22)&ui.name=Flash%20estimate%20of%20GDP%20and%20Total%20employment%20according%20to%20ESA%2095%20%5bnu0001qs%5d&run.outputFormat=&run.prompt=true&cv.header=false&ui.backURL=%2fcognosext%2fcps4%2fportlets%2fcommon%2fclose.html&run.outputLocale=en (Download on 19 February 2020)

On the liability side, deposits from banks declined to EUR 13.1 billion (EUR 17.7 billion) while **customer deposits** increased again markedly – across all Erste Group markets – to EUR 173.8 billion (+6.9%; EUR 162.6 billion). **The loan-to-deposit ratio** stood at 92.2% (91.8%).

The **common equity tier 1 ratio** (CET 1, CRR final, see glossary for definition) stood at 13.7% (13.5%), the **total capital ratio** (see glossary for definition) at 18.5% (18.1%).

### Dividend

A dividend distribution of EUR 1.50 per share will be proposed at the annual general meeting (2018: EUR 1.40 per share).

### Outlook

Erste Group targets a return on tangible equity (ROTE) of above 10% in 2020. The expected positive, albeit moderating, macroeconomic development in the core markets Czech Republic, Slovakia, Hungary, Romania, Croatia, Serbia and Austria as well as an improvement in other operating result that was negatively impacted by one-off effects in 2019 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 2020, the positive development of the economy should be reflected in growth rates (real GDP growth) of 2% to 4% 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 1.3%. 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. Despite negative interest rates in the euro zone but supported by moderately increasing short term market rates in Czech Republic and Hungary net interest income should thus increase further in 2020. The second key income component, net fee and commission income, is also expected to rise. As in 2019, some positive momentum should again come from asset management, insurance brokerage and payment services. Most of the other income components are expected to remain stable, by and large. Considering the good performance in 2019, net trading and fair value results are expected to be lower. Overall, operating income should continue to grow in 2020. Operating expenses are expected to rise in 2020, partly due to anticipated further wage increases in all core markets of Erste Group. However, Erste Group will continue to invest in IT and thereby its future competitiveness in 2020. The focus will be on progressive IT modernisation, back office digitalisation 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 2020. Positive jaws is the ambition for 2020, even though it will be tougher to achieve than in 2019 as revenue pressures increase. Overall, the operating result is projected to rise in 2020.

Risk costs should remain low in 2020 on the back of the low interest rate environment. While precise forecasts are difficult in the current environment, Erste Group projects for 2020 risk costs of below 20 basis points of average gross customer loans. The solid, albeit slowing, macro environment should support asset quality as will the well-balanced diversified loan portfolio.

We do expect an improvement in other operating result due to the non-recurrence of the significant one-off negative effects of 2019. Assuming a tax rate of below 20% and a similar high level of minority charges, Erste Group aims to achieve a return on tangible equity (ROTE) of above 10%.

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

## ANALYSIS OF PERFORMANCE

### Net interest income

Net interest income rose to EUR 4,746.8 million (EUR 4,582.0 million). The marked increase in the Czech Republic was attributable to the benign interest rate environment and sustained growth in lending to customers. Higher net interest income was also posted in Romania driven primarily by higher market interest rates and in Hungary on the back of lending growth. The implementation of IFRS 16 led to a negative impact of EUR 24.6 million on net interest income. Year on year, interest-bearing assets rose faster than net interest income, not least because of a marked increase in interbank assets, which resulted in the net interest margin (net interest income as a percentage of average interest-bearing assets) slightly narrowing to 2.18% (2.30%).

### Net fee and commission income

Net fee and commission income increased to EUR 2,000.1 million (EUR 1,908.4 million). Growth was registered in all core markets, most notably in Austria, Hungary and Slovakia. In Austria, growth was driven mainly by payment fees and asset management fees, while Slovakia saw primarily a rise in insurance brokerage fees.

