Erste Bank a.d. Novi Sad

Disclosure of data and information for the year ended 31 December 2012

GENERAL INFORMATION

ERSTE BANK A.D. NOVI SAD

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DEFINITIONS

Economic capital	Amount of capital needed to cover all the Bank's risks using economical measures to ensure its sustainability
Internal capital	Amount of capital, including capital like components, according to the Bank's internal definitions
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
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 of Banks
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
Regulatory capital	Amount of capital charges according to National Bank of Serbia Decision on Capital Adequacy of Banks
Risk Profile	Bank's assessment of the structure and level of risks it is or could be exposed to in its operations
Value at Risk	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	Credit Risk Officer
ICAAP	Internal Capital Adequacy Assessment Process
IRB	Internal Ratings Based Approach
LCR	Liquidity Coverage Ratio
NSFR	Net Stable Funding Ratio
IAS	International Accounting Standards
IFRS	International Financial Reporting Standards
MREL	Maximum Risk Exposure Limit
NBS	National bank of Serbia
p.a.	per annum
PVBP	Price Value Basis Point
VaR	Value-at-Risk
RCC	Risk-bearing Capacity Calculation
PD	Probability of Default
EAD	Exposure at Default
LGD	Loss Given Default
RSD	Republic of Serbia Dinar
RWA	Risk Weighted Assets
AMA	Advanced Measurement Approach

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 2012 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.

Activities that ensure correctness and adequacy of 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.

The risk management strategy is described and defined in details within the following Bank's documents: Risk Materiality Assessment Policy, Risk-bearing Capacity Calculation Policy, Stress Testing Policy and Risk Appetite Statement Policy. The documents layout the summary and definitions of all risks the Bank is or may be exposed to, long-term goals determined by the bank's business policy and strategy, as well as propensity to risks defined in accordance with these goals, main principles of risk assumption and risk management, risk materiality assessment, methodology on capital requirements calculation, stress testing methodology as well as other main principles of the internal capital adequacy assessment process.

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 following four 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 established 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 and concentration 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 Management Board and the Executive Committee are ultimately responsible for risk management. The Executive Committee, and in particular the Executive Committee 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 Committee 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 Committee 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 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;
- Risk assessment of new products and processes;
- 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.

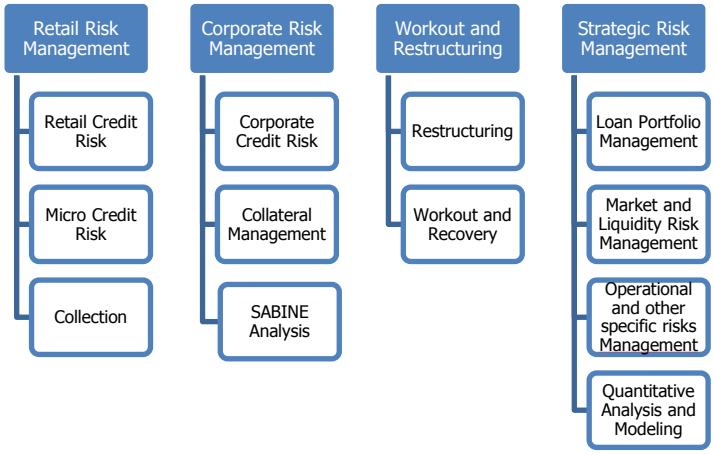


Figure 1: Strategic Risk Management Division organisation

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. Department is also responsible for management and monitoring of collaterals provided by Bank's corporate clients.

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

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.

Credit Committee

Credit Committee as decision making authority is responsible for loan underwriting and approving Bank exposure towards customers. Committee is organised in five levels (CC1 to CC5) depending on the total client limit, its collateral coverage and rating. Any decision has to follow the 4-eye-principle suggesting that any decision has to be signed by two competent decision makers (approval authorities).

