ERSTE BANK A.D. NOVI SAD
EXECUTIVE COMMITTEE
No: 40-301/2012
Date: 29 May 2012

Erste Bank a.d. Novi Sad

Disclosure of data and information for the year ended 31 December 2011

GENERAL INFORMATION

ERSTE BANK A.D. NOVI SAD

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CONTENT

DEFINITIONS

Economic capital	Amount of capital needed to cover all the Bank's risks using economical measures to ensure its sustainability
Internal Capital Adequacy Assessment process	Process and systems established to determine the level of internal capital adequate to cover materially significant risk types the Bank faces, different from those provided by the National Bank of Serbia Decision on Capital Adequacy by Banks rules
Internal capital	Amount of capital, including capital like components, according to the Bank's internal definitions
Liquidity Coverage Ratio	Ratio of Stock of high-quality liquid assets and Total net cash outflows over the next 30 days
Net Stable Funding Ratio	Ratio of Available amount of stable funding and Required amount of stable funding
Price Value Basis Point	Measurement of risk of change in portfolio value caused by changing interest rate for one basis point. Can be calculated only for instruments whose value is sensitive to changes in interest rates
Regulatory capital	Amount of capital charges according to National Bank of Serbia definition
Risk Profile	Bank's assessment of the structure and level of risks it is or could be exposed to in its operations
VaR	The largest possible loss in the Bank's portfolio during a specified time period and within a given interval of confidence

ABBREVIATIONS

ALM	Asset and Liabilities Management
BIA	Basic Indicator Approach
CRM	Credit Risk Mitigation
CRO	Chief Risk Officer
IAS	International Accounting Standards
ICAAP	Internal Capital Adequacy Assessment Process
IFRS	International Financial Reporting Standards
IRB	Internal Ratings Based Approach
LCR	Liquidity Coverage Ratio
MREL	Maximum Risk Exposure Limit
NBS	National bank of Serbia
NSFR	Net Stable Funding Ratio
p.a.	per annum
PVBP	Price Value Basis Points
RCC	Risk-bearing Capacity Calculation
RSD	Republic of Serbia Dinar
RWA	Risk Weighted Assets
VaR	Value-at-Risk

1. INTRODUCTION

Erste Bank a.d. Novi Sad (hereinafter referred as "the Bank"), member of Erste Bank Group (hereinafter referred as "the Group"), prepares Disclosure Report on data and information (hereinafter referred as "Disclosure Report" or "Report") as at 31 December 2011 and for the year then ended.

This Report gives the reader an opportunity to gain comprehensive overview of the current risk profile and the risk and capital management systems of the Bank. The Report comprises particularly the qualitative and quantitative data and/ or information falling in the following areas:

- risk management strategy and policies;
- capital structure;
- capital adequacy;
- internal capital adequacy assessment process;
- Bank's exposure to risks and approaches for risk measurement and assessment.

The Report fulfils the disclosure requirements according to article 51a of the Law on banks ("Official Gazette of the Republic of Serbia", no. 107/2005 and 91/2010) and according to National Bank of Serbia Decision on Disclosure of Data and Information by Banks ("Official Gazette of the Republic of Serbia", no. 45/2011).

Pursuant to the Decision on Disclosure of Data and Information by Banks, the Bank is obliged to disclose qualitative and quantitative data and/or information, within the scope of the said Decision, once a year, as at 31 December. Additionally, quantitative data and/or information are required to be disclosed also as at 30 June.

The data and/or information published within the scope of the Disclosure Report are subject to an independent audit.

The Report is available at the Bank's website (http://www.erstebank.rs/rs/O_nama/Izvestaji).

The data and/or information in this Report are presented in Republic of Serbia Dinars ("RSD") currency and all values are rounded to the nearest thousand (RSD '000), except when otherwise indicated.

2. RISK MANAGEMENT SYSTEM

2.1. RISK MANAGEMENT SYSTEM, STRATEGY AND POLICIES

Having in mind its area of business, the Bank is susceptible to different risks in its operations and therefore the presence of risks is a general attribute of Bank's different business activities. Related, the Bank has established a comprehensive and reliable risk management system which is based on its clear risk management strategy and integrated in all its business activities, thus ensuring that the Bank's risk profile is in line with its established risk appetite.

Risk management system comprises management of all risks the Bank is or can be exposed to in its operations and encompasses risk identification, measurement and/ or assessment, mitigation and monitoring, including supervision and reporting on risks, In addition to meeting the internal goal of effective and efficient risk management, Bank's risk management system has been developed to fulfil external, and in particular, regulatory requirements.

Bank's proactive risk strategy aims at achieving an optimal acceptable level of risks so as to minimize potential adverse effects to the Bank's capital and financial performance, while at the same time complying with the principles of stability, safety, liquidity and rentability.

Bank's acceptable level of risk, i.e. its risk appetite, represents the structure and maximum level of risks the Bank is willing to take from strategic point of view. Bank's risk appetite is consistent with the Bank's strategic and business plans. Ensuring that the Bank is performing its operations in accordance with determined risk appetite is achieved through regular budgeting process for the following year as well as for the three following years, through implementation of operating goals for individual risk types and operating limits, securing in such a manner integration of risk management system in all Bank's operations.

The Bank has policies and processes according to the defined risk management strategy which provide sufficient support and guidance to achieve strategic goals and regulatory compliance related to management of individual risks, as well as procedures related to the Bank's regular reporting in relation to the risk management. Policies and procedures framework is comprehensive, centrally stored, transparent and accessible for relevant stakeholders.

Given the Bank's business strategy, the key risks for the Bank are credit risk, market risks and operational risk. The Bank also focuses on managing liquidity, concentration and business risks. In addition to managing these risks, the Bank's control and risk management framework takes account of other significant risks faced by the Bank.

2.2. ORGANISATION OF RISK MANAGEMENT

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

The Board of Directors and the Executive Board are ultimately responsible for risk management. The Executive board, and in particular the Executive board member in charge of risks (Chief Risk Officer - CRO), has to perform its oversight function within the Bank's risk management structure. Risk control and management functions within the Bank are performed based on the business and risk strategies approved by the Board of Directors and the strategic risk management framework. The CRO is responsible for the implementation of and adherence to the risk control and risk management strategies across all risk types and business lines. While the Executive board and, in particular the 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 setting limits for the relevant risks are performed at the operating level. The Executive board is supported by several separate independent units and/ or bodies established to perform operational risk control functions and exercise strategic management responsibilities.

Risk Management is committed to the following units/bodies:

Risk Management Division

Risk Management Division, being a separate organisational structure, functionally and organizationally separated from Bank's risk underwriting (front office) activities, is responsible for risk management system within the Bank.