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

Valuation effects have a substantial impact on both positions – net trading result & gains/losses from financial instruments measured at fair value through profit or loss. Debt securities issued measured at FV through profit or loss are particularly impacted – related valuation results are shown in the line gains/losses from financial instruments measured at fair value through profit or loss while valuation results of corresponding hedges are shown in net trading result – as are financial assets in the fair value and trading portfolios.

Due to the interest rate development, net trading result improved significantly to EUR 318.3 million (EUR -1.7 million). On the other hand, gains/losses from financial instruments measured at fair value through profit or loss declined to EUR -24.5 million (EUR 195.4 million).

### General administrative expenses

General administrative expenses amounted to EUR 4,283.3 million (EUR 4,181.1 million). **Personnel expenses** increased – mainly in Austria and the Czech Republic – to EUR 2,537.1 million (EUR 2,474.2 million). **Other administrative expenses** declined to EUR 1,205.1 million (EUR 1,234.9 million). Contributions to deposit insurance systems increased to EUR 104.8 million (EUR 88.6 million) on the back of continued strong deposit growth. Contributions were up most sharply in Romania (to EUR 12.7 million from previously EUR 4.4 million) and Austria (EUR 58.4 million versus EUR 51.2 million). The first-time application of the new financial reporting standard for leases (IFRS 16) as of 1 January 2019 had a positive impact on other administrative expenses – through lower rental expenses – in the amount of EUR 81.5 million, but negatively impacted **depreciation and amortisation** by EUR 74.0 million, pushing the latter to EUR 541.0 million (EUR 472.0 million).

### Operating result

Operating income rose to EUR 7,255.9 million (+4.9%; EUR 6,915.6 million) on the back of significantly improved net interest and net trading income and a rise in net fee and commission income. General administrative expenses increased to EUR 4,283.3 million (+2.4%; EUR 4,181.1 million) due to a rise in personnel expenses and higher depreciation and amortisation while other administrative expenses declined. The operating result improved to EUR 2,972.7 million (+8.7%; EUR 2,734.6 million). The cost/income ratio improved likewise to 59.0% (60.5%).

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

Gains from the derecognition of financial instruments not measured at fair value through profit or loss (net) increased to EUR 23.5 million (EUR 5.7 million). This item includes primarily gains/losses from the sale of securities and the derecognition of financial liabilities.

### Impairment result from financial instruments

Due to net allocations, the impairment result from financial instruments amounted to EUR -39.2 million (net releases of EUR 59.3 million). The negative balance of the allocation/release of provisions for the lending business was partly offset by continued high income received from the recovery of loans already written off in the amount of EUR 154.0 million (EUR 162.9 million) as well as the release of provisions for commitments and guarantees given in the amount of EUR 70.0 million (EUR 6.6 million).

### Other operating result

Other operating result amounted to EUR -628.2 million (EUR -304.5 million). Levies on banking activities rose to EUR 128.0 million (EUR 112.2 million), including a EUR 11.0 million banking tax payable in Romania for the first time in the reporting year. Levies payable in Austria rose slightly to EUR 24.3 million (EUR 23.0 million) and in Slovakia increased to EUR 32.5 million (EUR 30.3 million). Hungarian banking tax declined to EUR 12.6 million (EUR 13.5 million). Including financial transaction tax of EUR 47.6 million (EUR 45.4 million), bank levies in Hungary totalled EUR 60.2 million (EUR 58.9 million).

In view of the expected negative impact on future income resulting from a change in the law on banking tax in Slovakia, the goodwill in Slovakia in the amount of EUR 165.0 million was written down completely and posted to other operating result. Allocations/release of other provisions amounted to EUR -207.0 million (net releases of EUR 13.3 million). The significant deterioration is attributable to a provision in the amount of EUR 153.3 million set aside for losses expected from a decision of the Romanian High Court in relation to the business activities of a local subsidiary. In addition, other operating result also reflects the annual contributions to resolution funds in the amount of EUR 75.3 million (EUR 70.3 million). The steepest rise, to EUR 26.6 million (EUR 19.0 million), was recorded in the Czech Republic.