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, and 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 is reports directly to the Executive Committee 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

Internal Audit conducts independent evaluation of Risk management processes, regularly performs assessment of the Bank's internal control system - its adequacy, reliability and efficiency, and reports their findings to Bank's management and 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;
- anti-money laundering compliance – anti-money laundering and terrorism financing risks;
- 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 limits set in order to ensure adequate risk profile of the Bank.

Information compiled from all operating activities are being examined and processed in order to identify, analyse and control new risks. This information is presented and explained to the Management Board, Executive Committee, 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, market risk measurements, liquidity ratios, departure from established limits, etc. Reports are prepared and provided on a daily, weekly, monthly or quarterly basis, but as well upon 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, movements of different risk indicators, accepted collateral values and risk provisions levels, as well as 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 Value at Risk (VaR) and Price Value Basis Point (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 Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR) ratios 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. Analysis is done on monthly or quarterly basis, based on the type of the interest rate risk analysed. 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 Management Board that includes all relevant information needed to estimate the risks the Bank is exposed to.

Additional reports on risk management are prepared 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 collateral acceptable in secured lending according to this catalogue are constituted (i.e. become effective as collateral) in compliance with the applicable national laws. This involves valuing and categorising the items of collateral 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 of Banks (Official Gazette of the Republic of Serbia No. 46/2011, 6/2013) 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 2012, 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	1,843,171
Retained earnings from previous years	14,815
Intangibles	-357,551
Regulatory compliance values - Unrealized losses on securities available for sale	-1,470
Regulatory compliance values - Required reserves for estimated losses on balance sheet assets and off-balance sheet items	-633,527
Core capital	**11,029,913**
Subordinated liabilities	2,267,218
Part of positive revaluation reserves	28,039
Supplementary capital	**2,295,257**
Required reserves for estimated losses on balance sheet assets and off-balance sheet items	-1,900,581
Excess qualified investment in non-financial sector entities	-3,925
Deductions from capital	**-1,904,506**
Of which: reduction of Core capital	*952,253*
Of which: reduction of Supplementary capital	*952,253*
Total core capital	**10,077,660**
Total supplementary capital	**1,343,004**
Total capital	**11,420,664**

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 2012, 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 2012nd 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 2012.

The shareholder structure of the Bank as at 31 December 2012 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	**1,004,000**	**100.0**

Table 2: Shareholders structure

Share premium

Share premium amounting to RSD 124,475 thousand as at 31 December 2012 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 1,843,171 thousand as at 31 December 2012. Reserves from profit amounted to RSD 1,054,168 thousand as at 31 December 2011 and were increased by RSD 789,003 thousand from the 2011 retained earnings, in accordance with the General Assembly's Decision dated 21 April 2012.

Other

Retained earnings from previous years of RSD 14,815 thousand refer to actuary gain determined in accordance with IAS 19.

Intangible assets as at 31 December 2012 were RSD 357,551 thousand.

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

During the year 2012th, the Bank treated 25% of required reserves for estimated losses as deductible item from core capital, therefore as at 31 December 2012 amount of RSD 633,527 thousand from required reserves was deducted from core capital. See also chapter 3.2.3.

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 2012:

RSD '000

Creditor	Loan Currency	Initially Contracted amount in currency	Maturity date	In %	Balance as at 31 December 2012
EGB Ceps	EUR	10,800,000	20 Dec 2015	29.1	701,804
Erste GCIB	EUR	15,000,000	27 Dec 2021	70.9	1,705,775
Total		**25,800,000**		**100.0**	**2,407,579**

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 and interest rate equal to quarterly EURIBOR increased by 2.4% per annum. 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 GCIB 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 and interest rate equal to quarterly EURIBOR increased by 3.65% per annum. 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 Group Bank Ceps Holding GmbH, Vienna has been reduced by a respective discount factor.

