

Risk and capital management

32. Financial risk management

Risk policy and strategy

Erste Group has developed a risk management framework that is forward-looking and tailored to its business and risk profile. This framework is based on a clear risk strategy that sets out general principles according to which risk taking must be performed across the Group. The risk strategy is consistent with the business strategy and incorporates the expected impact of external environment on the planned business and risk development.

The risk strategy describes the current and targeted risk profile, defines risk management principles, strategic goals and initiatives for the main risk types as well as sets strategic limits for the significant financial and non-financial risk types as defined in the Risk Materiality Assessment. The risk strategy is executed within a clearly defined governance structure. This structure also applies to monitoring of risk appetite, additional metrics, as well as to the escalation of limit breaches.

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Risk management organisation

Risk monitoring and control is achieved through a clear organisational structure with defined roles and responsibilities, delegated authorities, and risk limits.

The management board and in particular Erste Group's Chief Risk Officer (Group CRO) perform the oversight function within Erste Group's risk management structure. Risk control and risk steering within Erste Group are performed based on the business strategy and risk appetite approved by the management board. The Group CRO, working together with the chief risk officers of the subsidiaries, is responsible for the implementation and adherence to the risk control and risk management strategies across all risk types and business lines.

The management board and, in particular the Group CRO, ensure the availability of appropriate infrastructure and staff as well as methods, standards and processes to that effect; the actual identification, measurement, assessment, approval, monitoring, steering and limit setting for the relevant risks are performed on the operating entity level within Erste Group.

At group level, the management board is supported by several divisions established to perform operating risk control functions and exercise strategic risk management responsibilities. The following risk management functions report directly to the Group CRO:

- Group Liquidity and Market Risk Management;
- Enterprise wide Risk Management;
- Credit Risk Methods;
- Group Compliance;
- Retail Risk Management:
- Credit Risk Portfolio;
- Corporate Risk Management;
- Cyber Risk Management;
- Local Chief Risk Officers.

The management board regularly deals with risk issues of all risk types in its regular board meetings. Actions are discussed and taken when needed.

Furthermore, certain cross-divisional committees were established with the purpose of carrying out risk management activities in the Erste Group.

- Risk Committee of the Supervisory Board;
- CRO Board;
- Holding Credit Committee;
- Market Risk Committee;
- Operative Market Risk Committee;
- Strategic Risk Executive Committee;
- Strategic Risk Management Committee;
- Stress Testing Committee;
- Group Resolution Committee;
- United States Risk Committee;
- Regional Operational Conduct Committee;
- Group IT Risk & Security Committee;
- Group Asset/Liability Committee;
- Operational Liquidity Committee;
- Banking Book Committee.

In addition, committees are established at local level, such as the ‘Team Risikomanagement’ in Austria. It is responsible for a common risk approach with the Austrian savings banks.

Group-wide risk and capital management

Enterprise-wide Risk Management (ERM) includes as its fundamental component the Internal Capital Adequacy Assessment Process (ICAAP) as required under Pillar 2 of the Basel framework and regulatory guides (e.g., ECB Guide to ICAAP).

The ERM framework is designed to support the management of the bank in managing the risk portfolios as well as the coverage potential and to ensure that the bank holds adequate capital for the nature and magnitude of its risk profile at all times. The framework is tailored to the Erste Group’s business and risk profile and reflects the strategic goal of protecting shareholders and senior debt holders while ensuring the sustainability of the organisation.

ERM framework is a modular and comprehensive management and steering system within Erste Group as well as an essential part of the overall steering and management instruments. The ERM components necessary to ensure all aspects, in particular to fulfil regulatory requirements and to provide an effective internal steering tool, can be clustered as follows:

- Risk Appetite Statement (RAS), limits and risk strategy;
- portfolio and risk analytics including Risk Materiality Assessment (RMA), concentration risk management, and stress testing;
- Risk-bearing Capacity Calculation (RCC);
- capital allocation and performance management;
- planning of key risk indicators;
- recovery and resolution planning.

In addition to the ICAAP’s ultimate goal of assuring capital adequacy and sustainability at all times, the ERM components serve to support the bank’s management in pursuing its strategy.