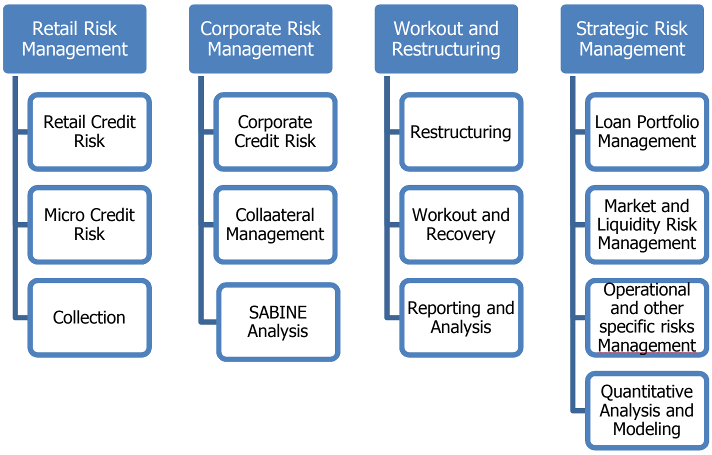
Responsibilities of the Risk Management Division encompass the following:

- Identification and measurement and/or assessment of Bank's exposure to individual risk types;
- Risk monitoring, including risk supervision, analysis and reporting on individual risk types amount, their sources and consequences;
- Measurement and/or assessment of Bank's risk profile and capital adequacy;
- Monitoring of parameters influencing Bank's risk exposure position, primarily including management and optimisation of credit portfolio quality and risk cost;
- Development, application and validation of quantitative risk measurement methods and models, being element of business decision making;
- Developing strategies and proposing Bank's risk exposure limits per different risk types, as well as monitoring of the fulfilment of the same;
- Quantification of stress testing results of changes in economic environment and macroeconomic conditions that influence Bank's financial position and capital;
- New products and processes risk assessment;
- Defining methodologies, rules, policies and procedures for risk management in accordance with applicable regulatory framework, Group requirements as well as Bank's specific circumstances;
- Enabling of consistency and transparency within the process for identification, measurement, management, supervision and reporting on risks;
- Establishment of business practice and development of risk oriented culture by raising employees' awareness on risk management.

Considering different areas of business it covers and with the aim of efficient performance of its responsibilities, Risk Management Division is divided into the following organization units:

- Retail Risk Management Department;
- Corporate Risk Management Department;
- Workout and Restructuring Department;
- Strategic Risk Management Department.

The following diagram presents an overview of Bank's Risk Management Division organisation structure, showing its Departments and associated Units, thus presenting Division's respective control governance.



Strategic Risk Management Division organisation

Retail Risk Management Department focuses on retail business, encompassing private individuals and micro clients. It coordinates retail credit risk management processes and standards, primarily through retail clients underwriting process. The Department is also responsible for collection process from non-performing clients as well as provision of different credit risk analysis and reports on the Bank's retail business.

Corporate Risk Management Department is the operative credit risk management function for Bank's corporate business clients. It is responsible for the formal verification, recommendation and approval of all credit risks of corporate clients, in line with credit competencies.

Workout and Restructuring Department is responsible for collection from as well as restructuring of non-performing accounts in the corporate and micro segments.

Strategic Risk Management Department is responsible for macro-managing the Bank's risk portfolios, provision of adequate risk measurement methodologies and tools as well as an appropriate risk control and policy framework.

Assets and Liability Management Committee

Assets and Liability Management Committee (ALCO) monitors Bank's exposure towards the risks coming from the structure of its balance sheet liabilities and receivables and off-balance sheet items, suggests measures for interest rate risk and liquidity risk management, as well as conducts other operations foreseen by Bank's internal regulation and National Bank of Serbia regulation.

Asset and Liability Management Unit

Asset and Liability Management Unit is organized as an independent organizational unit that reports directly to the Executive Board of the Bank. It is primarily responsible for management of funding and liquidity position of the Bank, as well as management of interest rate risk and foreign currency risk.

Internal Audit Division

Risk management processes throughout the Bank are audited at least annually by the internal audit function, which examines both the adequacy of the procedures and the Bank's compliance with such procedures. Internal audit discusses the results of all assessments with the Bank management and reports its findings and recommendations to the Audit Committee.

Compliance Division

Compliance Division, as independent organizational unit, monitors Bank's operations and procedures compliance with risk relevant regulation and other internal by-laws. Compliance function is performed in accordance with its plan of activity, all in order to mitigate risks.

Compliance Division manages following risks, in line with its organisational structure:

- central compliance – risks of compliance with regulation, risks related to securities within the scope of conflict of interests risk and reputational risk management;
- anty-money laundering compliance – anty-money laundering and terrorism financing risks. Anty-money laundering compliance function acts independently in its activities as defined by relevant regulation;
- financial crime risks management – risks of internal and external frauds, criminal actions, non-compliance with regulation and Bank's internal policies, risk of unethical behaviour.

2.3. RISK MANAGEMENT REPORTING SYSTEM

A reporting framework is vital to provide the Bank's management with steering relevant information. Adequacy in terms of scope, quality and timelines is necessary to enable management to adequately and timely respond to the actual and foreseeable risk developments.

Monitoring and controlling risks is, among other, achieved through a comprehensive reporting system supported by establishment of limits. The limits reflect the business strategy and market environment of the Bank, as well as the level of risks the Bank is willing to accept. Risk exposure and its development are compared against different risk limits set, with closely approaching to or breaching of a limit signalling for management action.

Information compiled from all operating activities are being examined and processed in order to identify, analyze and control new risks. This information is presented and explained to the Board of Directors, Executive Board, Asset and Liabilities Management Committee as well as heads of respective units. Such reports sufficiently inform about the total exposure to different risk types, regions and countries, industries and customer groups, customer and other concentrations, placement and investment forecasts, market risk measurements, liquidity ratios, departure from established limits, etc. Reports are prepared and sent on a daily, weekly or monthly basis or upon management's request.

The most important credit risk reports contain information on the development of volumes in each of the business areas, the quality of the portfolio by rating grades and detailed risk-relevant information on customers at risk of default or already defaulted. The reports serve as a basis for the reviews of the credit policy for the business areas as well as their business and risk strategy.

Reporting on market risks comprises measurement of the market risk in the trading book based on VaR and PVBP measurements. Additionally, external regulatory reporting on market risk, to which the Bank can be exposed to in respect of its banking book and trading book positions, covers balance of net open currency position

Operational risk reports cover development and analysis of different operating risk events and key risk indicators.

The most important reports on liquidity risk encompass reports on liquidity indicator, daily dinar and foreign exchange liquidity, the five-daily liquidity as well as LCR and NSFR as required by Basel III standard.