The table below summarises amount of subordinated liabilities included in Supplementary capital as at 31 December 2012:

RSD '000

Creditor	Supplementary capital
Erste Group Bank Ceps Holding GmbH, Beč	561,443
Erste GCIB Finance, Amsterdam	1,705,775
Total	**2,267,218**

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 28,039 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 2012 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, 57/2012 и 123/2012) 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 2012 required reserves for estimated losses on balance sheet assets and off-balance sheet items amounted to RSD 2,534,108 thousand. During 2012th, the Bank treated 75% of required reserves for estimated losses as deductible item from capital, therefore as at 31 December 2012 amount of RSD 1,900,581 thousand from required reserves was deducted from capital.

Excess qualified investment

Excess qualified investment in non-financial sector entities amount to RSD 3,925 thousand as at 31 December 2012 and were used as deductible item from capital.

4. CAPITAL ADEQUACY

4.1. REGULATORY CAPITAL REQUIREMENTS

Under Decision on Capital Adequacy of 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 of Banks, i.e. capital adequacy ratio, of 12% were complied with at all times during the reporting period. As at 31 December 2012 capital adequacy ratio amounted to 21.34%.

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 for all asset classes.

For risk weighted assets calculation purposes, Bank does not use external ratings by external rating agencies. For asset class Central Government and Central bank, Bank uses country risk classifications of the Participants to the Arrangement on Officially Supported Export Credits (OECD ratings).

Additionally, in compliance with Decision on Capital Adequacy, risk weights for exposures to Institutions are derived from remaining maturity and credit quality step of the domain country based on OECD rating.

Table below provides overview of OECD ratings to credit quality steps relevant for asset class Central Government and Central Bank:

OECD Country risk classification	0	1	2	3	4	5	6	7
Minimum export insurance premium assigned to the credit assessment	0	1	2	3	4	5	6	7
Risk Weight bands	0%	0%	20%	50%	100%	100%	100%	150%

Table 5: Assignments of risk weight to credit assessments from an export credit agency

Exceptionally, for exposures towards Republic of Serbia and National bank of Serbia, Bank uses preferential risk weight of 0% as prescribed by Decision on Capital Adequacy of Banks.

Further information on the topic is available in Chapter 6.

The table below shows an overview of total minimum capital requirements to cover credit risk as at 31 December 2012. The credit risk capital requirement is broken down into exposure classes as follows:

RSD '000

Exposure class	Capital requirement
Central Governments and Central Banks	0
Local Governments and Local Authorities	17,926
Public Administrative Bodies	2,614
Institutions	43,314
Corporates	3,596,942
Retail	1,451,811
Exposures secured by residential property	419,935
Past due exposures	38,354
Shares in Investment Funds	1,771
Other items	101,040
Total	**5,673,706**

Table 6: Capital requirements for credit risk per exposure class

4.1.2. MARKET RISKS

As at 31 December 2012, 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 2012, 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 2012:

RSD '000

Market risks	Capital requirement
Capital requirement for price risk on debt securities	2,531
Capital requirement for foreign exchange risk	46,145
Total	**48,675**

Table 7: 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 2012, capital requirement for operational risk totalled RSD 699,511 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 on-going 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 of 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 potentials 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 available internal capital;
    - the amount of minimum capital requirement in accordance with the Decision on Capital Adequacy of Banks and internal capital requirement;
    - total minimum capital requirement and total internal capital requirement (economic 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). 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

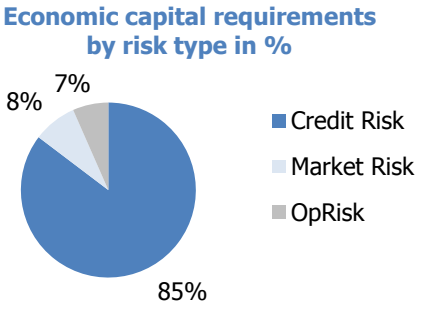
adverse events or deteriorations of the economic environment which could have a negative effect on the Bank.