RISK APPETITE

Risk appetite defines the maximum level of risk Erste Group is willing to accept in pursuing its business goals. The overall approach includes a risk appetite statement, risk limits, and the roles and responsibilities of those overseeing the implementation and monitoring of the risk appetite framework. Limit framework (i.e., risk appetite framework) of Erste Group includes risk limits set in Risk Appetite Statement and Risk Strategy, industry limits, maximum lending limits and operational limits.

The Group Risk Appetite Statement (Group RAS) represents a strategic statement that expresses the maximum level of risk it is willing to accept in order to deliver its business objectives. The Group RAS acts as a binding constraint to Erste Group’s business activities within its overall risk appetite via triggers and limits approved by the management board and the risk committee of the supervisory board and brought to the supervisory board for information. It is integrated and embedded into Erste Group’s structural processes, including business and risk strategy, budgeting process, capital and liquidity planning, recovery plan, stress testing and remuneration framework. The Group RAS consists of a set of core risk metrics (capital, liquidity, risk/earnings) providing quantitative direction for overall risk-return steering and qualitative statements in the form of key risk principles that are part of the guidelines for managing risks.

The core risk metrics are set as ultimate boundaries for the Group risk-return target setting. They are also a key part of the annual strategic planning / budgeting process and give an overall picture of capital, liquidity, and risk-return trade-offs. The key objective of the RAS is to:

- ensure that Erste Group has sufficient resources to support its business at any given point in time and absorb stress events;
- set boundaries for the Group's risk target setting;
- support the group's financial strength and the robustness of its systems and controls.

To foster risk-return steering and ensure proactive management of the risk profile, Erste Group creates its RAS on a forward-looking basis. External constraints such as regulatory requirements create the floor and ceiling for the RAS and therefore the amount of risk Erste Group is willing to accept. To ensure that the group remains within the targeted risk profile, a traffic light system was established and assigned to the core metrics. This approach allows a timely delivery of information to the respective governance and the implementation of effective remediation measures. The RAS traffic light system is defined as follows:

- RAS is green: The target risk profile is within the specified boundaries.
- RAS is amber: The undershooting or overshooting of a pre-defined threshold leads to an escalation to the designated governance and the discussion of potential remediation actions.
- RAS is red: The undershooting or overshooting of a pre-defined limit initiates an immediate escalation to the designated governance and a prompt implementation of remediation actions.

Moreover, stress indicators are defined for selected core metrics and integrated into the assessment of the stress test results. They are reported as early warning signals to the management board to support proactive management of the risk and capital profile.

In addition, supporting metrics and principles are defined by material risk type in the Group Risk Strategy based on Group RAS. These support implementation of the mid- to long-term strategy. Risk management governance ensures full oversight of risk decisions and sound execution of the Group risk strategy. Mitigating actions are undertaken as part of the regular risk management process to ensure that the Group remains within its RAS.

Group RAS is also cascaded to local entities. Local RAS is approved by the management board to ensure compliance with the Group RAS and approved also by the local management board to ensure alignment with local regulatory requirements. The Group may also decide to include further compulsory constraints and limits in local RAS to ensure alignment with Group RAS and Group Risk Strategy.

The Group further developed an aggregated and consolidated risk appetite dashboard, which is part of Group Risk Report (Group Risk Report/Risk Dashboard) illustrating the group and local entities' risk profile developments by comparing the risk exposure and risk limits. The Group Risk Report/Risk Dashboard is regularly presented to the management board and to the supervisory board (including risk committee of supervisory board) to support its review, oversight, and monitoring of the group risk profile and the risk profile of its local entities.

Group RAS 2023-2027 was approved by the management board and the risk committee of the supervisory board and brought to the supervisory board for information in the last quarter of 2022.

ESG risks are embedded in the Risk Appetite Statement and in the risk strategy and are also part of Erste Group's Risk Materiality Assessments. They are integrated into Erste Group's risk taxonomy as transversal risks (risk types that have impact and are reflected through more than one key risk category) and are included in the relevant risk categories credit, market, liquidity and operational risk. Erste Group's definition of ESG risk is part of the Group ICAAP guideline and covers a wide range of risks arising from environmental, social and governance factors.