### Profit/loss for the year

The pre-tax result from continuing operations amounted to EUR 2,329.7 million (EUR 2,495.0 million). Taxes on income increased to EUR 418.7 million (EUR 332.4 million) as the positive impact of deferred taxes that were recognised resulting in deferred tax income was lower than in 2018. In addition, neither the goodwill write-down in Slovakia nor the extraordinary provisions in Romania were tax deductible in 2019. The minority charge rose to EUR 440.9 million (EUR 369.1 million) due to solid results of the savings banks. The net result attributable to owners of the parent amounted to EUR 1,470.1 million (EUR 1,793.4 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 2019. The current tax loss carried forward increased in 2019.

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 418.7 million (EUR 332.4 million).

### Balance sheet development

The decline in **cash and cash balances** to EUR 10.7 billion (EUR 17.5 billion) was primarily due to a significant reduction of cash balances held at central banks.

**Trading and investment securities** held in various categories of financial assets increased to EUR 44.3 billion (EUR 43.9 billion).

**Loans and advances to credit institutions (net)**, including demand deposits other than overnight deposits, increased primarily in the Czech Republic and in the Holding to EUR 23.1 billion (EUR 19.1 billion).

**Loans and receivables to customers (net)** rose in all core markets – most notably in Hungary and Serbia as well as in the Czech Republic, Austria and Slovakia – to EUR 160.3 billion (EUR 149.3 billion) driven by retail and corporate loan growth.

**Loan loss allowances for loans to customers** declined to EUR 3.2 billion (EUR 3.6 billion), mostly due to continuing asset quality improvement. The **NPL ratio** (non–performing loans as a percentage of gross customer loans) improved again to 2.5% (3.2%). The **NPL coverage ratio** (based on gross customer loans) rose to 77.1% (73.4%).

**Intangible assets** amounted to EUR 1.4 billion (EUR 1.5 billion).

**Miscellaneous assets** were up at EUR 6.0 billion (EUR 5.4 billion).

**Financial liabilities – held for trading** declined to EUR 2.4 billion (EUR 2.5 billion).

**Deposits from banks,** primarily overnight deposits and term deposits, decreased to EUR 13.1 billion (EUR 17.7 billion).

**Deposits from customers** increased to EUR 173.8 billion (EUR 162.6 billion) due to strong growth in retail overnight deposits in all core markets. The **loan-to-deposit ratio** stood at 92.2% (91.8%).

**Debt securities in issue** rose to EUR 30.4 billion (EUR 29.7 billion) on the back of increased issuing activity.

**Miscellaneous liabilities** amounted to EUR 5.4 billion (EUR 5.4 billion).

**Total assets** grew to EUR 245.7 billion (+3.8%; EUR 236.8 billion).

**Total equity** increased to EUR 20.5 billion (+8.6%; EUR 18.9 billion) including additional tier 1 (AT1) instruments in the amount of EUR 1,490.4 million. After regulatory deductions and filtering according to the Capital Requirements Regulation (CRR) **common equity tier 1 capital** (CET1, CRR final) rose to EUR 16.3 billion (EUR 15.5 billion). Total **own funds** (CRR final) went up to EUR 22.0 billion (EUR 20.9 billion). **Total risk (risk-weighted assets** including credit, market and operational risk, CRR final) increased to EUR 118.6 billion (EUR 115.4 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**, total eligible qualifying capital in relation to total risk pursuant to CRR (final), was 18.5% (18.1%), well above the legal minimum requirement.

The **tier 1 ratio** (CRR final) stood at 15.0% (14.3%), the **common equity tier 1 ratio** (CRR final) at 13.7% (13.5%).