Additionally, a "traffic light " system has been deployed in order to signal the Bank's 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 level 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, 94/2011, 119/2012 and 123/2012). 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:

Risk-bearing capacity calculation as at 31 December 2012	*RSD '000*
Economic capital requirement	8,215,109
Coverage potential	15,235,249
Excess	7,020,140

Table 8: 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.

By the risk materiality assessment process the Bank sees the following risk types as materially significant:

- credit risk (including residual risk)
- market risk in the trading book
- interest rate risk in the banking book
- FX risk in the banking book
- operational risk
- liquidity risk
- concentration risk
- reputational risk
- strategic risk
- macroeconomic risk

The Bank calculates internal capital requirements for credit risk, market risk in the trading book, interest rate risk in the banking book and operational risk while other material risks are covered through the comprehensive stress testing process. Concerning the reputational risk, the Bank's assessment process showed the medium level of materiality significance of this risk type. Nevertheless, tight management framework and control systems defined within the Bank efficiently curb the risk and therefore the Bank does not put the capital aside for the coverage of this risk type.

[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).

The internal capital requirement for credit risk is computed, by using adjusted standardised approach and equals to 12% of the credit Risk Weighted Assets (RWA) calculated for Erste Group Pillar 1 purposes which are in accordance with National Bank of Austria regulation (*Solvency Regulation, Austrian Federal Law Gazette II No 374/2006 and 253/2007*)[2].

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

Under ICAAP, for interest rate risk within the banking book the Bank applies historical simulation approach based on actual balance sheet positions of the Bank and the one year changes of interest rates in the preceding five years. The actual balance sheet positions (assets and liabilities) are re-valued using the scenario corresponding to the selected worst year on year changes of interest rates. The revaluation is performed via shifting up and down the interest rates by the same amount. Value of the market risk is, therefore, seen as the difference between larger decrease in the value of equity based on one of the two scenarios and equity value at current interest rate levels.

For the purpose of assessment and measurement of operational risk and the calculation of its internal capital requirement, the Bank used to apply Basic Indicator Approach (BIA) while started applying Advanced Measurement Approach (AMA) in September 2012 under Pillar 2. Under this approach the Bank is allowed to develop its own statistical model to quantify required capital for operational risk. AMA framework includes set of operational risk management techniques proposed under Basel II capital adequacy rules for banking institutions.

The Bank uses Loss Distribution Approach for computing VaR in modelling Operational Risk capital requirement within AMA. The modelling of the aggregate loss distribution is done in two steps. First the single distributions of loss frequency and loss severity are computed and then these distributions are compounded to the loss distribution by applying Monte Carlo technique. The VaR for Operational Risk is generated for four modelling categories, which are based on the Basel II event type categories.

[2] The single largest difference between NBS and Austrian capital adequacy regulation refers to risk weight assigned to exposures within the asset class Central governments and Central banks denominated in currency other than RSD – according to NBS 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 and required collateralization level, as well as by regular monitoring of the same during the credit contract life, by defining different loan approval levels (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 on-going 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.

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 as he is experiencing financial difficulties, probability exists that he will enter financial restructuring, 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.

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;
- the borrower drew down an unauthorized credit facility.

6.1.3. PROVISIONS OF BANK BALANCE SHEET ASSETS AND OFF-BALANCE SHEET ITEMS

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 loan exposure 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. A loan is considered to be defaulted i.e. impaired when it is likely that the Bank will be unable to collect all amounts according to the contractual terms. Precisely, the Bank determines through the impairment test whether there is objective evidence of impairment of receivables from clients.