The Bank calculates and reports the interest rate risk separately by each important currency (currency exposure more than 5% of the balance sheet), in particular EUR and RSD. Analyses are done on monthly or quarterly basis, based on the type of the interest rate risk analyzed. Furthermore, report on market overview is also prepared monthly for ALCO meetings.

In addition to the above said, the Bank quarterly presents comprehensive report on risks to the Board of Directors that includes all relevant information needed to estimate the risks the Bank is exposed to.

Additional reports on risk management are prepared for different levels in the Bank to ensure that all business units have access to comprehensive, necessary and updated information.

2.4. RISK MITIGATION

In the course of a lending transaction, the Bank expects the debt repayment primarily through the future cash flow that is generated by the debtor. In order to supplement this debt repayment and to minimize any loss from a potential default of the debtor the Bank takes collateral security. The Bank takes as much collateral security as possible, with collaterals that can be easily and quickly realized being advantageous. The possibility of taking collateral is dependent on the actual market situation and business competition. Efficiency in credit risk mitigation technique is measured and managed by monitoring time period needed for collateral realization and deviation of collateral realized values from expected values of realisation.

All acceptable types of collateral, as well as regulation of valuation and management of the same, are detailed in an exhaustive Collateral catalogue. The items of security acceptable in secured lending according to this catalogue are constituted (i.e. become effective as security) in compliance with the applicable national laws. This involves valuing and categorising the items of security and using them to mitigate credit risk according to their category.

3. REGULATORY CAPITAL

3.1. REGULATORY CAPITAL STRUCTURE

The Bank complied with the articles of the National Bank of Serbia Decision on Capital Adequacy by Banks (Official Gazette of the Republic of Serbia No. 46/2011) on calculating the regulatory capital.

Total eligible regulatory capital is the sum total of Core capital and Supplementary capital minus deductions.

As at 31 December 2011, the Bank has the following regulatory capital structure:

	RSD '000
	Qualifying capital
Nominal value of paid-in shares, other than cumulative preference shares	10,040,000
Share premium	124,475
Reserves from profit	1,054,168
Retained earnings from previous years	21,510
Intangibles	(295,083)
Regulatory compliance values - Unrealized losses on securities available for sale	(1,470)
Core capital	**10,943,600**
Subordinated liabilities	2,258,450
Part of positive revaluation reserves	23,449
Supplementary capital	**2,281,899**
Required reserves for estimated losses on balance sheet assets and off-balance sheet items	(2,436,112)
Excess qualified investment in non-financial sector entities	(2,888)
Deductions from capital	**2,439,000**
Of which: reduction of Core capital	*1,219,500*
Of which: reduction of Supplementary capital	*1,219,500*
Total core capital	**9,724,100**
Total supplementary capital	**1,062,399**
Total capital	**10,786,499**

Table 1: Regulatory capital structure

The Bank manages its capital structure and performs adjustments in accordance with economic conditions and risks related to the Bank's operations.

Additionally, in the course of its operations, the Bank ensures that its capital never declines below the RSD equivalent value of EUR 10,000,000 at the official NBS middle exchange rate, as proscribed by the Law on Banks.

3.2. KEY FEATURES OF REGULATORY CAPITAL ITEMS

3.2.1. CORE CAPITAL

Share capital

As at 31 December 2011, nominal value of paid-in shares, other than cumulative preference shares, i.e. subscribed and paid-in share capital, of the Bank comprised 1,004,000 ordinary shares with a nominal value of RSD 10,000 each. During 2011 there were no changes in share capital.

The major shareholder of the Bank is Erste Group Bank Ceps Holding GmbH, Vienna holding 74 % of the shares as at 31 December 2011.

The shareholder structure of the Bank as at 31 December 2011 is as follows:

Shareholder	Number of shares	In %
Erste Group Bank Ceps Holding GmbH, Vienna	742,960	74.0 %
Steiermärkische Bank und Sparkassen AG, Graz	261,040	26.0%
Total	**1,040,000**	**100.0%**

Table 2: Shareholders structure

Share premium

Share premium amounting to RSD 124,475 thousand as at 31 December 2011 resulted from a positive difference between the selling price of the shares and their nominal value.

Reserves from profit

Reserves from profit amount to RSD 1,054,168 thousand as at 31 December 2011. Reserves from profit amounted to RSD 736,001 thousand as at 31 December 2010 and were increased by RSD 318,167 thousand from the 2010 retained earnings, in accordance with the General Assembly's Decision dated 21 April 2011.

Other

Retained earnings from previous years of RSD 21,510 refer to actuary gain determined in accordance with IAS 19.

Intangible assets as at 31 December 2011 of RSD 295,083 mainly encompass licences.

Unrealized losses on securities available for sale amount to RSD 1,470 thousand.

3.2.2. SUPPLEMENTARY CAPITAL

Subordinated liabilities

Outstanding balance of subordinated liabilities, fulfilling criteria for inclusion in Supplementary capital, is as follows as at 31 December 2011:

RSD '000

Creditor	Currency	Contracted amount	Maturity date	In %	31 December 2011
EGB Ceps	EUR	10,800,000	20 Dec 2015	35.4%	861,045
Erste GCIB	EUR	15,000,000	27 Dec 2021	64.6%	1,569,614
Total		**25,800,000**		**100.0%**	**2,430,659**

Table 3: Subordinated liabilities composition

Subordinated long-term loan granted by Erste Group Bank Ceps Holding GmbH, Vienna was granted on 20 December 2005 in the amount of EUR 10,800,000 for the period of 10 years with a 5 year grace period. In accordance with the loan agreement, loan principal is repayable in 21 quarterly repayments and the first repayment is due upon the end of the grace period.

Subordinated long-term loan granted by Erste GICB Finance, Amsterdam was granted on 27 December 2011 in the amount of EUR 15,000,000 for the period of 10 years with a 5 year grace period. In accordance with the loan agreement, loan principal is repayable in 21 quarterly repayments and the first repayment is due upon the end of the grace period.

In accordance with NBS Decision on Capital Adequacy by Banks, subordinated term debt included in Supplementary capital is, during the last five years to maturity, reduced by a cumulative discount factor of 20% per year and consequently shall not be included in Supplementary capital in the last year of maturity. Accordingly, contracted amount of subordinated long-term loan granted by Erste GICB Finance, Amsterdam has been reduced by a respective discount factor.

The table below summarises amount of subordinated liabilities included in Supplementary capital as at 31 December 2011:

RSD ' 000

Creditor	Supplementary capital
Erste Group Bank Ceps Holding GmbH, Vienna	688,836
Erste GICB Finance, Amsterdam	1,569,614
Total	**2,258,450**

Table 4: Supplementary capital composition

Part of revaluation reserves

Revaluation reserves refer to securities quoted on the stock exchange and which are once a month aligned to the current market price. Based on these alignments, the Bank has realised positive revaluation reserves of RSD 23,449 thousand (after tax deduction).