## 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 46, 47 and 51 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 2019 development costs in the amount of EUR 76 million (EUR 61 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

### Investor information pursuant to section 243a (1) of the Austrian Commercial Code (UGB)

With regard to the statutory disclosure requirements related to the composition of the capital, the class of shares as well as own shares, special reference is made to the relevant information in the notes to the financial statements, in section C 38.

As of 31 December 2019, together with its syndicate partners, DIE ERSTE oesterreichische Spar-Casse Privatstiftung (ERSTE Stiftung), a foundation, controls 30.39% (prior year: 29.99%) of the shares in Erste Group Bank AG and with 16.46% (prior year: 16.21%) is the main shareholder. ERSTE Stiftung holds 6.37% (prior year: 6.49%) of the shares directly; the indirect participation of the ERSTE Stiftung amounts to around 10.09% (prior year: 9.72%) of the shares held by Sparkassen Beteiligungs GmbH & Co KG, which is an affiliated undertaking of the ERSTE Stiftung. 0.93% (prior year: 0.78%) are held directly by savings bank foundations (Sparkassenstiftungen) respectively saving banks foundations acting together with the ERSTE Stiftung and affiliated with Erste Group Bank AG through the Haftungsverbund/IPS fund. 9.92% (prior year: 9.92%) of the subscribed capital is controlled by ERSTE Stiftung on the basis of a shareholder agreement with Caixabank S.A.. 3.08% (prior year: 3.08%) are held by other partners to the shareholder agreement.

Furthermore, it should be noted that in addition to the joint liability scheme in place since 2001, from 1 January 2014 onwards Erste Group Bank AG has formed a recognized institutional protection scheme in accordance with article 113 (7) CRR together with the Austrian savings banks. The joint liability scheme complies with the requirements of article 4 (1) Z 127 CRR, whereby the required individual services of the individual members of the scheme are subject to an individual and general ceiling. The applicable amounts are determined by the steering company and made known to the paying members. Due to the requirements for an IPS, the ceilings for individual members' support measures were raised and an ex-ante fund established which was endowed beginning in 2014 for the following 10 years.

In the financial statements, the payments by the individual members are recognised as participations in IPS GesbR – which is in charge to manage the ex-ante-fund. Furthermore retained earnings are built, whereby a shift from untied reserves to tied reserves was conducted in 2014. On the basis of the contractual provisions, these retained earnings represent a restricted reserve. These tied retained earnings may be released only in case of a drawdown of the ex-ante-fund due to a triggering event. 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 ERSTE Stiftung 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 ERSTE Stiftung. The partners can dispose of shares according to a predefined sale procedure and can purchase shares only within the quotas agreed with ERSTE Stiftung (of a maximum of 2% within 12 months in total); with this regulation an unwanted creeping-in according to takeover law 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.

The Articles of Association contain no restrictions in respect of voting rights or the transfer of shares.

Pursuant to section 243a (1) no. 6 UGB not directly prescribed by the law regarding the appointment and dismissal of members of management and supervisory boards as well as on the amendment of the Articles of Association:

This concerns:
- Art. 15.1 of the Articles of Association, which provides that ERSTE Stiftung will be granted the right to nominate up to one third of the members of the Supervisory Board to be elected by the shareholders' meeting, as long as ERSTE Stiftung is liable or all present and future liabilities of the company in the case of its insolvency pursuant to Section 92 (9) Banking Act and
- Art. 15.4 of the Articles of Association, which provides that a three-quarter majority of valid votes cast and a three-quarter majority of the subscribed capital represented at the meeting considering the proposal are required to pass a motion for removal of Supervisory Board members
- Art. 19.9 of the Articles of Association, which provides that the Articles of Association, in so far as they do not alter the business purpose, may be passed by simple majority of votes cast and 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 Art. 19.9 require a three-quarter majority of the votes cast and a three-quarter majority of the subscribed capital represented at the meeting considering the proposal.