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:

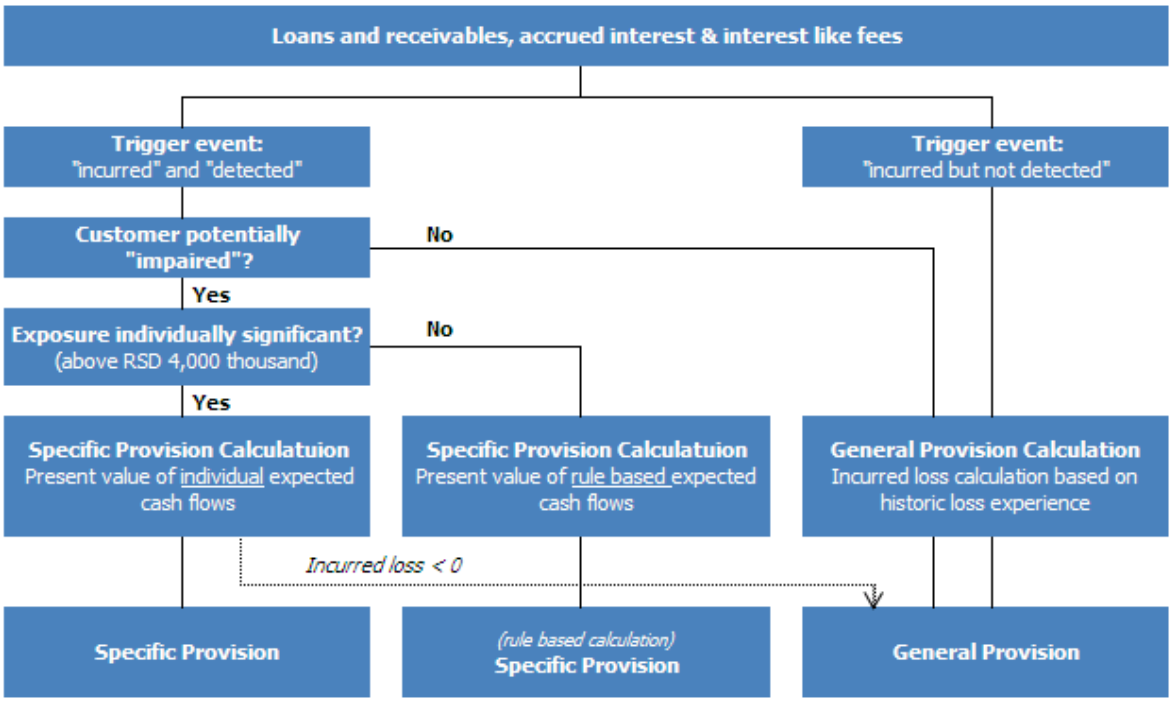


Figure 2: Loan loss provisioning process

Specific Provision assessment

For each impaired individually significant 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 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.

Portfolio loan loss provisioning is based on the Basel II expected loss calculation for credit risk, which represents quantification of expected loss in one year period, multiplied with the loss identification period (LIP).

Expected loss is the average amount of credit losses for the period of one year that the Bank should expect to incur per single receivable. It measures the anticipated average loss from a portfolio over a relevant time horizon and is calculated by multiplying following three credit risk parameters in accordance with Basel II standards:

- Probability of default (PD),
- Exposure at Default (EaD), and
- Loss given default (LGD)

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 2012 is shown in the table below:

RSD '000

Exposure class	Exposure	In %	Average Exposure
Central Governments and Central Banks	14,226,089	12.2	14,306,127
Local Governments and Local Authorities	302,900	0.3	344,856
Public Administrative Bodies	22,365	0.0	23,484
Institutions	12,887,209	11.1	13,940,795
Corporates	43,395,958	37.2	39,923,646
Retail	22,133,816	19.0	22,851,289
Exposures secured by residential property	8,491,452	7.3	7,991,107
Past due exposures	8,180,407	7.0	8,065,013
Shares in Investment Funds	15,536	0.0	15,274
Other items	6,957,759	6.0	6,207,226
Total	**116,613,492**	**100.0**	**113,668,816**