PORTFOLIO AND RISK ANALYTICS

Erste Group uses dedicated infrastructure, systems and processes to actively identify, measure, control, report and manage risks within its portfolio. Portfolio and risk analytics processes are designed to quantify, qualify, and discuss risks in order to raise awareness to management in a timely manner.

Risk materiality assessment

The Risk Materiality Assessment (RMA) determines the materiality of risk types and consequently the risk profile across Erste Group. RMA is an annual process with the purpose of systematic identification of new and assessment of all risks for the Group. Senior management may require to perform RMA on ad hoc basis in addition, in order to address changing operating environment or emerging risks. As such, the RMA is an integral part of the ICAAP and serves as a steering tool for senior management.

ESG risks and their materiality keep being assessed within existing risk types. The criteria for assessing physical and transitory risks were further enhanced in the most recent RMA.

Insights generated by the assessment are used to improve risk management practices and further mitigate risks within the Group. The assessment also serves as input for the design and definition of the Group's risk strategy and Risk Appetite Statement. Key outputs and recommendations of the RMA are considered in the scenario design and selection of the comprehensive and reverse stress tests.

Risk concentration analysis

Erste Group has implemented a process to identify measure, control and manage risk concentrations. This process is important to ensure the long-term viability of Erste Group, especially in times of an adverse business environment and stressed economic conditions.

The risk concentration analysis at Erste Group is performed on an annual basis covering credit risk, market risk, operational risk, liquidity risk and inter-risk concentrations. Identified risk concentrations are considered in the scenario design of the comprehensive stress test and measured under stressed conditions. The output of the risk concentration analysis additionally contributes to the identification of material risks within the RMA and to the setting/calibration of Erste Group's limit system.

Stress testing

Modelling sensitivities of the group's assets, liabilities and profit or loss provide management steering information and help to optimise Erste Group's risk-return profile. Stress tests help to factor in severe but plausible scenarios providing further robustness to measurement, steering and management. Risk modelling and stress testing are vital forward-looking elements of the ICAAP. Finally, sensitivities and stress scenarios are considered within the group's planning process.

Erste Group's most complex stress testing activities are scenario stress tests that take a comprehensive account of the impact of various economic scenarios. This includes second-round effects on all major risk types (credit, market, liquidity and operational) and effects on the associated volumes of assets and liabilities as well as on profit and loss. In addition to the standard scenario-driven stress testing exercises, reverse stress tests are performed to identify a scenario or a combination of scenarios in which viability of the current business model can be questioned.

Erste Group has developed specific tools to translate macroeconomic variables (e.g., GDP or unemployment rate) into risk parameters in order to support the stress testing process, which combine bottom-up and top-down approaches. For adapting the stress parameters, Erste Group additionally leverages the experience of its local professionals and uses, where appropriate, their statistical models to simulate the impacts of macroeconomic variables on the risk parameters in the respective portfolios. Special attention is taken to account for the granularity and special characteristics (i.e., countries and industries) when determining the segmentation in which the stressed parameters are defined.

Erste Group has integrated climate risk analysis into the internal stress testing framework. Both physical risk and transition risk from projected climate change are now included in the internal stress testing framework. Further development of climate-based stress analysis will support the Group's overall strategic approach to climate risk.

Results from Erste Group's internal stress tests are analysed in order to decide on appropriate measures and inform the bank steering. The internal comprehensive stress tests performed in 2023 indicated no breach of stressed RAS triggers after the application of scenario contingent measures in the adverse scenario.

RISK-BEARING CAPACITY CALCULATION

The Risk-bearing Capacity Calculation (RCC) describes the methodology of Pillar 2 capital adequacy calculation. In contrast to the normative (regulatory) view of Pillar 1, referring to the Group's ability to fulfil all its capital-related regulatory and supervisory requirements and demands, the RCC is based on an economic view of Pillar 1+ approach, assuming continuation of Erste Group as expected by the ECB Guide to ICAAP. The RCC determines whether the Group has sufficient internal capital for covering all (regulatory and economic) risks it is exposed to. Economic and normative perspectives at Erste Group are set in a way to mutually inform each other and are integrated into all material business steering activities and decisions. In addition, with applied Pillar 1+ approach the Group increases efficiency and ensures comparability with the Pillar 1 calculation. Based on the results of the RMA, the economic capital is considered for relevant risk types as approved by the management board. The economic capital requirement is then compared to internally available capital (coverage potential) to cover the Group's risks in Pillar 2. Both economic capital and coverage potential are computed on the CRR scope of consolidation of Erste Group as ultimate parent entity based on IFRS accounting standards.