Pursuant to section 243a (1) no. 7 UGB, members of the Management Board have the right to issue or repurchase shares, where such a right is not prescribed by statutory law:
As per decision of the Annual General Meeting of 15 May 2019:
- 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 may 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 14 November 2021.

_ 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 14 November 2021, 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 14 May 2024, 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 to redeem shares without further resolution at the Annual General Meeting with the approval of the Supervisory Board.

_ According to section 65 paragraph 1 Z 4 as well as paragraph 1a and 1b Stock Exchange Act, the Management Board is authorised for the duration of 30 months following the date of resolution, hence until 14 November 2021, and with the approval of the Supervisory Board to purchase own shares at an amount equaling up to 10% of share capital of the company also under repeated utilisation of the 10% limit both via the stock market as well as off-market under exclusion of the pro rata tender rights of shareholders for the purpose of granting shares for free or at concessionary terms to Erste Mitarbeiterbeteiligung Privatstiftung, their beneficiaries, employees, executive employees and members of the board at Erste Group Bank AG as well as affiliated group companies or other companies according to section 4d paragraph 5 Z 1 Income Tax Act. The value per share may neither be lower than the floor value of two Euros nor higher than the ceiling of 120 Euros.

All sales and purchases were carried out as authorised at the Annual General Meeting.

According to section 8.3 of the Articles of Association, the Management Board is authorized, 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.

Significant 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 [section 243a (1) no. 8 UGB]:

### 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 grossly harms the duties resulting from the 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 bank 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 bank sector irrespective of the reason.

The Haftungsverbund's 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's steering company and Erste Group Bank AG by registered letter within twelve weeks from the change of control that it intends to withdraw from the Haftungsverbund.

### Directors and Officers Insurance

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

- the insured ceases to exist as a result of a 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 consent, who are not insured parties, acquire more than 50% of the insured's outstanding equity or more than 50% of its voting power (resulting in the right to control the voting power represented by the shares, and the right to appoint the Management Board members of the insured),

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 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 shall remain 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 in relation to unlawful acts committed or alleged to have been committed by the insured during the existence of this entity as a subsidiary. No insurance cover is provided for claims brought against an insured 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)

Erste Group Bank AG 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 of the general sales agreement was mainly 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 recent developments of the legal framework on the regulatory front. The parties already determined in the first agreement that each party had the right to terminate the agreement in the case of a takeover. In the case of a takeover of Erste Group Bank AG, VIG has the right to terminate the general sales agreement. If a takeover occurs at VIG, Erste Group Bank AG has the reciprocal right. Regarding Erste Group Bank AG, a takeover is deemed to occur if a shareholder or third party holding less than 50% of the total shares or the voting rights in Erste Group Bank AG so far, holds more than 50% of the total shares or the voting rights in Erste Group Bank AG for the first time. Share purchases by shareholders/buyers of DIE ERSTE oesterreichische Spar-Casse Privatstiftung and/or Austrian savings banks are excluded from this ruling. With regard to VIG, the aforementioned rules also apply – share purchases by the shareholder Wiener Städtische Wechselseitiger Versicherungsverein Vermögensverwaltung – Vienna Insurance Group are excluded from this ruling.

Aside from this contract termination possibility, upon renewal and extension of this contract the contractual parties agreed that in case changed legal or other regulatory requirements significantly impact the defined business models in the respective so-called country sales agreements between the contractual partners, a termination of the respectively affected country sales agreements for good cause is possible as long as the presence of such a good cause is confirmed by a court of arbitration appointed in accordance with the rules of the general sales agreement.

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 | |
|---|---|
| Bernhard Spalt mp, Chairman | |
| Ara Abrahamyan mp, Member | Stefan Dörfler mp, Member |
| Ingo Bleier mp, Member | Alexandra Habeler-Drabek mp, Member |
| Peter Bosek mp, Member | David O'Mahony mp, Member |

Vienna, 28 February 2020