Table 9: Gross exposure after accounting write-offs by exposure class

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

RSD '000

Geographic area	Exposure class	Exposure
Serbia	Central Governments and Central Banks	14,226,089
	Local Governments and Local Authorities	302,900
	Public Administrative Bodies	22,365
	Institutions	3,903,092
	Corporates	43,338,391
	Retail	22,106,131
	Exposures secured by residential property	8,490,851
	Past due exposures	8,180,407
	Shares in Investment Funds	15,536
	Other items	6,957,759
	Total	107,543,523
Austria	Institutions	7,981,749
	Corporates	7,402
	Retail	1
	Total	7,989,152
Other Countries	Institutions	1,002,368
	Corporates	50,164
	Retail	27,684
	Exposures secured by residential property	601
	Total	1,080,817
Total		**116,613,492**

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

Table below gives a breakdown of Gross credit risk exposure by sector[4] and exposure class with focus on exposures for which loan loss provision was made , as well as a comprehensive preview of Past due Exposure class.

RSD '000

Exposure class	Sector	Exposure	Exposures with loan loss provisions	Loan loss provisions
Central Governments and Central Banks	Domestic fin. institutions	7,200,693	0	0
	Public sector	7,025,396	0	0
	Total	14,226,089	0	0
Local Governments and Local Authorities	Public sector	302,900	302,897	3,442
	Total	302,900	302,897	3,442
Public Administrative Bodies	Public sector	22,365	14,339	428
	Total	22,365	14,339	428
Institutions	Domestic fin. institutions	3,903,092	623,950	15,309
	Foreign entities	8,984,117	431,448	34,217
	Total	12,887,209	1,055,398	49,526
Corporates	Domestic fin. institutions	508,954	447,063	26,916
	Public companies	4,793,452	213,014	2,834
	Other domestic companies	37,171,737	33,736,434	1,084,534
	Entrepreneurs	224,223	224,223	7,689
	Private individuals	367,658	256,558	17,617
	Foreign entities	57,066	36,187	7,032
	Agricultural producers	138,157	60,363	4,886
	Other counterparties	134,711	120,159	118,805
	Total	43,395,958	35,094,001	1,270,311
Retail	Public companies	40,472	35,471	870
	Other domestic companies	2,944,942	2,812,275	84,657
	Entrepreneurs	673,314	654,307	24,146
	Private individuals	18,007,372	14,615,285	471,844
	Foreign entities	12,254	27	7
	Agricultural producers	455,457	270,734	8,529
	Other counterparties	5	5	5
	Total	22,133,816	18,388,103	590,057
Exposures secured by residential property	Domestic fin. institutions	920	920	27
	Other domestic companies	822,738	561,528	40,683
	Entrepreneurs	114,279	93,838	3,457
	Private individuals	7,448,924	4,968,159	67,452
	Agricultural producers	104,591	52,695	4,691
	Total	8,491,452	5,677,140	116,310
Past due exposures	Domestic fin. institutions	100,037	66,014	65,980
	Other domestic companies	3,028,575	2,447,609	1,729,612
	Entrepreneurs	138,903	97,958	80,016
	Private individuals	1,652,977	1,133,644	900,617
	Agricultural producers	305,526	157,872	108,145
	Other counterparties	2,954,389	2,251,813	1,928,413
	Total	8,180,407	6,154,910	4,812,783
Shares in Investment Funds	Domestic fin. institutions	15,536	15,536	777
	Total	15,536	15,536	777
Other items	Domestic fin. institutions	6,815,127	812,487	81,531
	Other counterparties	142,632	129,679	4,168
	Total	6,957,759	942,166	85,699
Total		**116,613,492**	**67,644,492**	**6,929,334**

Table 11: Gross Exposure by sector and exposure class with focus on exposures for which loan loss provision was made

[4] as defined in NBS instruction for collection and delivery of balances and account structure of loans, assets and liabilities of banks

Break down of Gross credit risk exposure into maturity buckets according to final loan maturity is shown below.