3.2.3 DEDUCTIONS FROM CAPITAL

Items deductible from capital are deducted from Core and Supplementary capital in the manner that 50% is deducted from Core capital and 50% from Supplementary capital.

As at 31 December 2011 the following items were items deductible from capital:

Required reserves for estimated losses

Required reserves for estimated losses on balance sheet assets and off-balance sheet items equals the sum of positive differences, determined at each borrower level, between the reserve for estimated losses calculated in accordance with the NBS Decision on the Classification of Bank Balance Sheet Assets and Off-balance Sheet Items (Official Gazette of the Republic of Serbia No. 94/2011) and the established amount of allowances for impairment of balance sheet assets and off-balance sheet loss provisions calculated in accordance with IFRS/ IAS.

As at 31 December 2011 required reserves for estimated losses on balance sheet assets and off-balance sheet items amounted to RSD 2,436,112 thousand. The entire amount of required reserves for estimated losses the Bank treated as deductible item from capital.

Excess qualified investment

Excess qualified investment in non-financial sector entities amount to RSD 2,888 thousand as at 31 December 2011 and were used as deductible item from capital.

4. CAPITAL ADEQUACY

4.1. REGULATORY CAPITAL REQUIREMENTS

Under Decision on Capital Adequacy by Banks, the full amount of the capital requirements is calculated and its relationship to the regulatory capital is established. The eligible regulatory capital must be available at least in the amount of the sum of minimum capital requirements.

The minimum capital requirements pursuant to the Decision on Capital Adequacy by Banks, i.e. capital adequacy ratio, of 12% were complied at all times during the reporting period. As at 31 December 2011 capital adequacy ratio amounted to 24.37%.

Based on the business activities of the Bank, the following minimum capital requirements result for credit risk, market risks (i.e. price risk on debt securities and foreign exchange risk) and operational risk.

4.1.1. CREDIT RISK

Capital requirement for credit risk is calculated by multiplying total credit risk-weighted assets by 12%. The Bank calculates credit risk-weighted assets by applying standardized approach.

External ratings by external rating agencies have not been used to calculate risk-weighted assets as at 31 December 2011.

Further information on the topic is available in Chapter 6.1.

The table below shows an overview of total minimum capital requirements to cover credit risk as at 31 December 2011. The credit risk capital requirement is broken down into exposure classes as follows.

RSD '000

Exposure class	Capital requirement
Central Governments and Central Banks	-
Local Governments and Local Authorities	18,335
Public Administrative Bodies	-
Banks	70,652
Corporates	2,933,252
Retail	1,631,973
Exposures secured by residential property	311,997
Past due exposures	29,414
Other items	127,007
Total	**5,122,630**

Table 5: Capital requirements for credit risk per exposure class

4.1.2. MARKET RISKS

As at 31 December 2011, the Bank calculates regulatory minimum capital requirements to cover following market risks: price risk on debt securities and foreign exchange risk.

Regulatory minimum capital requirements for price risk on debt securities is calculated as sum of capital requirements for general and specific price risk on these securities, multiplied by 1.5. Capital requirement for general price risk on debt securities is calculated by applying duration method. As at 31 December 2011 the Bank was not exposed to specific price risk on debt securities.

Capital requirement for foreign exchange risk the Bank calculates as 12% of the sum of total net open foreign currency position and absolute value of net open position in gold.

The table below gives an overview of the total minimum capital requirements to cover market risks broken down by risk type as at 31 December 2011:

RSD '000

Market risks	Capital requirement
Capital requirement for price risk on debt securities	6,038
Capital requirement for foreign exchange risk	24,097
Total	**30,135**

Table 6: Capital requirement for market risks

4.1.3. OPERATIONAL RISK

For the calculation of regulatory capital requirements for operational risk the Bank uses Basic Indicator Approach (BIA).

As at 31 December 2011, capital requirement for operational risk totalled RSD 627,997 thousand.

5. INTERNAL CAPITAL ADEQUACY ASSESSMENT PROCESS

5.1. THE PROCESS

The Internal Capital Adequacy Assessment Process (ICAAP) is established with the aim to assess and maintain on an ongoing basis the internal capital that the Bank considers adequate to cover the nature and level of risks to which it is exposed. ICAAP essentially serves to assess as to whether the Bank can "afford" its acquired risks by comparing its risk portfolio across all material risk types with its internal capital (coverage potentials*).*

The ICAAP is designed to support the Bank's proactive and consistent risk management at all times, assuring adequate capital capacity reflecting the nature and level of the Bank's risk profile. The ICAAP defines the rules for quantification of all material risks to which the Bank is or can be exposed, irrespective of the regulatory requirements proscribed by the NBS Decision on Capital Adequacy by Banks.

Further on, ICAAP is designed to reflect capital strategy and assure proactive management of capital requirements. By means of planning internal capital, the Bank assures maintenance of such a level and structure of capital which can support expected portfolio growth, future sources of funds and their utilization, dividend policy as well as all changes in regulatory capital requirements.

ICAAP as a management tool predominantly aims for:
- Analysis, monitoring and reporting of the Bank's risk profile;
- Analysis, monitoring and reporting of the Bank's internal capital adequacy/ coverage capacity in relation to its risk profile;
- Forecasting of trends with regards to the Bank's risk profile as well as its capital.

Internal capital adequacy assessment process encompasses the following phases:
- identification of materially significant risks;
- calculation of the amount of necessary internal capital for individual risks, i.e. economic capital;
- determination of the total internal capital;
- comparison of the amount of capital calculated in accordance with the Decision on Capital Adequacy of Banks (i.e. regulatory capital) and the amount of necessary internal capital.

Within ICAAP, an internally designed model, Risk-bearing Capacity Calculation (RCC), has been developed in order to define the internal capital adequacy as required by the ICAAP. RCC measures the risks the Bank is exposed to and compares them to the internal capital the Bank has for covering such risks. It essentially determines whether the Bank can "afford" its acquired risks by comparing Bank's economic capital with its internal capital.

For the purpose of ICAAP, decision was made to solely consider risks defined as material within RCC via economic capital allocation. More specifically, economic capital is the amount of capital needed to cover all the Bank's material risks calculated by using economical measures, described further in this chapter, without consideration of any diversification effects. This economic capital is then compared to internal capital (coverage potentials) equalling balance sheet equity. Internal capital differs from regulatory capital calculated in accordance with NBS Decision on capital adequacy of banks.

In general, the entire coverage potential has to be higher than or equal to the Bank's overall risk exposure. The Bank has defined a Maximum Risk Exposure Limit (MREL) as one of different measures to express and monitor the Bank's risk appetite. The MREL amounts to entire coverage potential reduced for the stress tests results, which portray effects of potential severe but plausible future adverse events or deteriorations of the economic environment which could have a negative effect on the Bank.