Besides the Pillar 1 risk types (credit, market in trading book, FX in banking book and operational risks), concentration risk, interest rate risk in the banking book, credit spread risk in the banking book as well as business risk are explicitly considered within the economic capital calculated over a horizon of one year and at a confidence level of 99.9%. For the calculation of the economic capital, Erste Group uses, where possible, more risk sensitive/advanced methodologies tailored to its individual risk profile and specificities of the Group's individual risk exposures. Diversification effects between risks (inter-risk diversification) are not considered, reflecting the Group's prudent approach to maintain sufficient internal capital in times when correlations between risks may change dramatically (like in times of stress). The largest portion of economic capital requirements is coming from credit risk, which accounts for 73.5% of total economic capital requirements at the end of 2023.

The calculation of internal capital or coverage potential required to cover Pillar 2 risks/unexpected losses is based on Pillar 1+ approach. Namely, CRR and CRR II (Regulation (EU) No. 575/2013 and Regulation (EU) No. 876/2019 amending Regulation (EU) No. 575/2013) regulatory own funds are adjusted by internal capital components, i.e. Pillar 2 adjustments, necessary to come to the internally available capital deemed as risk-bearing and loss absorbing from the economic view (e.g. exclusion of Additional Tier 1 and Tier 2 capital instruments, Pillar 2 IRB expected loss excess/shortfall add-on, year-to-date profit, if it is not already considered in Pillar 1 capital, etc.).

The coverage potential must be sufficient to absorb Pillar 2 risks/unexpected losses resulting from the Group's operations at any point in time (normal and stressed), as reflected in the Group's Risk Appetite through the limits set for Group economic capital adequacy and stressed capital adequacy utilisation. At the end of 2023, the economic capital adequacy was at 56.7%, fully in line with group RAS.

The management board and supervisory board (including risk committee of supervisory board) are briefed quarterly on the results of the ICAAP capital adequacy through the Group Risk Report. The includes risk profile developments, available capital (coverage potential), consideration of potential losses in stress situations, the degree of the risk limit utilisation and the overall status of capital adequacy.

RISK PLANNING

Group Risk Planning framework is essential for the capital allocation and overall financial planning processes and supports the adequate reflection of risks within the strategy, steering and management processes of the group.

Methods and instruments applied

Key risk indicators covered by the Risk Planning framework include indicators that provide an overview of incurred or potential risks, with respect to both portfolio and economic environment developments. Indicators include RWA (and related indicators), portfolio quality indicators (impairments, NPL/NPE and relevant performance indicators etc.), as well as indicators required by the regulatory authorities under the responsibility of the Risk division.

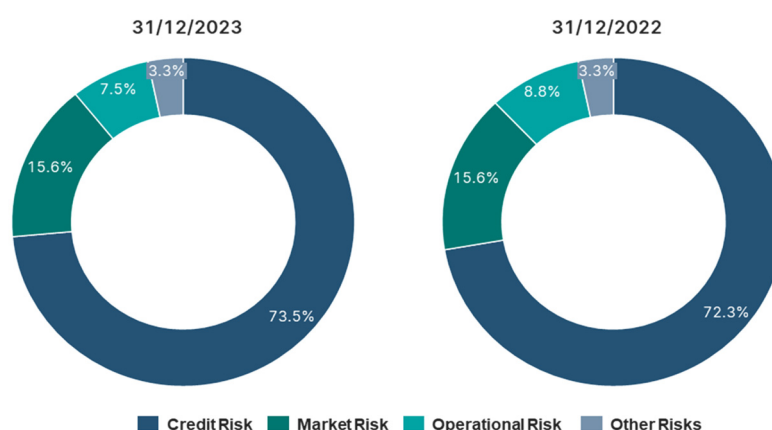
Planning activities are performed in close cooperation with all stakeholders in the group's overall process and follow a clear governance structure to ensure sound risk planning process.