RSD '000

	Exposure			
Exposure class	**<1 years**	**1 – 3 years**	**>3 years**	**Total**
Central Governments and Central Banks	13,303,797	922,291	-	14,226,089
Local Governments and Local Authorities	11,462	34,099	257,339	302,900
Public Administrative Bodies	21,365	1,000	-	22,365
Institutions	12,886,809	400	-	12,887,209
Corporates	14,306,759	16,616,604	12,472,594	43,395,958
Retail	6,080,357	5,032,694	11,020,765	22,133,816
Exposures secured by residential property	136,143	393,297	7,962,012	8,491,452
Past due exposures	5,792,674	1,043,841	1,343,893	8,180,407
Shares in Investment Funds	15,536	-	-	15,536
Other items	6,879,176	45,270	33,313	6,957,759
Total	**59,434,080**	**24,089,496**	**33,089,915**	**116,613,492**

Table 12: 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):

RSD '000

Loan loss provision	
Provisions as at 01 January 2012	5,934,946
Provisions allocation during the year	10,264,805
Provisions release during the year	-8,782,548
Provisions write off during the year	-464,006
Other	-23,863
Provisions as at 31 December 2012	**6,929,334**

Table 13: Loan loss provision movement

As at 31 December 2012, 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**
Domestic fin. institutions	212,858	359,141	466,163	101968	83,900	1,224,030
Public companies	4,586,570	220,839	8,815	-	-	4,816,224
Other companies	24,690,557	8,671,749	2,391,029	2,280,452	2,412,590	40,446,377
Entrepreneurs	753,499	115,394	52,906	76,714	102,440	1,100,953
Public sector	302897	7,840	-	-	-	310,737
Private individuals	21,091,622	144,534	42,553	600,750	1,544,789	23,424,248
Foreign entities	1,060,057	73,373	-	1	33,248	1,166,679
Agricultural producers	333,683	9,417	19,796	27,204	154,706	554,806
Other counterparties	57,587	53,173	27623	1,503	2,371,524	2,511,410
Total	**53,089,330**	**9,655,460**	**3,018,885**	**3,088,592**	**6,703,197**	**75,555,464**
Reserve for estimated losses	**-**	**173,766**	**444,494**	**898,744**	**6,698,572**	**8,215,576**
Provisions	**787,259**	**249,336**	**384,175**	**394,740**	**5,047,391**	**6,862,901**
Required reserve for estimated losses	**-**	**18,765**	**275,107**	**587,774**	**1,652,462**	**2,534,108**

Table 14: 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 collateral is admitted for credit risk mitigation is decided by the Strategic Risk Management Department after determining whether applicable legal requirement prescribed by NBS Decision on Capital Adequacy of Banks are met. The items of collateral 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.

Currently, the Bank does not 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 2012. Preferential risk weight of 0% as prescribed by Decision on Capital Adequacy of Banks was applied:
- 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. As at 31 December 2012 bank guarantees were not used for credit risk mitigation (CRM) purposes.

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 collateral when all applicable criteria proscribed by NBS Decision on Capital Adequacy of 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 net exposure before and after the use of credit protection, i.e. adjustment for effects of CRM techniques, for every level of credit quality.

RSD '000

Exposure class	Risk weight band	Net Exposure	Exposure after CRM*
Central Governments and Central Banks	0%	14,226,089	18,774,821
Local Governments and Local Authorities	50%	299,458	299,458
Public Administrative Bodies	100%	21,781	21,781
Institutions	20%	12,477,267	12,477,267
	50%	600	600
	100%	263,753	263,753
	150%	39,801	39,801
Corporates	100%	41,400,340	36,378,753
Retail	75%	21,027,121	20,795,361
Exposures secured by residential property	35%	6,896,538	6,896,538
	100%	1,295,596	1,295,596
Past due exposures	100%	2,260,853	2,259,749
	150%	57,309	57,309
Shares in Investment Funds	100%	14,760	14,760
Other items	0%	5,733,658	5,733,658
	100%	1,135,230	1,125,541
Total		**107,150,153**	**106,434,745**