Additionally, a traffic light system has been deployed in order to signal the management the extent to which the MREL of the Bank is utilized and to ensure sufficient time to respond to changes by taking relevant measures on either the risk or the capital side.

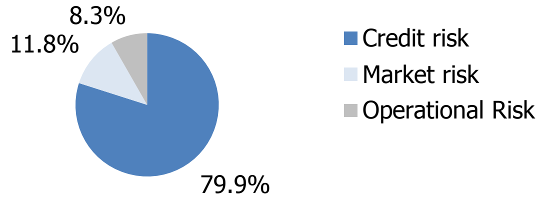
Within the internal capital adequacy assessment process the Bank considers local regulatory requirements, namely the National Bank of Serbia Decision on Risk Management by Banks (Official Gazette of the Republic of Serbia No. 45/2011 and 94/2011). At the same time the Bank complies with the Group standards[1].

Bank's ICAAP framework has been introduced in 2011.

The illustration on the right shows the distribution of risk types which form the economic capital requirements of the Bank.

The results of the risk-bearing capacity calculation are presented in the table below:

Economic capiral requirements by risk type in %



Risk-bearing capacity calculation as at 31 December 2011	RSD '000
Economic capital requirement	8,133,797
Coverage potential	14,476,006
Excess	6,342,209

Table 7: Risk-bearing capacity calculation

5.2. MATERIAL RISKS

Materiality of risks was assessed on the basis of clear quantitative and qualitative factors defined for each risk type, while at the same time complexity of Bank's operations as well as particularities of surroundings where it performs its operations were taken into consideration.

The Bank currently assesses the following risk types as material and consequently considers them within RCC:

- Credit Risk
- Market Risk in the Trading Book
- Market Risk in the Banking Book
- Operational Risk

Credit Risk within the Bank is for ICAAP purposes calculated as 12% of the Risk Weighted Assets (RWA) calculated for Group Pillar 1 purposes in accordance with Austrian Solvency Regulation (Austrian Federal Law Gazette II No 374/2006 and 253/2007)[2]. The Bank's current RWA calculation for Group reporting purposes is based on standardized approach and in the forward looking manner the Bank will endeavour to implement IRB approach.

For Market Risk within the Trading Book, the Bank uses a VaR approach based on daily historical simulation for the calculation of 1-day VaR at 99% confidence level, which is then scaled up to 1-year horizon and a confidence level of 99.9%.

For Market Risk within the Banking Book the Bank applies historical simulation approach based on actual balance sheet position of the Bank and the one year changes of market interest rates in the preceding five years. The actual balance sheet position is revalued using the scenario corresponding to the selected worst year on year changes of interest rates.

For the purpose of calculating Operational Risk, the Bank applies Basic Indicator Approach (BIA).

[1] Group standards are in alignment with Basel 2 under Pillar 2 (Supervisory Review Process as stipulated in the EU directive no. 2006/48/EG).

[2] The single largest difference between local NBS and Austrian capital adequacy regulation refers to risk weight assigned to exposures within the Exposure class Central governments and Central banks denominated in currency other than RSD – according to local regulation risk weight of 0% assigned while risk weight of 100% assigned for Austrian reporting purposes.

6. RISK TYPES

6.1. CREDIT RISK

6.1.1. RISK MANAGEMENT AND CONTROL

Credit risk is the risk that credit beneficiaries will not be able to fulfil contractual obligations to the Bank, whether fully or partially, that will generate the loss for the Bank.

Bank's business policy requires and foresees the maximum protection from credit risk, being the most important risk in the banking industry. By its internal by-laws, policies and procedures for credit risk management, the Bank has implemented an adequate credit risk management system so as to reduce the credit risk to an acceptable level.

The Bank's credit risk is caused by the debtor's creditworthiness, timeliness in the performance of obligations to the Bank as well as quality of the collateral.

The Bank controls and manages credit risk primarily by establishing rigorous processes for determining minimal creditworthiness of the debtor during the credit approval process, as well as by regular monitoring of the same during the credit contract life, by defining different levels of underwriters (reflecting skills and experience of employees), by establishing limits, which define the level of risk the Bank is willing to accept on the individual client, geographical area and industry basis as well as through monitoring of the said limits.

6.1.2. PAST DUE DEFINITION

The ongoing Bank's assessment of the customers' ability to meet their obligations is carried out using a large number of risk management instruments. This includes consistent monitoring of the portfolio past due loans.

The payments are considered past due as of the date when:

- the borrower did not make a contractually agreed payment in due time, and the amount concerned is significant[3];
- the borrower exceeded approved credit limit.

6.1.3. VALUE ADJUSTMENTS AND PROVISIONS

Credit risk inherent in the banking business is taken into account through assessment of an allowance for impairment for lending recognised on the balance sheet and through provisions for off-balance sheet transaction (hereinafter: loan loss provisioning), in accordance with International Accounting Standards (IAS)/ International Financial Reporting Standards (IFRS).

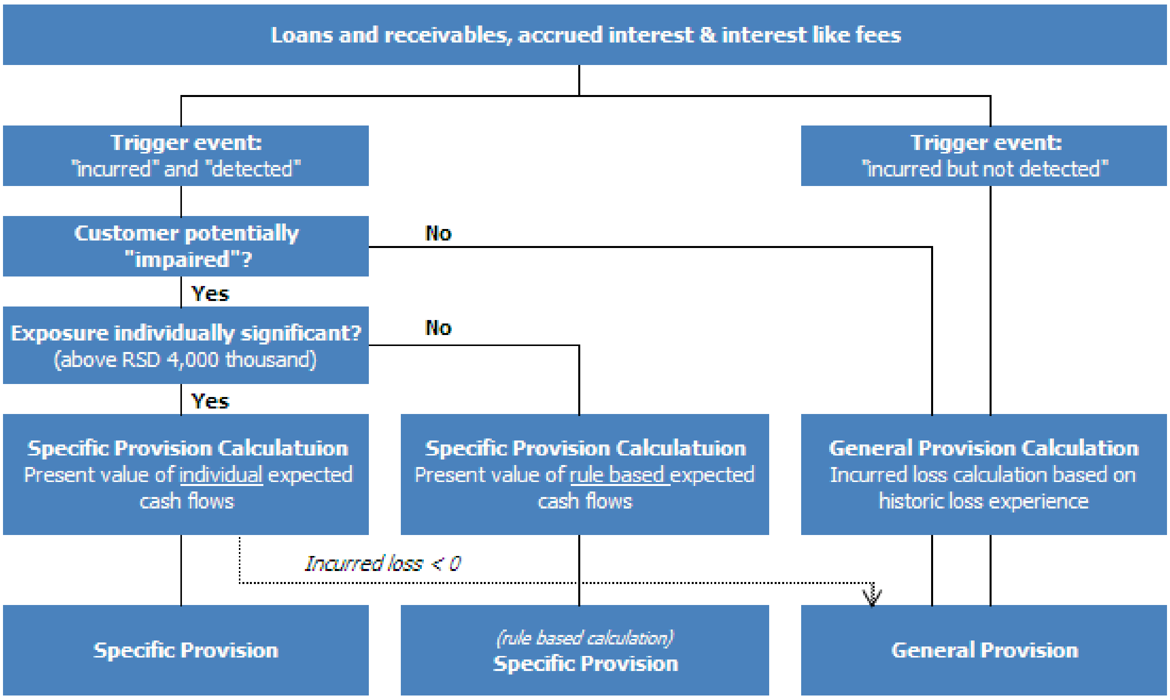
Bank's loan loss provisioning includes Specific provision (individual assessment) and General provision (collective impairment).