Capital allocation

An important task integral to the risk planning process is the allocation of capital to entities, business lines and segments. This is done with close cooperation between Risk Management and Controlling. Methodology for allocation reflects risk and controlling processes to allocate capital with risk-return considerations.

ERSTE GROUP'S AGGREGATE CAPITAL REQUIREMENTS BY RISK TYPE

The following diagrams present the composition of the economic capital requirements according to type of risk:



Other risks include business risk.

RECOVERY AND RESOLUTION PLANS

The Directive (EU) 2014/59 as amended (Bank Recovery and Resolution Directive – BRRD) has been implemented in Austria into national law by the Austrian Recovery and Resolution Act ('Sanierungs- und Abwicklungsgesetz – BaSAG'). On 7 June 2019 a legislative package (EU Banking Package) was published in the Official Journal of the EU. The EU Banking Package comprises the Directive (EU) No 2013/36 as amended (CRD IV), and the Regulation (EU) No 575/2013 as amended (CRR) as well as the BRRD as

amended and the Regulation (EU) No 806/2014 as amended (SRMR). The EU Banking Package entered into force on 27 June 2019 and was amended into national legislation in Austria on 28 June 2021.

Recovery Planning. In compliance with the current Austrian Banking Recovery and Resolution Law ('Bundesgesetz über die Sanierung und Abwicklung von Banken – BaSAG'), Erste Group annually submits a Group Recovery Plan to Joint Supervisory Team (JST). The Group Recovery Plan is regularly assessed by ECB. The Group Recovery Plan identifies potential options for the replenishment of capital and liquidity resources of the bank in order to cope with a range of severe scenarios including both idiosyncratic and market-wide stress. The Recovery Framework is mainly reconciled with the Risk Appetite Framework across indicators and indicator thresholds, ensuring comprehensive enterprise-wide risk management. It is relevant to demonstrate that in a severe stress, which is close to a failing or likely to fail situation, there is sufficient recovery capacity available in order to be able to recover back into the recovery green zone. The recovery governance described in the plan ensures timely identification and proper management of a recovery situation of Erste Group. Furthermore, the assessment of the Group Recovery Plan and the assessment of the overall recovery capacity are part of the Supervisory Review and Evaluation Process (SREP) assessment.

Resolution Planning. Erste Group collaborates with the resolution authorities in the drawing up of resolution plans as required by BaSAG and EU Regulation No 806/2014 establishing the Single Resolution Mechanism (SRM Regulation). The legislative framework allows for a multiple-point-of-entry (MPE) or a single-point-of-entry (SPE) resolution strategy. The Resolution Authorities formed a joint decision in the resolution college for Erste Group which defines the MPE approach forming six separate resolution groups with Erste Group's core CEE subsidiaries and Austria, but with SPE approaches on country level. This results in having resolution groups in AT, CZ, HR, HU, RO and SK. Under the MPE strategy, a group has more than one Resolution Entity Level which is the entry point for resolution. The resolution plans (including resolution strategy and MREL decisions) are regularly updated by the Resolution Authorities and subject to Joint Decision formed in a resolution college by Resolution College Members.

MREL. The Bank Recovery and Resolution Directive (BRRD) introduced the Minimum Requirement for Own Funds and Eligible Liabilities (MREL). MREL notifications are provided by the national resolution authorities on the level of resolution groups and relevant individual subsidiaries of resolution entities, reflecting the resolution strategy, based on the MREL joint decision taken by the resolution college. MREL requirements are expressed as a percentage of the total risk exposure amount (TREA) as well as leverage ratio exposure (LRE).

Based on the MREL joint decisions taken, the National Resolution Authorities provided their legal notifications. In April 2023, Erste Group received Joint Decision determining the minimum requirement for own funds and eligible liabilities for its resolution groups and some non-resolution entities (i.e. direct and indirect subsidiaries of resolution entities). The requirement is set including binding intermediate requirements as of 1 January 2022 and binding requirements as of 1 January 2024. Information on MREL targets have been published on the local entities' website based on legal notifications released by the relevant national resolution authorities. MREL metric is integrated into the RAS and Recovery Framework of Erste Group.