Table 15: Net 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 collateral. Correlation risk is monitored and identified 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 2012:

RSD '000

Exposure class	Net Exposure	Guarantees *	Cash deposit
Central Governments and Central Banks	14,226,089	-	-
Local Governments and Local Authorities	299,458	-	-
Public Administrative Bodies	21,781	-	-
Institutions	12,781,422	-	-
Shares in Investment Funds	14,760	-	-
Corporates	41,400,340	4,548,732	472,855
Retail	21,027,121	-	231,760
Exposures secured by residential property	8,192,134	-	-
Past due exposures	2,318,162	-	1,104
Other items	6,868,887	-	9,689
Total	**107,150,153**	**4,548,732**	**715,408**

Table 16: Net exposure and CRM by type of CRM instrument

**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.*

6.2. COUNTER PARTY RISK

Counterparty risk is the risk that the counterparty will not fulfil its contractual obligations before the final settlement of financial obligations of the transaction.

The Bank carries out transactions in trading and banking book, which fall under the counterparty risk while doing business of

- financial derivatives
- repo and reverse-repo transactions.

Good management framework and control of the trading book risks as well as properly established system of internal exposure limits (toward single client and/or the type of product) provides the basis for this type of risk to be considered materially insignificant in terms of internal risk measurement.

For the purpose of calculating exposure base for positions that are subject to the calculation of capital requirements for counterparty credit risk the Bank uses:

- current exposure method for financial derivatives
- comprehensive method for calculating the adjusted value of the transaction and the collateral in case of repo and reverse-repo transactions.

As at 31 December 2012 the Bank's exposure to counterparty credit risk resulted from financial derivatives (contracts on foreign currencies) and repo transactions:

RSD '000

Exposure to counter party risk per transaction type	Exposure amount
financial derivatives	3,972
repo transactions	701,166
Total	**705,138**

Table 17: Exposure to counter party risk

Specifically for repo transactions booked by the Bank on 31 December 2012, the other party is the National Bank of Serbia, whereas the collateral is not used as a means of eligible credit protection, as the issuer of the collateral is the same as the other party.

6.3. INTEREST RATE RISK

6.3.1. 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.

6.3.2. RISK MEASUREMENT

In 2010, the Bank installed 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 methodology 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.

During the 2012th, in accordance with the recommendations of the Group, based on the analysis of historical data on the movement of deposits for the last 5 years, ALM adopted a new way of modelling this group of products. The analysis is based on the volatility of demand deposits in the ordinary course of business in the current volatile markets with split-up of private individuals and legal entities demand deposits. Based on the analysis conducted, the obtained results are applied to form a profile of the interest rate for this type of product.

It was concluded that the demand deposits of the private individuals are more stable than legal entities demand deposits in all considered currencies; there is a slight difference between the volatility of local currency deposits and foreign currency deposits of legal entities observed on a monthly basis. This way of modelling the deposits without agreed maturity is in effect from 01 January 2013.

Modelling of corporate loans in EUR currency with administrative rate, overdrafts and credit card loans is conducted in accordance with group standards.

The Bank's risk option (optionality risk) is based on assumptions of premature repayment of loans and premature withdrawal of deposits derived from historical data for legal entities and private individuals taking into consideration two main currencies, RSD and EUR.

6.4. 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 2012.

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 2012, note 33.5.

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 2012, note 33.9.

Bank's equity investments in the banking book are mostly made prior to 2000th and priority purpose has not been achieving capital gains, profit sharing or strengthening the strategic position. Equity investments in other legal entities are either the result of collection of overdue loans or originated from the pre-acquisition period of Novosadska banka. Total assets are impaired and not materially significant.

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 2012, notes 2.6.5, 3c, 4,12, 13,19, 30.a, 33.2a, 33.4, 33.5.2 and 33.11.

Novi Sad, 31 May 2013

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