[3] Amount in delay is considered significant if larger than 1% of the placement or RSD 10,000 (RSD 1,000 for Retail clients), depending which amount is higher.

Specific provision is assigned when there is objective evidence that credit exposure is impaired. Exposure is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the exposure (an incurred "loss event") and that loss event (or events) has an impact on the estimated future cash flows of the exposure that can be reliably estimated.

Portfolio provision is applied for exposures that show no objective evidence of impairment and have not been individually assessed for impairment. Portfolio provision calculation is used for incurred but not detected losses i.e. an actual impairment has not yet occurred. These placements are impaired even though there is no current evidence that credit risk losses have occurred, as experience indicates that some of them will become impaired over time. Portfolio provision is allocated to cover potential losses that are not captured in the provisions for individually assessed exposures and reflects incurred but not yet reported losses of the portfolio with no impairment signals.

The following loan loss provisioning process is implemented in the Bank:



Trigger event

Trigger event for a potential impairment, i.e. loss event, implies that the Bank will be unable to collect all amounts according to the contractual terms (principal amount, interest and/ or fees). A customer is deemed defaulted if a trigger event in accordance with the following definition has occurred:

- the obligor is more than 90 days overdue on any material credit obligation, or
- the obligor is considered unlikely to repay its credit obligations in full due to: experienced financial difficulties, receivables restructuring resulting in financial loss for the Bank, insolvency or liquidation procedures as well as other events that permit the conclusion that the obligor is unlikely to pay its credit obligations in full to the Bank.

Specific Provision assessment

For each impaired exposure specific loan loss calculation method based on discounted cash flow model must be applied.

Impaired exposures with a single customer that, in the aggregate, equal or exceed a materiality threshold of RSD 4,000 thousand are assumed to be individually significant. Individually significant impaired exposures are assessed individually using discounted cash flow method, where expected cash flows from redemption and foreclosure of collateral are estimated by the responsible Workout manager. The provisioning requirement is the difference between the book value of impaired exposure and the present value of expected cash flow from recoveries, discounted at the original effective interest rate for that exposure.

For any individually significant placements that have been individually assessed for impairment and found not to be impaired, general provision is assigned.

For non-significant impaired exposures, the calculation is done on a rule basis. Customers belonging to this sub-portfolio are divided by criteria of regularity of settling liabilities.

General Provision assessment

Loans which show no objective evidence of impairment are grouped on the grounds of similar credit risk characteristics and their respective provisioning is calculated depending on group characteristics and level of credit risk.

Future cash flows on a group of assets that are collectively evaluated for impairment are estimated on the basis of contracted cash flows and historical loss experience for assets with credit risk characteristics similar to those in the group.

Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the years on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently.

The Bank regularly reviews the methodology and assumptions used for estimating future cash flows in order to reduce any differences between loss estimates and actual loss experience.

6.1.4. QUANTITATIVE DISLOSURES

Bank's gross credit risk exposure after accounting write-offs and excluding adjustment for credit risk mitigation techniques, per exposure class as at 31 December 2011 is shown in the table below[4]:

Exposure class	Exposure (*RSD '000*)	Exposure (*% of total*)
Central Governments and Central Banks	19,351,682	17.1%
Local Governments and Local Authorities	338,985	0.3%
Public Administrative Bodies	14,444	0.0%
Banks	18,956,341	16.8%
Corporates	36,269,407	32.1%
Retail	22,217,457	19.7%
Exposures secured by residential property	3,882,642	3.4%
Past due exposures	7,443,390	6.6%
Other items	4,538,452	4.0%
Total	**113,012,800**	**100.0%**

Table 8: Gross exposure after accounting for write-offs by exposure class

[4] Average amount of gross credit risk exposure after accounting write-offs, excluding effects of credit risk mitigation techniques, during reporting period has not been presented as historic data is not available.

The following tables give comprehensive breakdown of Gross credit risk exposure into groups of materially significant geographical areas.

Geographic area	Exposure (*RSD '000*)	Exposure (% of total)
Serbia	103,006,574	91.2%
Austria	7,694,025	6.8%
Other	2,312,201	2.0%
Total	**113,012,800**	**100.0%**

Table 9: Gross Exposure by materially significant geographic areas

Geographic area	Exposure class	Exposure (*RSD '000*)
Serbia	Central Governments and Central Banks	19,351,682
	Local Governments and Local Authorities	338,985
	Public Administrative Bodies	14,444
	Banks	9,780,858
	Corporates	35,452,984
	Retail	22,203,137
	Exposures secured by residential property	3,882,642
	Past due exposures	7,443,390
	Other items	4,538,452
Austria	Banks	7,694,025
Other	Banks	1,481,458
	Corporates	816,423
	Retail	14,320
Total		**113,012,800**

Table 10: Gross Exposure by materially significant geographic areas and per exposure class

Tables below give a breakdown of Gross credit risk exposure by sector per exposure class as well as a comprehensive preview of Past due Exposure class.

Sector	Exposure (*RSD '000*)	Exposure (% of total)
Private individuals	24,971,055	22.1%
Processing industry and mining	13,630,411	12.1%
Trade	8,353,886	7.4%
Energy	1,146,227	1.0%
Agriculture, hunting, fishing and forestry	1,489,759	1.3%
Construction	4,825,100	4.3%
Traffic and communications, tourism, catering and services	10,207,062	9.0%
Entrepreneurs	977,441	0.9%
Agriculturalist	1,009,784	0.9%
Banks	37,710,366	33.4%
Other financial institutions	205,479	0.2%
Other	8,486,230	7.5%
Total	**113,012,800**	**100.0%**

Table 11: Gross Exposure by sectors

Sector	Exposure class	Exposure (RSD '000)	Exposure (% of total)
Private individuals	Retail	21,095,758	18.7%
	Exposures secured by residential property	2,673,377	2.4%
	Past due exposures	1,201,920	1.1%
Processing industry and mining	Corporates	11,914,938	10.5%
	Exposures secured by residential property	246,929	0.2%
	Past due exposures	1,468,544	1.3%
Trade	Corporates	7,124,574	6.3%
	Exposures secured by residential property	371,199	0.3%
	Past due exposures	858,113	0.8%
Energy	Corporates	1,143,166	1.0%
	Past due exposures	3,061	0.0%
Agriculture, hunting, fishing and forestry	Corporates	1,336,806	1.2%
	Exposures secured by residential property	48,100	0.0%
	Past due exposures	104,853	0.1%
Construction	Corporates	4,051,340	3.6%
	Exposures secured by residential property	145,711	0.1%
	Past due exposures	628,049	0.6%
Traffic and communications, tourism, hospitality and services	Corporates	9,181,421	8.1%
	Exposures secured by residential property	270,554	0.2%
	Past due exposures	755,087	0.7%
Entrepreneurs	Corporate	179,768	0.6%
	Retail	637,232	0.2%
	Exposures secured by residential property	65,759	0.1%
	Past due exposures	94,682	0.1%
Agriculturalist	Corporate	238,962	0.4%
	Retail	484,467	0.2%
	Exposures secured by residential property	55,715	0.0%
	Past due exposures	230,640	0.2%
Banks	Central Governments and Central Banks	14,316,589	12.7%
	Banks	18,855,126	16.7%
	Past due exposures	199	0.0%
	Other exposures	4,538,452	4.0%
Other financial institutions	Banks	81,691	0.1%
	Corporates	39,644	0.0%
	Exposures secured by residential property	1,026	0.0%
	Past due exposures	83,118	0.1%
Other	Central Governments and Central Banks	5,035,093	4.5%
	Local Governments and Local Authorities	338,985	0.3%
	Public Administrative Bodies	14,444	0.0%
	Banks	19,524	0.0%
	Corporates	1,058,788	0.9%
	Exposures secured by residential property	4,272	0.0%
	Past due exposures	2,015,124	1.8%
Total		**113,012,800**	**100.0%**

Table 12: Gross Exposure by sector and per exposure class

RSD '000

Past due Exposure class	Exposure	Exposure (% of total)
Banks	8,358	0.1%
Corporates	5,907,789	79.4%
Retail	1,527,242	20.5%
Total	**7,443,390**	**100%**

Table 13: Pas due gross exposure class exposure and impairment amount per initial exposure class

Break down of Gross credit risk exposure into maturity buckets is shown below.

Maturity bucket	**Exposure (*RSD '000*)**	**Exposure (*% of total*)**
< 1 years	71,526,960	63.3%
1 – 3 years	11,197,396	9.9%
> 3 years	30,288,444	26.8%
Total	**113,012,800**	**100%**

Table 14: Gross Exposure according to remaining maturity

RSD '000

Exposure class	**Exposure**			
	<1 years	**1 – 3 years**	**>3 years**	**Total**
Central Governments and Central Banks	18,935,512	416,170	-	19,351,682
Local Governments and Local Authorities	9,235	25,568	304,182	338,985
Public Administrative Bodies	14,444	-	-	14,444
Banks	18,949,613	5,702	1,026	18,956,341
Corporates	18,380,533	6,179,045	11,709,829	36,269,407
Retail	4,651,941	3,623,338	13,942,178	22,217,457
Exposures secured by residential property	240,528	426,855	3,215,259	3,882,642
Past due exposures	5,806,702	520,718	1,115,970	7,443,390
Other items	4,538,452	-	-	4,538,452
Total	**71,526,960**	**11,197,396**	**30,288,444**	**113,012,800**

Table 15: Gross Exposure according to remaining maturity and principal exposure class

The table below shows changes in the amount of balance sheet impairment and probable losses on off balance sheet assets (i.e. loan loss provisioning):

	Provisions (*RSD '000*)
Provisions as at 01 January 2011	4,977,280
Provisions allocation during the year	7,908,417
Provisions release during the year	(6,936,178)
Provisions write off during the year	-
Other	(14,573)
Provisions as at 31 December 2011	**5,934,946**

Table 16: Loan loss provision movement

As at 31 December 2011, reserve for estimated losses and required reserve for estimated losses, calculated in accordance with National Bank of Serbia Decision on Classification of Bank Balance Sheet Assets and Off-balance Sheet Items, per counterparty type, amounted to[5]:

RSD '000

	Category of classification					
Counterparty type	**A**	**D**	**V**	**G**	**D**	**Total**
Banking	29,075	95,132	22,290	-	80,944	227,441
Public enterprises	4,222,761	206,975	11,866	-	-	4,441,602
Other companies	15,939,455	8,531,072	4,003,916	1,937,190	3,167,806	33,579,439
Entrepreneurs	534,051	217,461	60,878	53,709	77,149	943,248
Public sector	-	329,753	-	-	-	329,753
Retail	19,084,519	177,194	49,736	451,670	1,132,549	20,895,668
Foreign persons	2,905,174	277,417	-	3	31,198	3,213,792
Agricultural producers	344,174	24,917	58,079	53,774	130,512	611,456
Other clients	89,297	63,191	15	32,165	1,489,919	1,674,587
Total	**43,148,506**	**9,923,112**	**4,206,780**	**2,528,511**	**6,110,077**	**65,916,986**
Reserve for estimated losses	**-**	**164,088**	**510,922**	**681,177**	**6,103,538**	**7,459,725**
Provisions	**659,061**	**247,938**	**141,667**	**397,699**	**4,480,139**	**5,926,504**
Required reserve for estimated losses	**-**	**17,088**	**380,477**	**412,461**	**1,626,086**	**2,436,112**

Table 17: Exposure by NBS classification category

[5] Exposure presented in the table differs from Exposure for RWA purposes as different principles are applied for the calculation of classification basis calculated in accordance with NBS Decision on classification of balance sheet assets and off-balance sheet items and RWA basis calculated in accordance with NBS Decision on capital adequacy by banks.

6.1.5. CREDIT RISK MITIGATION

Management and Control

In process of credit risk capital requirements calculation, whether a type of security is admitted for credit risk mitigation is decided by the Strategic Risk Management Department after determining whether applicable legal requirement proscribed by NBS Decision on Capital Adequacy of Banks are met. The items of security acceptable as credit hedging instruments are detailed in a separate Bank's internal policy defining eligible credit hedging instruments as well as criteria for recognition of an instrument as a credit risk mitigation technique.

Main Types of Material Credit Hedging

The Bank predominantly uses cash and cash equivalents deposited with the Bank as a means of material credit protection.

The Bank does not yet use balance sheet and off-balance sheet netting for credit risk mitigation.

Main Types of Guarantors and Credit Derivative Counterparties

Guarantees used as immaterial credit hedge are provided by:

- central governments – only Republic of Serbia guarantee eligible as at 31 December 2011;
- commercial banks of sufficient credit quality – for claims with remaining maturity of three months or more secured by bank guarantee, the Bank assigns a risk weight that is assigned to the claims on the sovereign of the country of guarantor bank's incorporation or risk weight of 50%, depending which is less favourable.

Credit derivatives business has not been transacted during the reporting period.

Exposure Secured by Residential Property Exposure class

Residential real estate, i.e. buildings and land that are or will be occupied by the borrower or that are or will be rented, is acceptable as means of security when all applicable criteria proscribed by NBS Decision on Capital Adequacy by Banks are met. However, fulfilment of required criteria is treated as a means for of classification of a given exposure into separate Exposure class with corresponding favourable risk weight rather than application of credit risk mitigation technique.

Quantitative Disclosures

The table below presents exposure before and after the use of credit protection, i.e. adjustment for effects of Credit Risk Mitigation techniques (CRM), for every level of credit quality, including exposures representing deductibles from capital.

RSD '000

Exposure class	Risk weight band	Exposure	Exposure after CRM[6]	Exposure (% of total)
Central Governments and Central Banks	0%	19,351,682	23,553,967*	17.1%
Local Governments and Local Authorities	50%	338,985	331,850	0.3%
Public Administrative Bodies	0%	14,444	14,026	0.0%
Banks	20%	18,108,284	18,060,858	16.0%
	50%	39,496	22,918	0.0%
	100%	771,937	771,111	0.7%
	150%	36,624	36,624	0.0%
Corporates	100%	36,269,407	29,623,643*	32.1%
Retail	75%	21,005,986	20,019,716	18.6%
	100%	1,211,471	1,095,902	1.1%
Exposures secured by residential property	35%	3,882,642	3,794,884	3.4%
Past due exposures	100%	7,243,841	1,640,005	6.4%
	150%	199,549	194,543	0.2%
Other items	0%	3,408,238	3,408,238	3.0%
	100%	1,130,214	1,116,692	1.0%
Total		**113,012,800**	**103,684,977**	**100.0%**

Table 18: Gross exposure before and after CRM per exposure class

Concentration risk from credit risk mitigation techniques is understood as the risk of a detrimental correlation that may arise from the use of these techniques. This may affect a single customer, but also a portfolio defined by region, industry or type of security. Correlation risk is monitored and indentified in the course of portfolio monitoring through analysis of various customer segments per collateral type.

Gross exposure per exposure class is secured by the following amount of collateral type recognised as credit risk mitigation as at 31 December 2011:

RSD '000

Exposure class	Exposure	Guarantees	Cash deposit
Central Governments and Central Banks	19,351,682	-	-
Local Governments and Local Authorities	338,985	-	-
Public Administrative Bodies	14,444	-	-
Banks	18,956,341	-	-
Corporates	36,269,407	4,202,285*	771,363
Retail	22,217,457	-	190,452
Exposures secured by residential property	3,882,642	-	-
Past due exposures	7,443,390	-	4,268
Other items	4,538,452	-	-
Total	**113,012,800**	**4,202,285**	**966,083**

Table 19: Gross exposure and CRM by type of CRM

**Total amount of CRM acceptable guarantees refers to a State provided guarantee, resulting into substitution of exposure between Asset classes Corporates and Central Governments and Central Banks.*

[6] Exposure after CRM amount is calculated by applying CRM on Gross exposure after impairment.

6.2. INTEREST RATE RISK

6.2.1. RISK MANAGEMENT AND CONTROL

Interest rate risk is the risk of a change in the market value of the balance sheet as a result of a certain change in the yield curve. Changes in the yield curve can have a negative effect on net interest income and the amounts of interest-sensitive income and expenses. These changes also affect the market value of assets, liabilities and off-balance sheet items, as the future payments (and thus also their present value) vary directly with changes in interest rates. As a consequence, an effective risk management process that keeps the impacts of interest rate changes on the Bank's balance sheet within appropriate limits is of fundamental importance to the security and creditworthiness of the Bank.

6.2.2. RISK MEASUREMENT

In 2010, the Bank installed a specific software that makes planning possible as well as the modelling of the interest rate risk behaviour and the influence on the balance sheet of the Bank. This software captures all significant sources of interest rate risk and calculates the effect of these sources changes on the balance sheet of the Bank. The data for the current portfolio, market data for the date of modelling in question and assumptions on future portfolio developments (volume, margins, etc.) are all entered into the software by the Bank's employees. The software measures both the effect on profit and the market value of the banking book positions.

The data in the system is organised according to an account/ product structure. The account structure corresponds to that of the IRS/ IFRS balance sheet, while the product structure represents the currency and the interest rate-related behaviour of the products in this group.

Key assumptions used in risk measurement

Products without fixed maturity are simulated based on maturity/ interest rate profile analyses done. For the modelling of interest rate risk behaviour of products with variable interest rates, the Bank currently uses the applicable internal transfer pricing (moving average of short- and long term interest rates) increased by a certain margin.

6.3. REFERENCE ON OTHER AND NON-DISCLOSED ITEMS

Disclosures on credit risk required in situations when a bank applies IRB approach for capital requirements calculation, proscribed by NBS Decision on Disclosure of Data and Information by Banks, are not applicable as the Bank uses standardised approach for capital requirements calculation as at 31 December 2011. Disclosures relating to credit risk agencies are not applicable as at 31 December 2011 as the external credit ratings by credit rating agencies were not applied for risk weighted assets calculation.

Disclosures on counterparty risk proscribed by NBS Decision on Disclosure of Data and Information by Banks are not applicable as the Bank is not exposed to counterparty risk as at 31 December 2011.

Disclosures on market risks proscribed by NBS Decision on Disclosure of Data and Information by Banks are not applicable as the Bank does not apply internal models approach for the calculation of capital requirements for market risks. More details on market risks management are presented in Notes to financial statements for the year ended 31 December 2011, note 32.4.

Disclosures on operational risk proscribed by NBS Decision on Disclosure of Data and Information by Banks are not applicable as the Bank does not apply advanced approach for the calculation of capital requirements for operational risk. Details on the management of operational risk are presented in the Notes to financial statements for the year ended 31 December 2011, note 32.8.

Disclosures referring to exposures arising from equity investments in the banking book are presented in the Notes to financial statements for the year ended 31 December 2011, notes 2.6.5, 3c, 3, 12, 13,19, 32.2a, 32.3, 32.4.2 i 32.10.

Novi Sad, 31 May 2012

Approved by the management of Erste Bank a.d., Novi Sad: