# Erste Bank a.d. Novi Sad

## Basel 2 Pillar III disclosure of data and information for the year ended 31 December 2015

Bank


Subotica
Sombor
Kikinda
Kula
Vrbas
Bečej
Odžaci
Srbobran
Bački Petrovac
Temerin
Žabalj
Bač
Novi Sad
Zrenjanin
Bačka Palanka
Futog
Petrovaradin
Beočin
S. Karlovci
Plandište
Šid
S. Kamenica
Stara Pazova
Vršac
Sremska Mitrovica
Inđija
Nova Pazova
Novi Banovci
Zemun
Pančevo
Šabac
Beograd
Požarevac
Obrenovac
Smederevo
Ub
Lazarevac
Velika Plana
Valjevo
Svilajnac
Kragujevac
Čačak
Jagodina
Užice
Požega
Kraljevo
Kruševac
Niš
Novi Pazar

ERSTE Bank

# Contents

# 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

| | |
|---|---|
| AML | Anti-Money Laundering |
| BIA | Basic Indicator Approach |
| CFP | Contingency Funding Plan |
| CMU | Collateral Management Unit |
| CP | Coverage Potential |
| CRM | Credit Risk Mitigation |
| CRO | Chief Risk Officer |
| CSR | Corporate Social Responsibility |
| DCF | Discounted Cash Flow |
| EAD | Exposure at Default |
| EC | Economic Capital |
| ECA | Economic Capital Adequacy |
| FATCA | Foreign Account Tax Compliance Act |
| FX | Foreign Exchange |
| ICAAP | Internal capital adequacy assessment process |
| IAS | International Accounting Standards |
| IFRS | International Financial Reporting Standards |
| IRB | Internal Ratings Based Approach |
| IRR | Interest Rate Risk |
| KRIs | Key Risk Indicators |
| KYC | Know Your Client |
| LCR | Liquidity Coverage Ratio |
| LGD | Loss Given Default |
| LIP | Loss Identification Period |
| LLP | Loan Loss Provisioning |
| NSFR | Net Stable Funding Ratio |
| MiFID | Markets in Financial Instruments Directive |
| M&LMU | Market and Liquidity Risk Management Unit |
| NBS | National Bank of Serbia |
| OECD | Organisation for Economic Cooperation and Development |
| OLC | Other Liabilities Committee |
| ORCO | Operational Risk Conduct Committee |
| p.a. | per annum |
| PET | Polyethylene terephthalate |
| PD | Probability of Default |
| PI | Private Individuals |
| PVBP | Price Value Basis Point |
| RCC | Risk-bearing Capacity Calculation |
| SPA | Survival period Analysis |
| SDS | Special Diagnostic Study |
| 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: Erste Group), prepares Disclosure Report on data and information (hereinafter referred as: Disclosure Report or Report) as at 31st December 2015 and for the year then ended. 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 (hereinafter: RSD) currency and all values are rounded to the nearest thousand (RSD '000), except when otherwise indicated.

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 (hereinafter: ICAAP);
- 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, 91/2010 and 14/2015) and according to National Bank of Serbia Decision on Disclosure of Data and Information by Banks ('Official Gazette of the Republic of Serbia', no. 125/2014 and 4/2015).

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 31st December. Additionally, quantitative data and/or information are required to be disclosed also as at 30th 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.

# 2. GENERAL INFORMATION

## 2.1. BUSINESS MODEL

The Bank is a member of Erste Group, one of the leading financial institutions in the middle and east Europe, with over 16.6 million clients in 7 countries. Erste Group was originally founded in 1819 as the first Austrian savings bank. After successfully completed process of privatisation of Novosadska Banka (the oldest financial institution in Serbia, founded in 1864 as the first savings bank) in 2005, Erste Group started its operations in the Republic of Serbia as Erste Bank.

The Bank registered office is located in Novi Sad, Bulevar Oslobođenja 5. Within its structure, the Bank has 7 business centers, 47 branches, 9 sub-branches, and 5 teller desk facilities. Its registration number is 08063818 and tax identification number is 101626723. Its web address is www.erstebank.rs. Contact e-mail address and telephone number are info@erstebank.rs and 0800 201 201.

The Bank is registered in RS for carrying out payment transactions in the country and abroad, credit and deposit activities, the operations with credit cards, operations with securities, as well as dealer operations. In accordance with Law on Banks, the Bank Standalone operates on the principles of stable and safe operations.

The Bank its clients classifies within the following business segments:

| | | | | | |
|---|---|---|---|---|---|
| Retail | Small and Medium Enterprises | Real Estate | Large Corporate Clients | Financial markets | Other segments |

Figure 1: The Bank's business segments

More information on business segments are presented in the Note 37 to the financial statements for the year ended 31st December 2015.

As of January 15th 2014, on the basis of a contract on purchase and transfer of shares concluded with Steiermärkische Bank und Sparkassen AG and Erste Group Immorent International Holding GmbH, the Bank acquired 75% of the share in capital of the company S-Leasing doo Belgrade (hereinafter: S-Leasing). The Bank with its subsidiary S-Leasing form Banking Group, which organisational structure is presented in the following diagram.

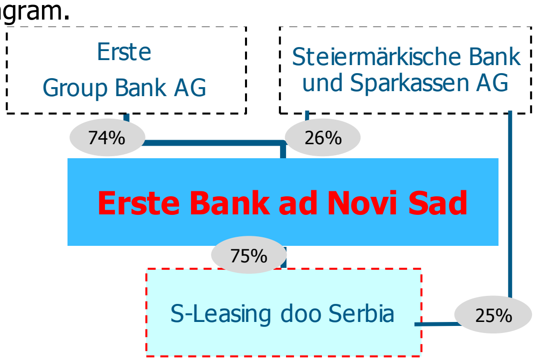



Figure 2: The Banking Group's organisational structure

S-Leasing was founded in 2003 and has been registered for the provision of financial leasing of movable assets to individuals and legal entities on the territory of the RS. Its registered office is located in Belgrade, Milutina Milankovića 11a/4, registration number is 08063818, and its tax identification number is 101626723. Its web address is www.s-leasing.co.rs. Contact e-mail address and telephone number are info@s-leasing.rs and +38111 2010 700.

Given the size of the subsidiary company S-Leasing doo in relation to the size of the Bank individually and the Banking group, S-Leasing does not affect the assessment of the stability and the risk of the Banking Group and substantiality of the information published in this document. Information presented in this document represents data and information relating to the Bank as a single entity, with exception of chapter 3.2 – Organisational Structure and chapter 6 – Banking Group.

## 2.2. CORPORATE SOCIAL RESPONSIBILITY

For the Bank, corporate social responsibility (hereinafter: CSR) is a strategic framework for company management, based on the investment in long-term and stable relations with all crucial stakeholders: employees, clients, and co-citizens in local communities we operate in, and on the commitment to provide active contribution to the development and welfare of the society we are an inseparable part of. This is a concept that encourages innovation, sustainable development, responsible management of risk and costs reduction, in order to achieve better operational results for the Bank and its clients, as well as of the society within which the Bank operates. The top topics in the field of the corporate social responsibility for 2015 include:

- support to programmes, festivals, and projects in the field of culture and art;
- Supererste.net – new platform for donations;
- Green ideas, programme for young entrepreneurs in co-operation with Trag Foundation.

All of the Bank corporate social responsibility reports may be found on the link: http://www.erstebank.rs/rs/O_nama/Drustveno_odgovorno_poslovanje. The Bank CSR Report for 2015 will be published until the end of July 2016 on the Bank's website.

## 2.3. ENVIRONMENTAL RESPONSIBILITY

Despite the fact that it is not a large polluter in terms of direct impacts of operation to environment, the Bank has for years monitored and measured its impacts in accordance with the world trends, with the aim of identifying such impacts as much as possible, and minimising them, year after year. That the Bank is consistent in this field of its activity and operation is demonstrated by the adoption and successful implementation of numerous policies and procedures on this topic. Additionally, in order to keep pace with the world standards, the Bank implemented in 2015 an application for more precise analysis of its operations on the environment.

Publications, internal magazine Plus, and the Bank Social Corporate Responsibility Report are printed on FSC paper (paper from the controlled forest growth), and since 2013, the Bank has exclusively used 100% recycled office paper.

For years, office paper, toner cartridges, PET (i.e. Polyethylene terephthalate) packaging and electronic waste have been recycled at the Bank.

In accordance with the objective of promoting and developing green branch concept, the Bank arranges branches according to this principle. So far, 12 branches have been arranged according to this principle.

# 3. RISK MANAGEMENT SYSTEM

## 3.1. 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 is outlaid in the following diagram. In addition to meeting the internal goal of effective and efficient risk management. The Bank's risk management system has been developed to fulfil external, and in particular, regulatory requirements. With an aim to increase transparency and risk awareness and culture, the Bank implemented holistic risk management and strengthen 'the 3 line of defence' model (where risk function represents the 2nd line of defence).


Diagram 3: The Bank's Risk Management System

Process of risk management is based on the following:

- **Strategic Risk Management Principles** and its main components that represents a foundation for setting limits relevant for the Bank's day-to-day operations;
- **Credit Risk Management Principles** that relate to: client's rating determination, internal credit assessment, collateral valuation, tenors, monitoring loan pay-out, documentation standards, etc.;
- **Strategic goals** introduced via the Bank's Business Strategy and budget for the following period.

Risk Management Principles should be consulted when making business decisions. Risk Management is based on the general management principles. Management and all employees are obliged to adopt and adhere to these principles. Understanding these principles at the Bank level is the starting point for the development of risk awareness and culture among all employees of the Bank.

**The Bank's Recovery Plan** became, in 2015, an integral part of the Bank's Risk Management System. It is prepared in accordance with Law on Banks and Decision on Recovery Plans of Banks and Banking Groups ('Official Gazette of the Republic of Serbia', no. 71/2015). The purpose of its preparation reflects in more efficient and timely recognition of indicators of potential leaving of usual mode of doing business and indicators that require increased management attention, with an aim of maintaining sustainable stability in the situations of serious financial distress.

The Bank's proactive **Risk management 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;
- Risk Concentration Management Policy;
- Stress Testing Policy;
- Risk Appetite Statement Policy;
- Policy for Lending Limits – Framework for Clients/Client Groups
- Industry Limit Framework Policy.

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 on risk management** are the object of regular annual review and are updated in order to ensure accordance with the relevant legislation, Erste Group's standards, as well as to increase efficiency of risk management processes. The key policies are as follows:

- Credit Risk Management Policies;
- Market and Interest Rate Risk (hereinafter: IRR) Management Policy;
- Trading Book Policy;
- Liquidity Risk Management Policy and Asset and Liability Management (hereinafter: ALM) Policy;
- Policy for Managing Operational Risks;
- Financial Crime Management/Fraud Policy;
- Anti-money Laundering (hereinafter: AML) and Sanctions and Embargoes Policy;
- Policy for General and Individual Act Management;
- Conflict of Interest Policy;
- Compliance Policy;
- Policy on IT Security Management;
- Business Continuity Planning and Crisis Management Policy;
- Policy on Physical Security Management.

Compliance with all relevant policies provides additional transparency in the methodological approaches and criteria related to risk quantification and management, which contributes to the embedding risk management culture across the Bank and ensures implementation of risk management system.

**The 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. The 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 five 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.

Given the Bank's business strategy, **the key risks for the Bank** are credit risk, market risks and operational risk. In addition to managing these risks, the Bank's control and risk management framework, as well as Bank's stress testing process, take account of other significant risks: liquidity, concentration, strategic, FX-induced, reputational, macroeconomic and residual risk.

## 3.2. 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, which is presented in the following diagram.

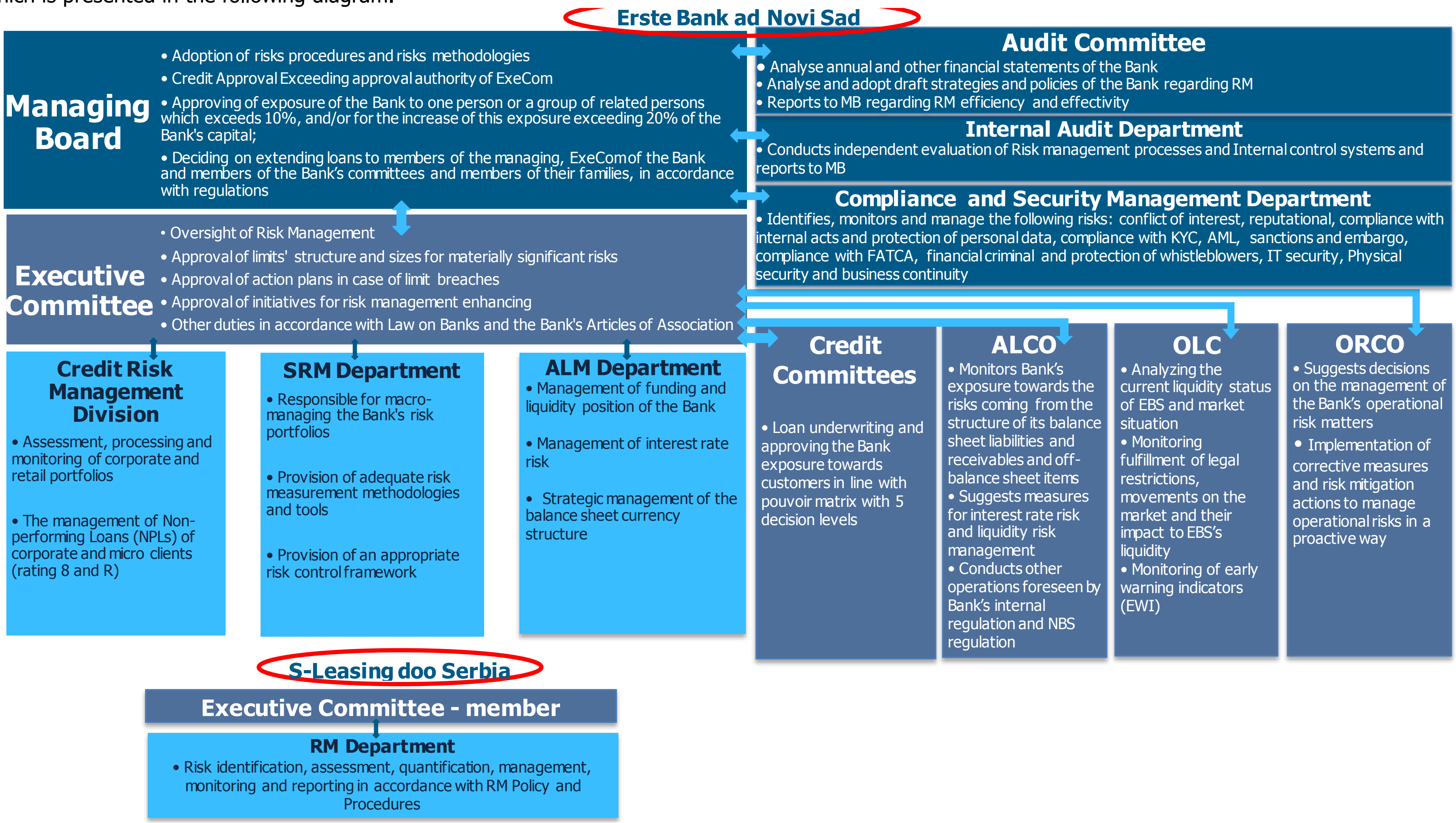



Figure 4: The Banking Group's Risk Management Organisational Structure

**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 Managing Board and 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, being a separate organisational structure functionally and organizationally separated from the Bank's risk underwriting activities, is responsible for risk management system within the Bank. Considering different areas of business it covers and with the aim of efficient performance of its responsibilities, Risk Management is divided into Credit Risk Management Division, Strategic Risk Management (hereinafter: SRM) Department and Compliance and Security Management Service.

## Credit Risk Management Division

Responsibilities of the Credit Risk Management Division encompass the following:

- Development of: the methodology, rules, policies and procedures regarding risk management, compliant with: current legislation, Erste Group's standards, good business practice and the Bank's specific needs, as well as control of compliance of credit process with these;
- Operational credit risk management at the level of individual clients or parts of portfolio;
- Approval of rating for a single entity and group of related entities and analysing loan applications from the aspect of credit risk: initial approval, regular annual re-approval and modification;
- Analysing and processing of the clients' financial statements, as well as continuous monitoring of legal and internal requirements in the field of financial statements;
- Preparation of detailed financial analysis for the predefined clients;
- FX-induced credit risk assessment on client level;
- Loans restructuring/rescheduling;
- Collection via realization of collateral via court or out of court procedure;
- Supervision of collection process.

**CRM Division** is divided into the following organization units:

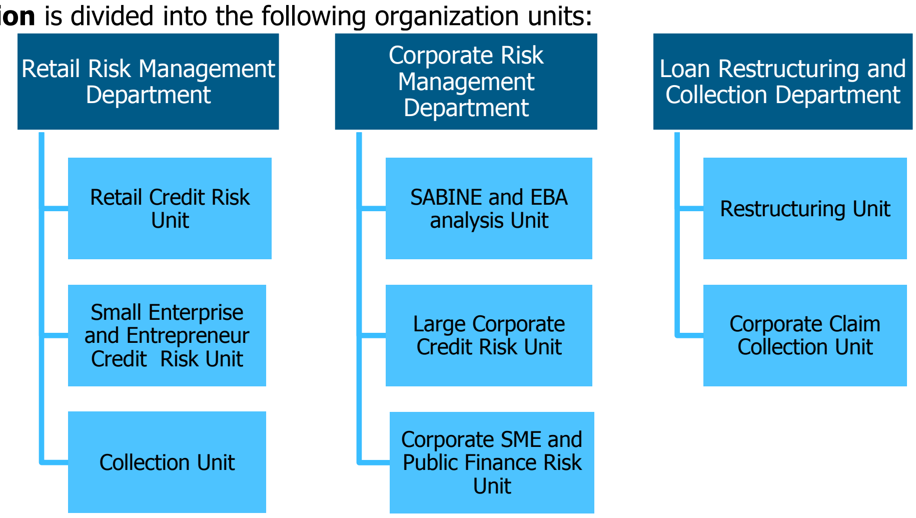



Figure 5: Organisation scheme of CRM Division

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 (private individuals only) 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 the Bank's corporate business clients. It is responsible for the formal verification, recommendation and determination of level of credit risks of corporate clients.

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

### Strategic Risk Management Department

Responsibilities of the SRM Department 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 the Bank's risk profile and capital adequacy;
- Monitoring of parameters influencing the 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 the 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 the Bank's financial position and capital;
- Enabling development and implementation of methodology for risk assessment of new products and processes introduction and outsourcing activities;
- Defining methodologies, rules, policies and procedures for risk management in accordance with applicable regulatory framework, Erste Group standards, good business practice as well as the Bank's specific circumstances;
- Development and implementation of different technical platforms and tool with an aim of increasing efficiency of risk management process.

**SRM Department** incorporates 5 Units, which together with CRM Division, Compliance and Security Management Department and Internal Audit Department form risk management control system within the Bank.

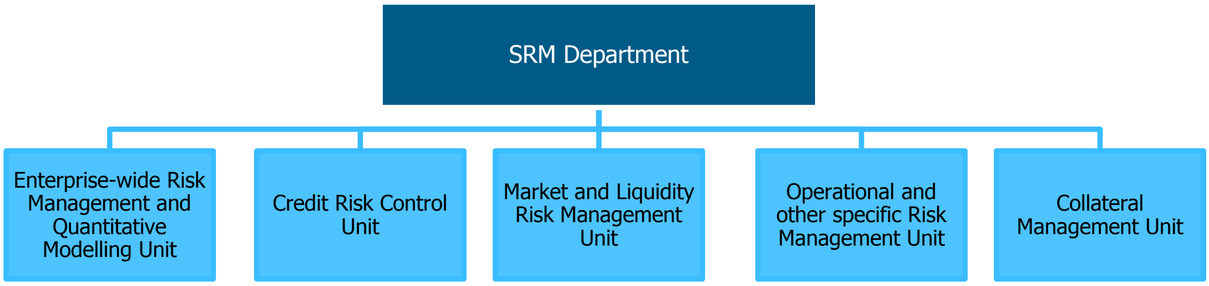



Figure 6: Organisational scheme of SRM Department

In December 2015 the SRM Department started with the provision of services, in the areas that it covers, for the purpose of S-leasing. The aim is to improve efficiency of these functions through activities performed by the Bank:

- Management of and compliance with the Erste Group's requirements concerning loan portfolio management;
- Fulfilling the reporting requirements for the purposes of different users in the field of credit risk;
- Operational risk management.

## Compliance and Security Management Department

Compliance and Security Management Department is an independent organizational department, primarily responsible for implementation of and oversight over the process of identification and monitoring of risks in the field of compliance and security, as well as management of these risks.

Organizationally, **Compliance and Security Management Department** consist of four units:

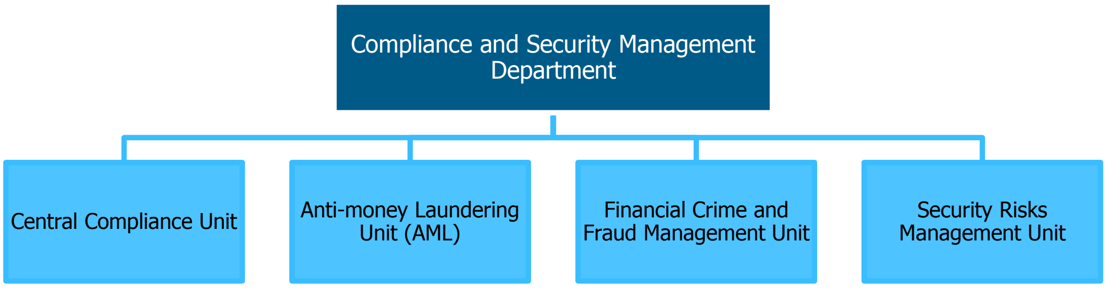



Figure 7: Organisational scheme of Compliance and Security Management Department

Central Compliance Unit in its work monitors, manages and reports on: risks of compliance with Policy for general and individual act management, risks related to securities in terms of adherence to Markets in Financial Instruments Directive (MiFID) and capital markets regulation, risks of conflict of interests including gift acceptance, reputational risk management including responsible financing, managing the protection of personal data.

Anti-money Laundering Unit in its work monitors, manages and reports on: compliance with Know Your Client (KYC) policy, money laundering and fighting terrorism funding in the context of client identification, compliance with the Bank's lending policy and transitions oversight and control with particular emphasis on sanctions and embargoes and related indicators, as well as adherence to Foreign Account Tax Compliance Act (FATCA).

Financial Crime and Fraud Management Unit in its work monitors, manages and reports on: risks of internal and external frauds, criminal actions including corruption, non-compliance with regulation and the Bank's internal policies, risk of non-compliance with business practices and unethical behaviour, as well as protection of whistle-blowers.

Security Risks Management Unit in its work monitors, manages and reports on: information security, risk of protection of information resources including information protection, physical and technical protection, business continuity (excluding financing and other major risks: ensuring liquidity and adequate level of capital requirements, market risks, etc.) and crisis management plans regarding the Bank's critical resources (It resources, employees, assets, suppliers) in the context of maintaining regular operations in the event of a disaster.

## 3.3. 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. The following figure outlays the process of monitoring of and reporting on risk management at strategic and operational level.

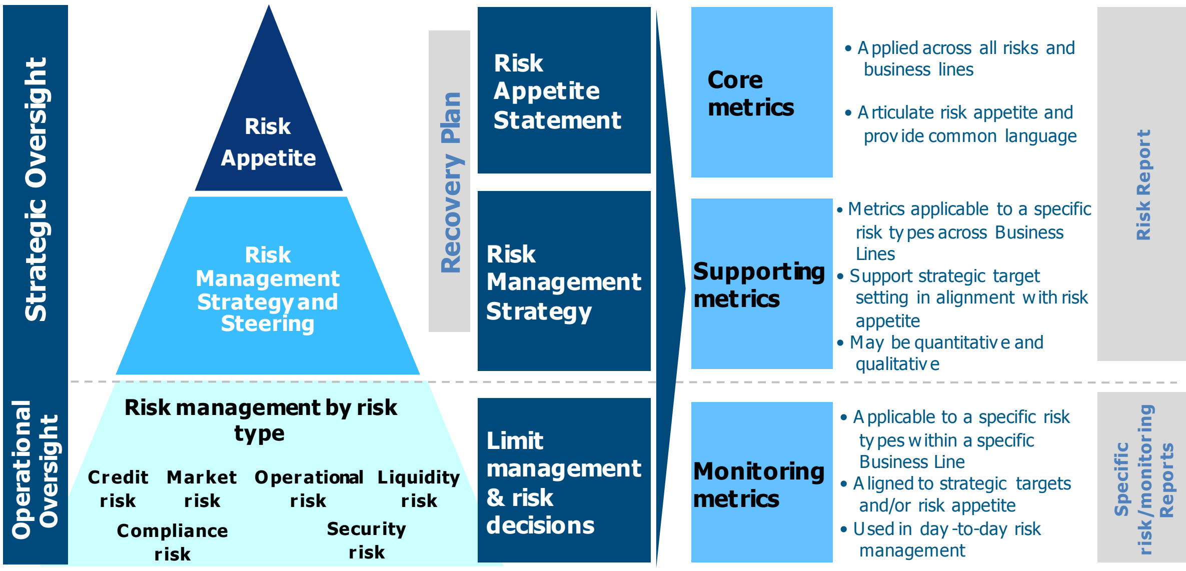



Figure 8: Process of monitoring of and reporting on risk management

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 (hereinafter: ALCO), Operational Risk Conduct Committee (hereinafter: ORCO), 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, concentration assessment, market risk measurements, liquidity ratios, deviations from established limits, management of non-financial risks, etc. Reports are prepared and provided on a daily, weekly, monthly or quarterly basis, but as well upon request.

The Bank prepares numerous reports, described within the chapter 5, by risk types. In addition to these, 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.

## 3.4. INTERNAL CAPITAL ADEQUACY ASSESSMENT PROCESS

The Internal Capital Adequacy Assessment Process (hereinafter: ICAAP) is established during 2011 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 (i.e. coverage potential - CP).

Within the ICAAP the Bank considers local regulatory requirements, namely the Decision on Risk Management by Banks ('Official Gazette of the Republic of Serbia', no. 45/2011, 94/2011, 119/2012, 123/2012, 23/2013-oth.decision, 43/2013, 93/2013, 33/2015 and 61/2015). At the same time the Bank complies with the Erste Group standards.

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 prescribed 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 and its basic goals are presented in the following figure:

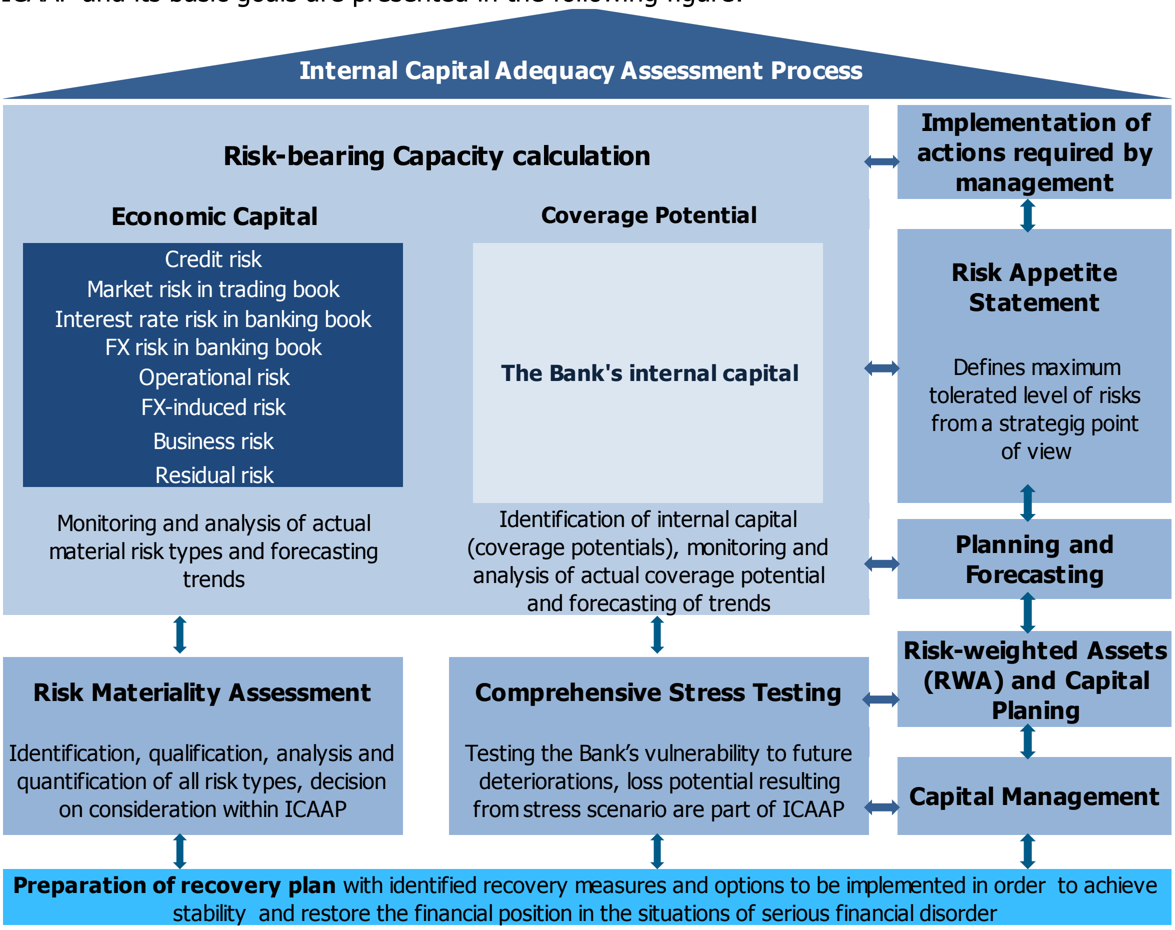


Figure 9: The Bank's internal capital adequacy assessment process

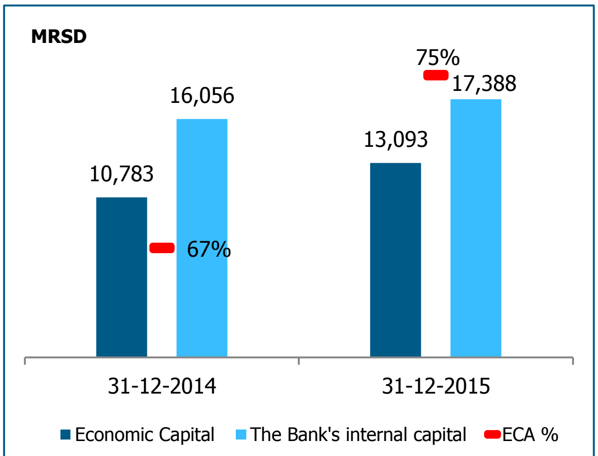
For the purpose of ICAAP, decision was made to solely consider risks defined as material[1] when quantifies economic capital (hereinafter: EC). More specifically, EC is the amount of capital needed to cover all the Bank's material risks calculated by using economic measures, described further in this chapter, without consideration of any diversification effects. This EC is then compared to internal capital (i.e. CP - broader concept than regulatory capital calculated in accordance with Decision on Capital Adequacy of Banks - 'Official Gazette of the Republic of Serbia', no. 46/2011, 6/2013 and 51/2014).

In general, the entire coverage potential should be higher than or equal to the Bank's overall economic capital. For those purposes, the Bank has defined Economic Capital Adequacy (hereinafter: ECA) ratio, capital adequacy ratio under Pillar 2 – ICAAP adequacy, as one of measures for expressing and monitoring the Bank's risk appetite, as the ratio between economic capital and coverage potential:

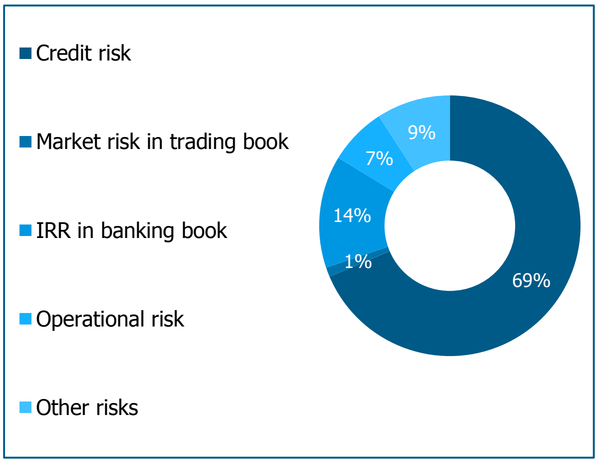
$$ECA = \frac{EC}{CP}$$

Additionally, a "traffic light " system has been deployed in order to signal the Bank's management the extent of Bank's available capital utilisation and to ensure sufficient time to respond to changes by taking relevant measures on either the economic capital or the coverage potential side.

The following graphs illustrates: the Bank's economic and internal capital, ECA ratio and the distribution of risk types which form the economic capital of the Bank as at 31 December 2015.




Graph 1: Risk-bearing capacity calculation overview




Graph 2: Distribution of ECA

## 3.5. 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 the Bank's operations as well as particularities of surroundings where it performs its operations were taken into consideration.

The following table summarizes risks that the Bank sees as materially significant and considers within the process of risk-bearing capacity calculation. Moreover, methods of quantification of risks according to Pillar 1 and Pillar 2 Basel II are briefly described.

[1] according to the Decision on Risk Management by Banks

| Risk type | Risk quantification – Pillar 1 Basel II | Risk quantification within ICAAP – Pillar 2 Basel II |
|---|---|---|
| Credit risk | Standardized approach | Internal capital requirement calculation – adjusted standardized approach (the key difference comparing to Pillar 1 Basel II reflects in add-on for sovereign exposure) |
| Market risk in trading book | Maturity-based approach for general position risk of debt securities | For computing internal capital requirement, the Bank uses a VaR approach based on daily historical simulation for the calculation of monthly VaR at 99% confidence level, which is then scaled up to 1-year horizon and a confidence level of 99.9%. |
| IRR in banking book | Without quantification | For computing internal capital requirement, 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. |
| FX risk in banking book | 12%of the sum of the Bank's overall open FX position and its open net position in gold, calculated in accordance with decision on capital adequacy of banks, if the sum of its overall open FX position and its net position in gold exceeds 2% of its total own funds | The method of computing internal capital requirement is the same as for Pillar 1, regardless of whether the sum of its overall open FX position and its net position in gold exceeds 2% of its total own funds or not. |
| Operational risk | Basic Indicator Approach - BIA | The Bank used to apply BIA, while started applying Advanced Measurement Approach -AMA in September 2012 – operational loss distribution approach is used for computing 1-year VaR at confidence level of 99.9% and by applying Monte Carlo technique total loss distribution is calculated. Internal capital requirement calculates Erste Group. |
| Business/ Strategic risk | Without quantification – monitored via budgeting process | Internal capital requirement calculates Erste Group. The model is based on analysis of the deviations between budgeted and realised monthly net operating result, which are used to estimate the logistic distribution, on which the model is build. |
| FX-induced credit risk | Without quantification – integrated in credit risk monitoring process | Model in development. Since Q4 2014 simulation has been applied – internal capital requirement = cost of credit risk for retail x total FX retail exposure. |
| Residual risk | Without quantification - monitored via collateral management process | Included into stress testing process. The Bank presumes that PI Mortgage loan loss provision (LLP) grows at a faster pace if the crisis situation occurs than for other segments and PI segment under normal circumstances. The difference occurring between percentage rise in PI Mortgage LLP and relative rise in the same risk calculated for other segments represents the add-on for residual risk. The difference represents economic capital for residual risk. |
| Liquidity risk | Without quantification – monitored through numerous the Bank's reports | Included into stress testing process. |
| Concentration risk | Without quantification – risk mitigation techniques are regularly analysed; compliance with limits is monitored | Encompass via risk concentration analysis (Herfindahl-Hirschman Index – HHI, etc.) and limits steering. |
| Reputational risk | Without quantification – part of credit risk management principles and risk appetite framework | Included into stress testing process and process of ensuring compliance with credit risk management principles and risk appetite framework which represent the key element within risk management system. |
| Macroeconomic risk | Without quantification – monitored via analysis by the bank's experts | Included into stress testing process. |

Table 1: Classification and quantification on material risks

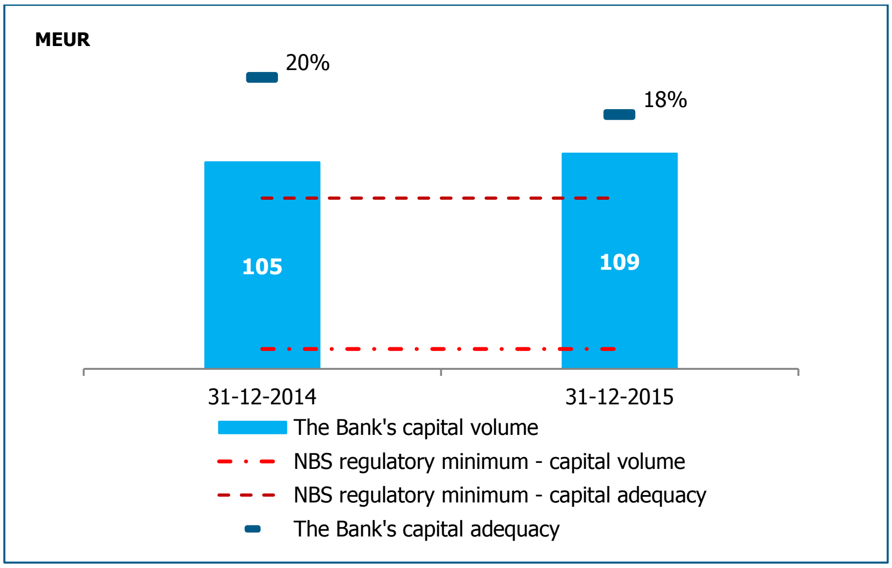
The Bank conducts a quarterly assessment of internal capital adequacy and results for 2015 indicate that the Bank has adequate financial resources and regulatory capital to cover all materially significant risks, in both normal and stress conditions. Annual Report on the internal assessment of capital adequacy as at 31st December 2015 was presented to the regulator, the National Bank of Serbia.

# 4. CAPITAL AND CAPITAL ADEQUACY

The Bank complied with the articles of the Decision on Capital Adequacy of Banks (Official Gazette of the Republic of Serbia No. 46/2011, 6/2013 and 51/2014) on calculating the regulatory capital. During the reporting period, the Bank's capital has been above the required regulatory minimum.

Additionally, 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.

Abovementioned compliance with regulatory limits is illustrated in the following graph.




Graph 3: The Bank's regulatory capital and capital adequacy

## 4.1. REGULATORY CAPITAL

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

- **The Core capital** consists of share capital, share premium, reserves from profit and retained earnings from previous years, as well as deductions for intangible assets and regulatory valuation adjustments related to IFRS / IAS (unrealized losses on securities available for sale and required reserve for estimated losses on balance sheet assets and off-balance sheet items).
- **Supplementary capital** consists of subordinated liabilities and part of the positive revaluation reserves arising from the effects of changes in fair value of fixed assets, securities and other assets that, in accordance with IAS / IFRS, are recorded in favour of the reserves.
- **Deductions from capital** consist of investments in other financial sector entities in the amount exceeding 10% of the capital of these persons.

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

**The Bank's objectives in managing capital** are:

- To ensure compliance with the requirements of the NBS - its capital shall never decline below the RSD equivalent value of EUR 10,000,000 at the official NBS middle exchange rate, as prescribed by the Law on Banks.t;
- To provide the level and structure of capital that can support the expected growth of placements;

- To ensure the long-term ability to continue operating while ensuring returns to shareholders and benefits for other stakeholders;
- To provide a strong capital base to support the further development of the Bank.

In accordance with the Decision on Disclosure of Data and Information, information on the Bank's capital is further provided in the following insets:

- Form PI-KAP (Inset 1) - the detailed structure of the regulatory capital of the Bank as at 31 December 2015 (with references to the position of the balance sheet assets set out in Inset 3 provided);
- Form PI-FIKAP (Inset 2) - data on main features of financial instruments included in calculation of Bank's capital;
- Form PI-UPK (Inset 3) - the balance sheet of the Bank, prepared in accordance with IAS / IFRS standards with breakdown and references to items enabling link to the positions included in Capital reports prepared in accordance with the decision on reporting on capital adequacy of banks (Inset 1 – form PI-KAP).

## Inset 1 - Form PI-KAP

**Data on Bank's capital position** (RSD thousand)

| No | Item | Amount | Data source reference to Inset 3 |
|---|---|---|---|
| I | TOTAL CORE CAPITAL | 12,111,235 | |
| 1. | CORE CAPITAL BEFORE DEDUCTIONS | 14,589,923 | |
| 1.1. | Par value of paid-in shares, except cumulative preferential shares | 10,040,000 | a |
| 1.2. | Share premium | 124,475 | b |
| 1.3. | Reserves from profit | 4,425,448 | v |
| 1.4. | Retained earnings from previous years | | g |
| 1.5. | Profit of the current year | | d |
| 1.6. | Minority participations in subordinate companies | | đ |
| 1.7. | Other positive consolidated reserves | | e |
| 2. | DEDUCTIBLES FROM CORE CAPITAL | 2,478,688 | |
| 2.1. | Losses from previous years | | ž |
| 2.2. | Loss of the current year | | z |
| 2.3. | Intangible assets | 350,852 | i |
| 2.4. | Acquired own shares, except cumulative preferential shares | | j |
| 2.5. | Amount of shares received in pledge, except cumulative preferential shares | | k |
| 2.6. | Regulatory value adjustments: | 2,127,835 | |
| 2.6.1. | Unrealised losses on securities available for sale | 1,837 | l |
| 2.6.2. | Other net negative revaluation reserves | | lj |
| 2.6.3. | Gains on bank liabilities measured at fair value due to the change in bank's credit rating | | m |
| 2.6.4. | Required reserve from profit for estimated losses on balance-sheet assets and off-balance sheet items of the bank | 2,125,998 | |
| 2.7. | Other negative consolidated reserves | 0 | n |
| II | TOTAL SUPPLEMENTARY CAPITAL | 1,235,815 | |
| 1. | SUPPLEMENTARY CAPITAL BEFORE DEDUCTIONS | 1,235,815 | |
| 1.1. | Par value of paid in cumulative preferential shares | | nj |
| 1.2. | Share premium on cumulative preferential shares | | |
| 1.3. | Part of revaluation reserves of the bank | 193,306 | p |
| 1.4. | Hybrid instruments | | |
| 1.5. | Subordinated liabilities | 1,042,509 | s |
| 1.6. | Overallocation of impairment allowances, provisions and required reserves from profit relative to expected losses | | |
| 2. | DEDUCTIBLES FROM SUPPLEMENTARY CAPITAL | | |
| 2.1. | Acquired own cumulative preferential shares | | t |
| 2.2. | Receivables in respect of balance-sheet assets and off-balance sheet items of the bank secured by a hybrid instrument or subordinated liability | | |
| 2.3. | Amount of cumulative preferential shares received in pledge | | ć |
| 2.4. | Amount of capital in excess of limitations on supplementary capital | | |
| III | TOTAL CAPITAL | 13,253,490 | |
| 1. | TOTAL CAPITAL BEFORE DEDUCTIONS | 13,347,051 | |
| 2. | DEDUCTIBLES FROM CAPITAL | 93,560 | |
| | Of which reduction in core capital | 46,780 | |
| | Of which reduction in supplementary capital | 46,780 | |
| 2.1. | Direct or indirect investment in banks and other financial sector persons that exceed 10% of the capital of such banks and/or other financial sector persons | 93,560 | (u+f+h) |
| 2.2. | Investment in hybrid instruments and subordinated liabilities of other banks and financial sector persons in which the bank has direct or indirect investment that exceeds 10% of the capital of such persons | | |
| 2.3. | Total amount of direct and indirect investment in banks and other financial sector persons in the amount of up to 10% of their capital, as well as investment in their hybrid instruments and subordinated liabilities that exceeds 10% of the sum of core and supplementary capital of the bank for which the calculation of capital is made | | u |
| 2.4. | The amount by which qualified participation in non-financial sector persons has been exceeded | | f |
| 2.5. | Underallocation of impairment allowances, provisions and required reserves from profit relative to expected losses | | h |
| 2.6. | The amount of exposure to free deliveries if the counterparty failed to fulfil its obligation within four working days | | |
| 2.7. | Receivables from and potential liabilities toward persons related to a bank or employees in the bank which the bank has negotiated under the terms that are more favourable than the terms negotiated with other parties | | |
| IV | NOTES | | |
| | Positive/negative difference between total impairment allowances for balance sheet assets, provisions for losses on off-balance sheet items and required reserves from profit on the one hand, and total estimated losses under IRB approach on the other | | |
| | Amount of impairment allowances, provisions and required reserves from bank's profit | | |
| | *Of which on a group basis* | | |
| | *Of which on an individual basis* | | |
| | *Amount of expected losses under IRB approach* | | |
| | Gross amount of subordinated liabilities | 1,824,392 | |

## Inset 2 - Form PI-FIKAP

**Main features of financial instruments included in calculation of Bank's capital**

| No. | Instrument features | The share capital of the Bank | The subordinated loan granted by Erste Group Bank AG, Vienna |
|---|---|---|---|
| **1.** | **Issuer** | **Erste Bank ad Novi Sad** | **Erste Bank ad Novi Sad** |
| **2.** | **Treatment as per legislation** | | |
| 2.1. | Treatment as per the Decision on Capital Adequacy of Banks | Core capital instrument | Supplementary capital instrument |
| 2.2. | Individual/group/individual and group level of inclusion of instrument in capital on group level | Individual and group | Individual and group |
| 2.3. | Type of instrument | Ordinary shares | Subordinated debt issued in the form of financial instrument |
| **3.** | **Amount recognised for the purpose of calculating regulatory capital (in RSD thousand, as at the last reporting date)** | Amount of 10,164,474 thousand RSD is recognized for the purposes of calculating regulatory capital (nominal value plus share premium in the amount of 124,474 thousand RSD). | Amount of 1,042,509 thousand RSD recognised as suplementary capital. This amount is calculated by applying the appropriate reduction weights for commitments in the last five years before maturity in accordance with the Capital Adequacy Decision. |
| **4.** | **Nominal value of instrument** | 10,040,000 thousand RSD | EUR 15,000,000 |
| **5.** | **Accounting classification** | Share capital | Liability – depreciated amount |
| **6.** | **Initial date of issuance of instrument** | 1st issue: 4.012.090 RSD 23/11/2004<br>2nd issue: 1.369.980 RSD 15/06/2006<br>3rd issue: 1.735.310 RSD 28/12/2006<br>4th issue: 2.922.620 RSD 19/12/2007 | 27-Dec-11 |
| **7.** | **Instrument with or with no maturity date** | No maturity date | With maturity date |
| 7.1. | **Original maturity** | No maturity date | 27-21-2021 |
| **8.** | **Does the issuer have call option** | No | No |
| 8.1. | First day of activating call option right activation | - | - |
| 8.2. | Subsequent dates of call option activation (if applicable) | - | - |
| **9.** | ***Coupons/dividends*** | | Refering to interest on subordinated loan |
| 9.1. | Fixed or variable dividends/coupons | Variable | Variable |
| 9.2. | Full, partial or no discretion regarding the time of payment of dividends/coupons | Full discretion | No discretion |
| 9.3. | Full, partial or no discretion regarding the amount of dividends/coupons | Full discretion | No discretion |
| 9.4. | Step up option | No | No |
| 9.5. | Non-cumulative or cumulative dividends/coupons | Non-cumulative | Non-cumulative |
| **10.** | **Convertible or non-convertible instrument** | Non-convertible | Non-convertible |
| 10.1. | If convertible, terms under which conversion may take place | - | - |
| 10.2. | If it is convertible, specify if it is partially or fully convertible | - | - |
| 10.3. | If it is convertible, rate of conversion | - | - |
| 10.4. | If it is convertible, mandatory or voluntary conversion | - | - |
| 10.5. | If it is convertible, specify instrument to which it is converted. | - | - |
| 10.6. | If it is convertible, the issuer of the instrument to which it is converted. | | |
| **11.** | **Write-off option** | No | No |
| 11.1. | If there is write-off option, specify terms under which the write-off may take place. | - | - |
| 11.2. | If there is write-off option, specify if partial or full | - | - |
| 11.3. | If there is write-off option, spefify if temporary or permanent write-off | - | - |
| 11.4. | If the write-off is temporary,specify terms of re-recognition | - | - |
| **12.** | **Type of an instrument which will be paid off directly before the said instrument during** | Minority participations | Other |

# Inset 3 - Form PI-UPK

**Breakdown of elements in the Bank's Balance Sheet and references to positions included in regulatory capital (Inset**

(RSD thousand)

| Designation of item | Item | Balance sheet | References |
|---|---|---|---|
| **A** | **ASSETS** | | |
| A.I | Cash and assets with the central bank | 18,523,428 | |
| A.II | Pledged financial assets | | |
| A.III | Financial assets recognised at fair value through income statement and held for trading | 8,363,472 | |
| A.IV | Financial assets initially recognised at fair value through income statement | | |
| A.V | Financial assets available for sale | 3,446,272 | |
| A.VI | Financial assets held to maturity | 7,008,412 | |
| A.VII | Loans and receivables from banks and other financial organisations | 2,733,351 | |
| A.VIII | Loans and receivables from clients | 75,182,667 | |
| A.IX | Change in fair value of hedged items | | |
| A.X | Receivables arising from hedging derivatives | | |
| A.XI | Investments in associated companies and joint ventures | | |
| | *Of which direct or indirect investments in banks and other financial sector person persons* | | **u** |
| A.XII | Investments into subsidiaries | 93,560 | |
| | *Of which direct or indirect investments in banks and other financial sector persons* | 93,560 | **f** |
| A.XIII | Intangible assets | 350,854 | **i** |
| A.XIV | Property, plant and equipment | 733,119 | |
| A.XV | Investment property | 238,508 | |
| A.XVI | Current tax assets | 1,116 | |
| A.XVII | Deferred tax assets | 161,382 | |
| A.XVIII | Non-current assets held for sale and discontinued operations | | |
| A.XIX | Other assets | 651,624 | |
| | *Of which direct or indirect investment in banks and other financial sector entities that exceed 10% of the capital of such banks and/or other financial sector entity* | | **h** |
| **A.XX** | **TOTAL ASSETS (AOP items from 0001 to 0019 in the balance sheet)** | **117,487,765** | |
| **P** | **LIABILITIES** | | |
| **PO** | **LIABILITIES** | | |
| PO.I | Financial liabilities recognised at fair value through income statement and held for trading | 94,235 | |
| PO.II | Financial liabilities initially recognised at fair value through income statement | | |
| PO.III | Liabilities arising from hedging derivatives | | |
| PO.IV | Deposits and other liabilities to banks, other financial organisations and central bank | 30,282,165 | |
| PO.V | Deposits and other liabilities to other clients | 68,295,393 | |
| PO.VI | Change in fair value of hedged items | | |
| PO.VII | Own securities issued and other borrowings | | |
| | *Of which liabilities arising from hybrid instruments* | | **r** |
| PO.VIII | Subordinated liabilities | 1,824,946 | |
| | *Of which subordinated liabilities included in bank's supplementary capital* | 1,042,509 | **s** |
| PO.IX | Provisions | 534,486 | |
| PO.X | Liabilities under assets held for sale and discontinued operations | | |
| PO.XI | Current tax liabilities | | |
| PO.XII | Deferred tax liabilities | | |
| PO.XIII | Other liabilities | 457,059 | |
| **PO.XIV** | **TOTAL LIABILITIES (AOP items from 0401 to 0413 in the balance sheet)** | 101,488,284 | |
| | **CAPITAL** | | |
| **PO.XV** | **Share capital** | **10,164,475** | |
| | *Of which nominal value of paid-in shares, except cumulative preferential shares* | 10,040,000 | **a** |
| | *Of which share premium on share capital, except cummulative preferential shares* | 124,475 | **b** |
| | *Of which nominal value of cumulative preferential shares* | | **nj** |
| | *Of which share premium on cumulative preferential shares* | | **o** |
| **PO.XVI** | **Own shares** | | |
| | *Of which acquired own shares, except cumulative preferential shares* | | **j** |
| | *Of which acquired own cumulative preferential shares* | | **t** |
| **PO.XVII** | **Profit** | **1,189,456** | |
| | *Of which retained earnings from previous years* | | **g** |
| | *Of which profit of the current year* | 1,189,456 | |
| | *Of which profit of the current year for which the General Assembly of the Bank adopted a decision on allocation to the core capital* | | **d** |
| **PO.XVIII** | **Loss** | | |
| | *Of which losses from previous years* | | **ž** |
| | *Of which loss in the current year* | | **z** |
| **PO.XIX** | **Reserves** | **4,645,550** | |
| | *Of which reserves from profit which represent element of core capital* | 4,425,448 | **v** |
| | *Of which other positive consolidated reserves* | | **e** |
| | *Of which other negative consolidated reserves* | | **n** |
| | *Of which other net negative revaluation reserves* | | **lj** |
| | *Of which gains on bank liabilities measured at fair value due to the change in bank's credit rating* | | **m** |
| | *Of which positive revaluation reserves created on the basis of effects of changes in fair value of fixed assets, securities and other assets which are, in accordance with IFRS/IAS, credited to these reserves.* | 193,306 | **p** |
| | *Of which unrealised losses on securities available for sale* | 1,837 | **l** |
| | Of which actuarial gains | 28,358 | |
| | *Of which tax liabilities* | 275 | |
| **PO.XX** | **Unrealised losses** | | |
| **PO.XXI** | **Non-controlling participation** | | |
| | *Of which minority participation in subordinated companies* | | **đ** |
| **PO.XXII** | **TOTAL CAPITAL** (result of adding up and/or subtracting the following balance sheet items: 0415-0416+0417-0418+0419+0420) ≥ 0 | 15,999,481 | |
| **PO.XXIII** | **TOTAL CAPITAL SHORTFALL** (result of adding up and/or subtracting the following balance sheet items: 0415-0416+0417-0418+0419+0420) < 0 | | |
| **PO.XXIV** | **TOTAL LIABILITIES** (result of adding up and/or subtracting the following balance sheet items: 0414+0421-0422) | **117,487,765** | |
| **В.П.** | **OFF-BALANCE SHEET ITEMS** | | |
| В.П.А. | Off-balance sheet assets | 143,595,947 | |
| | *Of which amount of shares received in pledge, except cumulative preferential shares* | | **k** |
| | *Of which amount of cumulative preferential shares received in pledge* | | **ć** |
| В.П.П. | Off-balance sheet liabilities | 143,595,947 | |

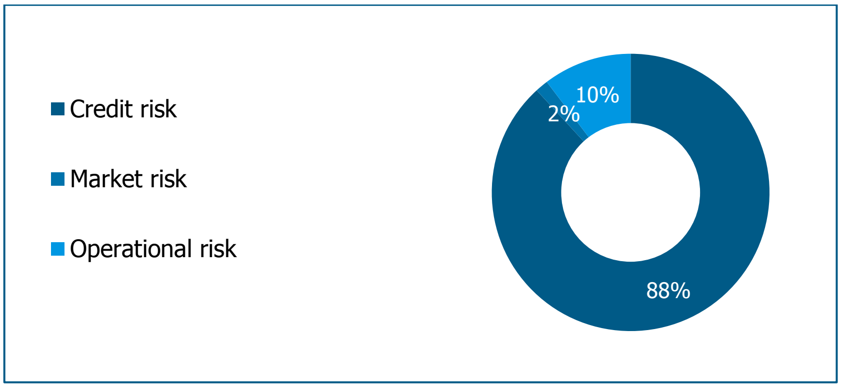
## 4.2. REGULATORY CAPITAL ADEQUACY

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.

Based on the business activities of the Bank and in accordance with Pillar 1 Basel II, the minimum capital requirements are computed for:

- **credit risk** - 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;
- **market risks**:
  - position risk on debt securities - calculated as sum of capital requirements for general and specific position risk on these securities, multiplied by 1.5; capital requirement for *general position risk on debt securities* is calculated by applying duration method; as at 31 December 2015, the Bank was not exposed to *specific position risk on debt securities*;
  - FX risk – computed as 12% of the sum of total net open foreign currency position and absolute value of net open position in gold, if it exceeds 2% of the Bank's capital; and
- **operational risk** - the Bank uses BIA.

The share of capital requirements, computed in accordance with Pillar 1 Basel II, by risk types as of 31 December 2015 is illustrated in the following graph:




Graph 4: The capital requirements by risk types

During 2015, the Bank was subject to the control within the Special Diagnostic Studies (SDS) of NBS conducted on a 14 banks (representing 88% of banking sector assets as of 31st March 2015). The purpose of this study was to examine: the quality of portfolios, compliance with Accounting Standards and whether banks are adequately capitalized, as well as to increase transparency. The Bank has successfully passed tests and reaffirmed its strong capital base, healthy loan portfolio and robust processes for risk management.

An overview of before mentioned capital requirements calculated as at 31st December 2015 is given in prescribed form PI-AKB as Inset 4 that follows.

# Inset 4 - Form PI-AKB

**Bank's total capital requirements and capital adequacy ratio**

(RSD thousand)

| No | Name | Amount | Coverage by core capital | Coverage by supplementary capital |
|---|---|---|---|---|
| | | 1 | 2 | 3 |
| I | CAPITAL | *13,253,490* | | |
| 1. | TOTAL CORE CAPITAL | 12,064,455 | | |
| 2. | TOTAL SUPPLEMENTARY CAPITAL | 1,189,035 | | |
| II | CAPITAL REQUIREMENTS | 8,893,864 | | |
| 1. | CAPITAL REQUIREMENTS FOR CREDIT RISK, COUNTERPARTY RISK AND SETTLEMENT/DELIVERY RISK IN CASE OF FREE DELIVERIES | 7,814,855 | *7,814,855* | |
| 1.1. | Standardised approach (SA) | 65,123,793 | | |
| *1.1.1.* | *Exposures to central governments and central banks* | | | |
| *1.1.2.* | *Exposures to territorial autonomies and local self-government units* | *778,645* | | |
| *1.1.3.* | *Exposures to public administrative bodies* | *13,030* | | |
| *1.1.4.* | *Exposures to multilateral development banks* | | | |
| *1.1.5.* | *Exposures to international organisations* | | | |
| *1.1.6.* | *Exposures to banks* | *555,203* | | |
| *1.1.7.* | *Exposures to corporates* | *41,300,954* | | |
| *1.1.8.* | *Retail exposures* | *15,194,159* | | |
| *1.1.9.* | *Exposures secured by real estate collateral* | *5,498,439* | | |
| *1.1.10.* | *Past due items* | *285,585* | | |
| *1.1.11.* | *High-risk exposures* | | | |
| *1.1.12.* | *Exposures in the form of covered bonds* | | | |
| *1.1.13.* | *Exposures in the form of open-end investment funds* | | | |
| *1.1.14.* | *Other exposures* | *1,497,778* | | |
| 1.2. | Internal Ratings Based Approach (IRB) | | | |
| *1.2.1.* | *Exposures to central governments and central banks* | | | |
| *1.2.2.* | *Exposures to banks* | | | |
| *1.2.3.* | *Exposures to corporates* | | | |
| *1.2.4.* | *Retail exposures* | | | |
| *1.2.4.1.* | *Retail exposures secured by real estate collateral* | | | |
| *1.2.4.2.* | *Qualifying revolving retail exposures* | | | |
| *1.2.4.3.* | *Other retail exposures* | | | |
| *1.2.5.* | *Equity exposures* | | | |
| *1.2.5.1.* | *Approach applied:* | | | |
| *1.2.5.1.1.* | *Simple Risk Weight Approach* | | | |
| *1.2.5.1.2.* | *PD/LGD Approach* | | | |
| *1.2.5.1.3.* | *Internal Models Approach* | | | |
| *1.2.5.2.* | *Types of equity exposures* | | | |
| *1.2.5.2.1.* | *Exchange traded equity exposures* | | | |
| *1.2.5.2.2.* | *Non-exchange traded equity exposures in sufficiently diversified portfolios* | | | |
| *1.2.5.2.3.* | *Other equity exposures* | | | |
| *1.2.5.2.4.* | *Equity exposures to which a bank applied Standardised Approach to credit risk* | | | |
| *1.2.6.* | *Exposures to other assets* | | | |
| *2* | CAPITAL REQUIREMENTS FOR SETTLEMENT/DELIVERY RISK ARISING FROM UNSETTLED TRANSACTIONS | | | |
| 3 | CAPITAL REQUIREMENTS FOR MARKET RISKS | 118,981 | *118,981* | |
| 3.1. | Capital requirements for price, foreign exchange and commodity risks calculated under standardised approaches | 118,981 | *118,981* | |
| *3.1.1.* | *Capital requirements for price risk arising from debt securities* | *103,527* | *103,527* | |
| *3.1.2.* | *Capital requirements for price risk arising from equity securities* | *0* | *0* | |
| *3.1.3.* | *Capital requirements for foreign exchange risk* | *15,454* | *15,454* | |
| *3.1.4.* | *Capital requirements for commodity risk* | | | |
| 3.2. | Capital requirements for price, foreign exchange and commodity risks calculated under the Internal Models Approach | | | |
| 4 | CAPITAL REQUIREMENTS FOR OPERATIONAL RISK | 960,028 | *960,028* | |
| 4.1. | Capital requirements for operational risk calculated under the Basic Indicator Approach | 960,028 | *960,028* | |
| 4.2. | Capital requirements for operational risk calculated under the Standardised Approach | | | |
| 4.3. | Capital requirements for operational risk calculated under the Advanced Approach | | | |
| 5 | COVERAGE OF CAPITAL REQUIREMENTS | *8,893,864* | *8,893,864* | |
| III | CAPITAL ADEQUACY RATIO (%) | *17.88* | | |

# 5. RISK TYPES

## 5.1. CREDIT RISK

### 5.1.1. RISK MANAGEMENT, CONTROL AND REPORTING

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 and via monitoring of early warning signs (EWS) that represents indicators of increased client's credit risk.

Additionally, the Bank implemented technical solutions for portfolio provisioning calculation and for assignment adequate NBS classification of the client, which is used for the formation of reserves for estimated losses in accordance with the Decision on classification of balance sheet assets and off-balance sheet items (RS Official Gazette, no. 94/2011, 57/2012, 123/2012, 43/2013, 113/2013, 135/2014, 25/2015 and 38/2015). The new program has been introduced to monitor the default recognition and upgrade. Moreover, scoring models for private individuals and micro clients were integrated in the rating system. The Bank's focus is on automation of processes for more efficient decision making process and risk control process.

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.

### 5.1.2. 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[2] 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.

[2] Amount in delay is considered significant if the overdue amount is higher than RSD 1,000 and above 1% of customer total exposure for private individuals or higher than RSD 10,000 for corporate clients.

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;
- the borrower exceeded approved credit limit;
- the borrower drew down an unauthorized credit facility.

Where possible, the Bank seeks to reschedule or restructure loans rather than foreclose collaterals. This may involve extending the payment terms or any other modification to the original loan agreement provisions. Rescheduling or restructuring may be business rescheduling or forbearance as per EBA definition.

**Business loan rescheduling** entails alteration to the originally agreed loan terms not caused by the borrower's financial position deterioration, or mitigation of the consequences of the deteriorated financial position of the borrower, and does not represent restructuring. It is rather a result of a changed market situation (customers, suppliers, competitors) and the need to adjust the loan repayment schedule and terms to the newly arisen situation.

**Forbearance represents restructuring** caused by:

- the borrower's inability to fulfil its contractual obligations due to financial difficulties; and
- the need of the Bank to make certain concessions to enable the borrower to service its liabilities.

During 2015 the Bank implemented forbearance recognition and appropriate flagging in its core system.

Once the terms have been renegotiated, the loan is no longer considered past due, but if after restructuring evidence of impairment arises, the client will again be assigned the default status. The Bank continuously monitors rescheduled/restructured loans to ensure that all criteria are met, as well as that future payments are made or default status assigned in a timely manner to the clients not complying with the re-defined criteria.

### 5.1.3. 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 - LLP), in accordance with International Accounting Standards (hereinafter: IAS)/ International Financial Reporting Standards (hereinafter: IFRS).

The Bank’s loan loss provisioning includes Specific provision (individual or rule based) and Portfolio provision (collective impairment).

Specific provision is assigned on exposures to defaulted customers who are found to be 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 (collective impairment) is applied on exposures to non-defaulted customers or to defaulted customers which are not found to be impaired. 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:

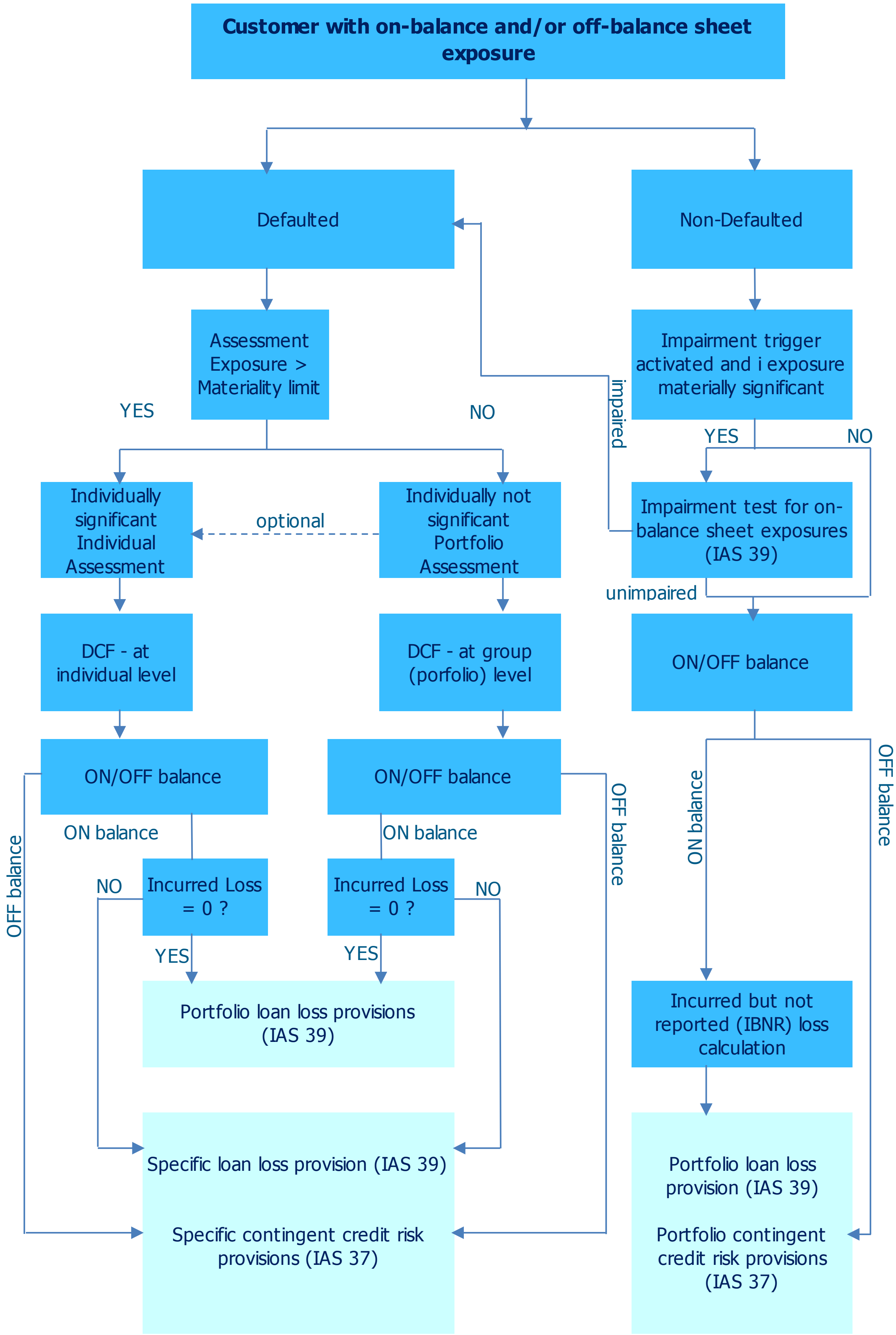



Figure 10: Loan loss provisioning process

### Specific Provision assessment

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

Individually significant impaired exposures are assessed individually using discounted cash flow method (DCF), where expected cash flows from redemption and foreclosure of collateral are estimated by the responsible Workout manager and Corporate Claim Collection Unit. 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.

### Portfolio 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 reviews the methodology and assumptions used for estimating future cash flows in order to reduce any differences between loss estimates and actual loss experience through Back-Testing analysis that is conducted on yearly basis.

### The release of Provisions

The release of specific LLP (computed on an individual or portfolio basis) occurs in the case of:

- collection of indirectly written-off loans;
- collection after the reprogram or restructuring process;
- enforced collection;
- the growth of material value of the collateral;
- improving the economic situation of the debtor, after showing signs of recovery, and thus the revocation of the status of default;
- loan collection as part of the portfolio for which specific provision is calculated on a portfolio basis, also after the reprogram or restructuring process.

The release of specific LLP has to be approved by responsible management authority. In the case of repayment by cash or via collateral sales, additional approval for reduction in receivables is not required. Still, this process needs to be documented by relevant units within the Bank.

The release of portfolio provisions occurs in the case of:

- improving the economic situation of the debtor;
- the growth of material value of the collateral;
- reduction in the total credit portfolio;
- reduction in LIP.

### 5.1.4. CREDIT RISK MITIGATION (CRM) TECHNIQUES

#### Management and Control

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.

Within the SRM Department, Collateral Management Unit (CMU) is responsible for the collateral management process – encompassing all processes between preliminary analysis and collateral realisation. The process consists of 3 phases:

Figure 11: The collateral management process

**Preliminary analysis** is the first step of the collateral management process. It starts with identification and analysis of potential collateral and collection of necessary information and documentation. It ends with recording collateral in the collateral database.

**Monitoring** refers to monitoring of eligibility and value of collateral. It encompasses: recording, monitoring, reviewing and control of collateral data within the collateral database.

**Realisation** is the last stage within the collateral management process and it represents e.g. collateral sale and closing of collateral in the collateral database. It also includes collection of data in order to compute Collateral Recovery Ratio.

Each phase and accompanying roles and responsibilities are explained in detail by Collateral Management Procedure.

CMU is also responsible for: selection, monitoring and suspension of valuators from the list of accepted valuators, i.e. for setting the minimum requirements for report on valuation; oversight over valuation methodologies adequacy, in order to ensure precise collateral value. Rules related to standards and valuation methodologies are defined in Collateral Management Policy.

Collateral value review is performed periodically, depending on the nature of review and collateral type. Collateral value review can be executed by external appraisals or government bodies (re-assessment, proof of tax payment, etc.) or via internal monitoring within CMU. Frequency of collateral review process will be different for each individual collateral type, as defined by local regulation and internal policies and procedures.

In process of credit risk capital requirements calculation, whether a type of collateral is admitted for credit risk mitigation, is decided by the SRM Department, after determining whether applicable legal requirement prescribed by 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 mean 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 Government – only Republic of Serbia guarantee eligible as at 31st December 2015. Preferential risk weight of 0% as prescribed by Decision on Capital Adequacy of Banks was applied;
- Commercial banks of sufficient credit quality – for exposures with remaining maturity of three months or more secured by bank guarantee, the Bank assigns a risk weight that is assigned to the exposures on the sovereign of the country of guarantor bank's incorporation or risk weight of 50%, depending which is less favourable; for exposures with remaining maturity of less than three months secured by bank guarantee, the Bank assigns a risk weight that is assigned to the exposures on the sovereign of the country of guarantor bank's incorporation or risk weight of 20%, depending which is less favourable.

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

### Exposure Secured by Real Estate Collateral class

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

Other types of real estate the Bank recognizes as collateral for internal purposes, although they are not used as a credit risk mitigation technique for regulatory purposes (i.e. capital adequacy).

### Other Types of Material Credit Hedging

In addition to the above-mentioned types of material credit hedging, the Bank applies the following credit risk mitigation techniques, but it does not use them to modify (i.e. reduce) risk-weighted exposure:

- mortgages on movables;
- mortgages on receivables;
- pledges on shares and bonds;
- life insurance policies pledged to the Bank;
- other types defined by the Collateral catalogue.

### 5.1.5. QUANTITATIVE DISLOSURES

Below is an overview of the Bank's gross credit risk exposure structure by exposure classes:

*RSD '000*

| Exposure class | Total gross exposure | On-balance sheet assets | Off-balance sheet items* | Off-balance sheet items for which there can be no payments | Financial derivatives | Reverse repo transactions |
|---|---|---|---|---|---|---|
| Central Governments and Central Banks | 28,100,900 | 27,352,607 | 0 | 243,252 | 4,969 | 500,072 |
| Local Governments and Local Authorities | 1,857,697 | 1,322,937 | 534,761 | 0 | 0 | 0 |
| Public Administrative Bodies | 13,310 | 13,310 | 0 | 0 | 0 | 0 |
| Multilateral development banks | 6,838,173 | 0 | 0 | 6,838,173 | 0 | 0 |
| Institutions | 18,786,460 | 1,688,962 | 621,648 | 16,435,936 | 39,914 | 0 |
| Corporates | 58,771,636 | 43,057,426 | 12,688,483 | 2,980,727 | 45,001 | 0 |
| Retail | 24,905,743 | 20,269,371 | 2,743,363 | 1,893,008 | 0 | 0 |
| Exposures secured by residential property | 11,736,191 | 11,478,453 | 253,351 | 4,386 | 0 | 0 |
| Past due exposures | 9,165,632 | 7,021,945 | 2,140 | 2,141,547 | 0 | 0 |
| Other items | 90,683,130 | 4,147,821 | 300,850 | 86,234,459 | 0 | 0 |
| **Total** | **250,858,873** | **116,352,832** | **17,144,596** | **116,771,490** | **89,883** | **500,072** |

** Without items for which there can be no payments*

Table 2 - Exposure Structure

The Bank's average credit risk exposure in 2015th per exposure class is shown in the table below:

*RSD '000*

| Exposure class | Exposure* 31-Dec-2015 | Exposure* 31-Dec-2014 | Average** Exposure | In % |
|---|---|---|---|---|
| Central Governments and Central Banks | 27,857,648 | 17,088,305 | 23,127,966 | *19.6* |
| Local Governments and Local Authorities | 1,857,697 | 1,413,560 | 1,485,184 | *1.3* |
| Public Administrative Bodies | 13,310 | 162,542 | 74,619 | *0.1* |
| Multilateral development banks | 0 | 0 | 0 | *0.0* |
| Institutions | 2,350,524 | 4,437,718 | 0 | *0.0* |
| Corporates | 55,790,909 | 44,652,235 | 46,293,763 | *39.1* |
| Retail | 23,012,735 | 21,374,847 | 22,675,219 | *19.2* |
| Exposures secured by residential property | 11,731,805 | 9,513,072 | 10,463,646 | *8.8* |
| Past due exposures | 7,024,084 | 7,456,312 | 7,368,698 | *6.2* |
| Other items | 4,448,670 | 9,844,908 | 6,777,883 | *5.7* |
| **Total** | **134,087,383** | **115,943,500** | **118,266,977** | ***100.0*** |

** Without items for which there can be no payments*

***Annual average derived from quarterly data.*

Table 3: 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 | Exposure* |
|---|---|---|---|
| Serbia | Central Governments and Central Banks | 28,100,900 | 27.857.648 |
| | Local Governments and Local Authorities | 1,857,697 | 1.857.697 |
| | Public Administrative Bodies | 13,310 | 13.310 |
| | Institutions | 4,969,103 | 237.023 |
| | Corporates | 58,606,103 | 55.625.376 |
| | Retail | 24,881,869 | 23.007.663 |
| | Exposures secured by residential property | 11,687,261 | 11.682.917 |
| | Past due exposures | 9,162,304 | 7.021.202 |
| | Other items | 90,492,445 | 4.257.985 |
| | Total | 229,770,992 | 131.560.822 |
| Austria | Institutions | 9,741,382 | 1.221.948 |
| | Corporates | 323 | 323 |
| | Retail | 463 | 320 |
| | Exposures secured by residential property | 7,682 | 7.682 |
| | Other items | 187,017 | 187.017 |
| | Total | 9,936,867 | 1.417.291 |
| Other Countries | Multilateral development banks | 6,838,173 | 0 |
| | Institutions | 4,075,976 | 891.553 |
| | Corporates | 165,210 | 165.210 |
| | Retail | 23,411 | 4.752 |
| | Exposures secured by residential property | 41,249 | 41.206 |
| | Past due exposures | 3,328 | 2.882 |
| | Other items | 3,668 | 3.668 |
| | Total | 11,151,014 | 1.109.270 |
| **Total** | | **250,858,873** | **134.087.383** |

** Without items for which there can be no payments*

Table 4: Gross Exposure by materially significant geographic areas and per exposure class

Table below gives a breakdown of Gross credit risk exposure by sector[3] 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.

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

*RSD '000*

| Exposure class | Sector | Exposure* | Exposures with loan loss provisions | Loan loss provisions |
|---|---|---|---|---|
| Central Governments and Central Banks | Domestic fin. institutions | 16,831,465 | 0 | 0 |
| | Public sector | 11,026,183 | 0 | 0 |
| | Total | 27,857,648 | 0 | 0 |
| Local Governments and Local Authorities | Public sector | 1,857,697 | 1,838,804 | 37,001 |
| | Total | 1,857,697 | 1,838,804 | 37,001 |
| Public Administrative Bodies | Public sector | 13,310 | 12,908 | 280 |
| | Total | 13,310 | 12,908 | 280 |
| Institutions | Domestic fin. institutions | 237,023 | 232,727 | 149 |
| | Foreign entities | 2,113,501 | 2,068,589 | 31,414 |
| | Total | 2,350,524 | 2,301,316 | 31,563 |
| Corporates | Domestic fin. institutions | 1,479,057 | 984,655 | 29,437 |
| | Public companies | 4,988,872 | 1,578,062 | 332,515 |
| | Other domestic companies | 48,823,023 | 48,155,928 | 1,046,636 |
| | Entrepreneurs | 109,643 | 109,643 | 2,754 |
| | Foreign entities | 144,871 | 130,506 | 2,265 |
| | Agricultural producers | 49,772 | 49,772 | 1,006 |
| | Other counterparties | 195,671 | 194,121 | 174,670 |
| | Total | 55,790,909 | 51,202,688 | 1,589,284 |
| Retail | Public companies | 2,094 | 2,094 | 115 |
| | Other domestic companies | 2,331,756 | 2,214,676 | 49,734 |
| | Entrepreneurs | 507,951 | 482,002 | 18,542 |
| | Private individuals | 19,931,282 | 19,923,297 | 764,860 |
| | Foreign entities | 159 | 40 | 1 |
| | Agricultural producers | 239,493 | 239,493 | 7,923 |
| | Total | 23,012,735 | 22,861,603 | 841,176 |
| Exposures secured by residential property | Domestic fin. institutions | 363 | 363 | 7 |
| | Other domestic companies | 1,337,779 | 1,337,779 | 25,470 |
| | Entrepreneurs | 73,426 | 73,426 | 2,379 |
| | Private individuals | 10,291,354 | 10,291,354 | 119,304 |
| | Agricultural producers | 28,883 | 28,883 | 1,648 |
| | Total | 11,731,805 | 11,731,805 | 148,809 |
| Past due exposures | Domestic fin. institutions | 121,063 | 121,063 | 98,710 |
| | Public companies | 13 | 13 | 9 |
| | Other domestic companies | 2,694,549 | 2,694,549 | 2,069,506 |
| | Entrepreneurs | 138,486 | 138,045 | 119,955 |
| | Private individuals | 1,876,252 | 1,876,252 | 1,519,309 |
| | Foreign entities | 46 | 46 | 28 |
| | Agricultural producers | 113,456 | 113,456 | 89,285 |
| | Other counterparties | 2,080,220 | 2,080,220 | 1,488,456 |
| | Total | 7,024,084 | 7,023,644 | 5,385,257 |
| Other items | Domestic fin. institutions | 4,027,822 | 0 | 0 |
| | Other domestic companies | 85,785 | 85,785 | 80,119 |
| | Foreign entities | 0 | 0 | 0 |
| | Other counterparties | 335,063 | 316,960 | 4,302 |
| | Total | 4,448,670 | 402,745 | 84,421 |
| Multilateral development banks | Domestic fin. institutions | 0 | 0 | 0 |
| | Total | 0 | 0 | 0 |
| **Total** | | **134,087,383** | **97,375,512** | **8,117,791** |

** Without items for which there can be no payments*

Table 5: Gross Exposure by sector and exposure class with focus on exposures for which loan loss provision was made

Break down of Gross credit risk exposure into maturity buckets according to final loan maturity is shown in the next table:

*RSD '000*

| | Exposure | | | |
|---|---|---|---|---|
| **Exposure class** | **<1 years** | **1 – 3 years** | **>3 years** | **Total** |
| Central Governments and Central Banks | 27,420,753 | 680,148 | - | 28,100,900 |
| Local Governments and Local Authorities | 25,689 | 44,197 | 1,787,812 | 1,857,697 |
| Public Administrative Bodies | 402 | - | 12,908 | 13,310 |
| Multilateral development banks | 6,838,173 | - | - | 6,838,173 |
| Institutions | 18,162,989 | 605,866 | 17,605 | 18,786,460 |
| Corporates | 19,266,582 | 12,101,507 | 27,403,547 | 58,771,636 |
| Retail | 5,848,012 | 5,335,440 | 13,722,291 | 24,905,743 |
| Exposures secured by residential property | 257,182 | 578,619 | 10,900,390 | 11,736,191 |
| Past due exposures | 5,219,022 | 1,748,335 | 2,198,275 | 9,165,632 |
| Other items | 90,199,007 | 279,265 | 204,858 | 90,683,130 |
| **Total** | **173,237,809** | **21,373,377** | **56,247,687** | **250,858,873** |

Table 6: 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 2015 | 7,444,307 |
| Provisions allocation during the year | 10,586,059 |
| Provisions release during the year | (9,188,684) |
| Provisions write off during the year | (790,751) |
| Other adjustments | 66,860 |
| **Provisions as at 31 December 2015** | **8,117,791** |

Table 7: Loan loss provision movement

As at 31st December 2015, reserve for estimated losses and required reserve for estimated losses, calculated in accordance with Decision on Classification of Bank Balance Sheet Assets and Off-balance Sheet Items, per counterparty type, amounted to[4]:

***RSD '000***

| Counterparty type | Category of classification | | | | | Total |
|---|---|---|---|---|---|---|
| | A | B | V | G | D | |
| Domestic financial institutions | 1,192,157 | 501,005 | 5,651 | - | 138,692 | 1,837,505 |
| Public companies | 4,660,530 | 34 | 1 | 155,734 | 174,680 | 4,990,979 |
| Other companies | 33,331,220 | 18,314,703 | 1,650,245 | 895,745 | 2,683,295 | 56,875,208 |
| Entrepreneurs | 617,780 | 37,405 | 15,054 | 15,013 | 144,255 | 829,507 |
| Public sector | - | 1,870,606 | - | - | - | 1,870,606 |
| Private individuals | 27,747,295 | 1,209,597 | 505,439 | 572,126 | 2,064,412 | 32,098,869 |
| Foreign entities | 2,056,390 | 143,625 | 23 | 36 | 22,256 | 2,222,330 |
| Agricultural producers | 290,715 | 17,487 | 6,184 | 9,479 | 107,739 | 431,604 |
| Other counterparties | 284,015 | 27,811 | 19,078 | 35,979 | 2,244,072 | 2,610,955 |
| **Total exposure subject to classification** | **70,180,102** | **22,122,273** | **2,201,675** | **1,684,112** | **7,579,401** | **103,767,563** |
| **Reserve for estimated losses** | **-** | **409,993** | **316,928** | **483,566** | **7,562,234** | **8,772,721** |
| **Provisions** | **982,725** | **430,684** | **147,273** | **697,154** | **5,859,955** | **8,117,791** |
| **Required reserve for estimated losses** | **-** | **68,029** | **209,031** | **135,574** | **1,713,364** | **2,125,998** |

Table 8: Exposure by NBS classification category

## External Rating Agencies Data and Quantitative Disclosures related to credit risk mitigation techniques application

For risk weighted assets calculation purposes, the Bank does not use external ratings by external rating agencies. For asset class Central Government and Central bank, the 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 9: Assignments of risk weight to credit assessments from an export credit agency

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

The table below presents net exposure before and after the use of credit protection, i.e. adjustment for effects of CRM techniques, by risk weight band.

[4] 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 Decision on classification of balance sheet assets and off-balance sheet items and RWA basis calculated in accordance with Decision on capital adequacy by banks.

*RSD '000*

| Exposure class | Risk weight band | Net Exposure* | Exposure* after CRM |
|---|---|---|---|
| Central Governments and Central Banks | 0% | 27.857.648 | 31.268.293 |
| Local Governments and Local Authorities | 50% | 1.820.319 | 1.820.319 |
| Public Administrative Bodies | 100% | 13.030 | 13.030 |
| Multilateral development banks | 0% | 0 | 0 |
| Institutions | 20% | 1.561.220 | 1.559.471 |
| | 50% | 736.698 | 760.661 |
| | 150% | 19 | 19 |
| | 100% | 20.287 | 20.287 |
| Corporates | 100% | 53.839.874 | 47.916.412 |
| Retail | 75% | 21.675.156 | 21.353.578 |
| | 100% | 222.465 | 269.329 |
| Exposures secured by residential property | 35% | 9.038.180 | 9.038.180 |
| | 100% | 2.419.547 | 2.545.298 |
| Past due exposures | 100% | 281.587 | 0 |
| | 150% | 3.469 | 0 |
| Other items | 0% | 2.703.748 | 2.703.748 |
| | 20% | 0 | 0 |
| | 100% | 1.650.933 | 1.611.357 |
| **Total** | | **123.844.179** | **120.879.983** |

** Without items for which there can be no payments*

Table 1: Net exposure before and after CRM per exposure class

Concentration risk from credit risk mitigation techniques is understood as the risk of a negative correlation that may arise from the use of these techniques. Correlation risk is monitored and identified in the course of portfolio monitoring through analysis of various customer segments per collateral type.

Net exposure per exposure class is secured by the following amount of collateral type recognised as credit risk mitigation as at 31st December 2015:

*RSD '000*

| Exposure class | Net Exposure* | Guarantees* | Cash deposit |
|---|---|---|---|
| Central Governments and Central Banks | 27,857,648 | - | - |
| Local Governments and Local Authorities | 1,820,319 | - | - |
| Public Administrative Bodies | 13,030 | - | - |
| Multilateral development banks | - | - | - |
| Institutions | 2,318,224 | - | 1,749 |
| Shares in Investment Funds | - | - | - |
| Corporates | 53,839,874 | 3,434,608 | 2,596,702 |
| Retail | 21,897,621 | - | 321,942 |
| Exposures secured by residential property | 11,457,726 | - | - |
| Past due exposures | 285,056 | - | 758 |
| Other items | 4,354,681 | - | 39,575 |
| **Ukupno** | **123,844,179** | **3,434,608** | **2,960,727** |

** Without items for which there can be no payments*

**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.*

Table 2: Net exposure and CRM by type of CRM instrument

## 5.2. COUNTERPARTY 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 and
- repo and reverse-repo transactions.

Adequate 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 31st December 2015 the Bank's exposure to counterparty credit risk resulted from financial derivatives (FX swap transactions):

*RSD '000*

| Exposure to counterparty risk per transaction type | Exposure amount |
|---|---|
| Financial derivatives | 89,883 |
| Repo transactions | 500,072 |
| **Total** | **589,955** |

Table 3: Exposure to counter party risk

Specifically for repo transactions booked by the Bank on 31st December 2015, 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.

## 5.3. MARKET RISK

### 5.3.1. MARKET RISK IN TRADING BOOK

**Market risk management** is the competence of the SRM Department, i.e. Market and Liquidity Risk Management Unit (hereinafter: M&LMU).

**Market risk monitoring and control** are, above all, based on setting up limits as well as the risk level the Bank is willing to accept. The Bank continuously monitors and manages market risks through the control of set limits, modification of the existing and definition of new ones, as well as the assessment of relevant risks resulting from launching new products and complex transactions.

**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.

As of 31st December 2015, the Bank was exposed only to market risk in trading book, i.e. position risk on debt securities, as presented in the table 13.

### 5.3.2. FX RISK

**Foreign exchange (FX) risk control** is performed daily, on the basis of open FX position report, by M&LMU and ALM Department.

M&LMU daily monitors open FX position (openness in each individual currency as well as the movement of RSD exchange rate against other currencies) and determines eventual breaches of defined limits. Additionally, ALM Department reports monthly to ALCO on revaluation effect of the open FX position. Suggestions for FX position management are presented at ALCO meetings.

In order to protect itself from the risks of any adverse exchange rates movements, Treasury Division should, on a daily basis, manage the total open net FX position and openness in every individual currency, monitor the movements of RSD exchange rate in relation to other currencies, and take measures to ensure that the openness of the net FX position is always in compliance with prescribed limits. Treasury Division should manage the transactions impacting the open FX position on a daily basis.

During 2015, the Bank has continuously paid attention to ensuring compliance with the FX risk ratio prescribed by the local regulator. The FX risk ratio of the Bank at the end of each business day was not greater than 20% of its capital.

### 5.3.3. QUANTITATIVE DISCLOSURES

The following table displays capital requirements for market risk, computed in accordance with Pillar 1 Basel II.

| Caqpital requirments for market risk | | 31/12/2015 RSD '000 | 31/12/2014 RSD '000 |
|---|---|---|---|
| **Caqpital requirment for position risk on debt securities** | | | |
| Maturity-based approach | General position risk | 103,527 | 69,860 |
| | Specific position risk | - | - |
| **Caqpital requirment for position risk of equity instruments** | | | |
| | General position risk | - | - |
| | Specific position risk | - | - |
| **Capital requirement for FX risk** | | 15,454 | 35,367 |
| **Capital requirement for commodity risk** | | - | - |
| **Total** | | **118,981** | **105,226** |

Tabel 13: The capital requirements for market risk

More details on market risks management are presented in Notes to financial statements for the year ended 31st December 2015, note 34.4.

## 5.4. INTEREST RATE RISK IN BANKING BOOK

### 5.4.1. RISK MANAGEMENT, CONTROL AND REPORTING

Interest rate risk (IRR) 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, due to reduction in interest rate margin, an ongoing trend in the current low IR environment. 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.

ALCO manages maturity structure of assets and liabilities, approves investment and interest rates positioning strategy prepared by ALM Department taking into consideration defined Bank's risk appetite, internal set and regulatory limits, the Bank's liquidity strategy, analysis of macroeconomic developments and potential changes in the Bank's business model.

The Banks applies the following measures for mitigating the interest risk exposure:
- change of deposit and loan maturity structure;
- other decisions to minimise the interest rate risk, in accordance with the ALCO recommendations.

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.

### 5.4.2. 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 net interest income 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.

During the 2012$^{th}$, 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. Above described modelling for the deposits without agreed maturity is in effect from 01 January 2013. Due to observed changes in the volatility of Corporate Division demand deposits in local currency, additional statistical analyses of their historical developments were carried out during 2014. In accordance with the recommendations of the Erste Group, separate indices for the Small and Mediums Size legal entities segment and for deposits of Large Corporate/Public segments were formed. The new indices are effective from January 01, 2015.

**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.

## 5.5. OPERATIONAL RISK

### 5.5.1. RISK MANAGEMENT, CONTROL AND REPORTING

Operational risk is the risk of possible occurrence of negative effects on financial result and equity caused by omissions in the work (intentional and unintentional) by employees, inadequate internal procedures and processes, inadequate management of information and other systems in the Bank, as well as occurrence of unforeseen external events. The Bank systematically identifies and manages operational risk through all the processes, activities, products and systems of the Bank.

Operational risk methodology and management, as well as steering and reporting, are the competence of the SRM Department, i.e. Operational and other Specific Risk Management Unit.

The Bank implemented numerous tools in order to increase efficiency of management, control and to minimize the possibility of operational risk materialisation:

- Quantitative analysis and oversight over operational risk exposure via collection of internal and external loss event data;
- Key Risk Indicators (KRIs) have been monitored within the Bank as trend indicators of operational risk exposure for defined risk points;
- Qualitative analysis of operational risk exposure (Operational Risk Management System Self-assessment and Scenario Analysis);
- Assessment of risk arising from launching of new products/markets, projects and outsourcing;
- Education of all employees in order to increase awareness of operational risk;
- Classic risk insurance (e.g. property damage, burglary, theft and general liability) and specific banking risk insurance (e.g. internal and external fraud, technological risks and civil liability).

ORCO discuss all operational risk management related topics (i.e. all non-financial risk management related topics, including compliance and security), requires and monitors implementation of corrective measures and risk mitigation action, as defined by Rulebook on Activity of Operational Risk Committee.

Regular **reporting on operational risk** provides detailed information to senior management and Executive Committee, Management Board, ORCO and other relevant bodies. The regular information flow supports the proactive management of operational risk, builds operational risk awareness about losses and exposures and enables the management of operational risk, ensures that corrective measures can be taken and the status of the measures can be followed.

Details on the management of operational risk are presented in the Notes to financial statements for the year ended 31st December 2015, note 34.8.

## 5.6. LIQUIDITY RISK

### 5.6.1. RISK MANAGEMENT, CONTROL AND REPORTING

Liquidity risk management process is organized through work of ALCO, M&LRMU and SLM Department.

ALCO and Other Liabilities Committee (OLC) are responsible for monitoring and management of liquidity risk, recommendation of measures and activities for maintaining of stability in liquidity to Executive Committee, monitoring of the structure of its balance sheet liabilities and receivables and off-balance sheet items, contingency funding planning and recommendation of other measures important for the maintain the financial stability of the Bank.

The most important reports on liquidity risk encompass reports on:
- liquidity ratio;
- daily monitoring of RSD and FX liquidity;
- 5-day net cash outflow;
- coverage with adequate highly liquid collateral;
- liquidity risk concentration analysis;
- Survival period Analysis (SPA), as a measure of the period the Bank can survive during a predefined liquidity crisis scenario by using its liquidity potential for covering future cash flows arising both from the current and future operations;
- Liquidity Coverage Ratio (LCR) and Net Stable funding Ratio (NSFR), part of Liquidity Projects run in line with Basel III liquidity requirements.

General standards of control and liquidity risk management are defined in internal acts that are regularly monitored and reviewed.

As part of its liquidity risk management process, the Bank undertakes the following:
- maintains required reserve in accordance with Decision on Banks` Required Reserves with the NBS (RS Official Gazette, no. 3/2011, 31/2012, 57/2012, 78/2012, 87/2012 107/2012, 62/2013, 125/2014, 135/2014, 4/2015, 78/2015 and 102/2015);
- prepares Contingency Funding Plan (CFP) - ensures a useful framework for management during temporary and long-lasting liquidity interruptions due to which the Bank would not be able to finance individual or all of its activities in a timely manner or at reasonable cost;
- prepares Recovery Plan - outlining how the Bank plan to regain viability if it is under severe financial pressure.

## 5.7. EXPOSURES ARISING FROM EQUITY INVESTMENTS IN THE BANKING BOOK

On January 15th 2014 the Bank made the payment of the agreed amount on the basis of concluded contract of purchase and transfer of S-leasing doo shares with Steiermarkische Bank und Sparkassen AG and Erste Group Immorent International Holding GmbH. On the date of payment of the agreed amount, the Bank acquired 75% of stake in the share capital of the company S-leasing doo Serbia in such a way that it paid 25% owned by Steiermarkische Bank und Sparkassen AG and 50% owned by Immorent AG.

Also, the bank acquired a 19% stake in the share capital of the company S Rent doo Serbia by paying 19% stake to Immorent International Holding GMBH.

These investments were motivated by strategic objectives, aiming to offer clients a wider range of services, while both companies still remain members of Erste Group.

The Bank's other 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 (shares in capital and securities of other legal entities) are result of the debt conversion to equity and have been mostly impaired.

The table below shows the structure and value of equity investments in the banking book as per 31st December 2015:

*RSD '000*

| Type of equity exposures | Valuation methods | Book value | Impairment | Fair value |
|---|---|---|---|---|
| Investment in subsidiaries (S-Leasing) | Historical cost method | 93,560 | - | 93,560 |
| Investments in associates (S-Rent) | Historical cost method | 27,005 | - | 27,005 |
| Exchange-traded equity investments | Fair value method (i.e. market price) | 53,660 | (42,292) | 11,368 |
| Other (non-exchange-traded equity investments) | Historical cost method | 118,448 | (79,269) | 39,179 |
| **Total** | | **292,673** | **(121,561)** | **171,112** |

Table 14: Equity investments in the banking book

| Realised and unrealised gains or losses from exposures in equities | *RSD '000* |
|---|---|
| Realized gain for the preceding period arising from the closure of positions on equity investments | 144 |
| Latent revaluation gains on equity investments | 19,849 |
| Unrealized gains/(losses) | (1,830) |
| **Total** | **18,163** |

Table 15: Realised and unrealised gains or losses from exposures in equities

Unrealized gains/(losses) from exposures in equities are included as a deduction from core capital within 'regulatory value adjustments'. Latent revaluation gains on equity investments are included within supplementary capital within 'revaluation reserves'.

Disclosures referring to accounting policies and valuation methods employed for equity investments in the banking book are presented in the Notes to financial statements for the year ended 31 December 20154, notes 2.5.5, 2.10, 3 (b-c).

The greatest Bank's investments in a single non-financial sector entity accounted for 0.20% of its capital (2014: 0.21%) and has not exceeded regulatory maximum of 10%, prescribed by the article 60 of Decision on Risk Management by banks.

The Bank's total investments in non-financial sector entities and in fixed assets and investment property accounted for 7.69% of its capital (2014: 5.94%), and has not exceeded regulatory maximum of 60%, prescribed by the article 60 of Decision on Risk Management by banks.

# 6. BANKING GROUP

The Banking Group prepares consolidated reports in accordance with International Financial Reporting Standards. The Banking Group also prepares consolidated reports in accordance with the Decision on Consolidated Supervision of Banking Group (RS Official Gazette, no. 45/2011).

For both purposes, consolidation is performed by applying full consolidation method for the subsidiary S-Leasing.

In accordance with the NBS Decision on Disclosure of Data and Information by banks, information on Banking Group consolidated capital as at 31st December 2015, is further provided in the following insets:

- Form PI-KAP (Inset cons. 1) - the detailed structure of the regulatory capital on consolidated basis (with references to the position of the consolidated balance sheet assets set out in Inset cons 3 provided);
- Form PI-FIKAP (Inset cons. 2) - data on main features of financial instruments included in calculation of Banking Group regulatory capital;
- Form PI-UPK (Inset cons. 3) – consisting of two tables:
  - *Table 1* – comparison of the balance sheet compiled for the needs of supervision of the Banking Group on consolidated basis and consolidated balance sheet of the Banking Group compiled in compliance with the IAS and/or IFRS,
  - *Table 2* - consolidated balance sheet of the Banking group (prepared in accordance with IAS/IFRS standards) with breakdown and references to items enabling link to the positions included in Consolidated Capital report prepared in accordance with the Decision on reporting on capital adequacy of banks (Inset cons. 1 – form PI-KAP);
- Form PI-AKB (Inset cons. 4) – overview of Capital Requirement calculated on consolidated basis.

## Inset cons. 1 - Form PI-KAP

**Consolidated data on capital position of the Banking group**

(RSD thousand)

| No | Item | Amount | Reference to Table 2 in Inset cons. 3 |
|---|---|---|---|
| I | TOTAL CORE CAPITAL | 12,189,103 | |
| 1. | CORE CAPITAL BEFORE DEDUCTIONS | 14,668,762 | |
| 1.1. | Par value of paid-in shares, except cumulative preferential shares | 10,040,000 | a |
| 1.2. | Share premium | 124,475 | b |
| 1.3. | Reserves from profit | 4,425,448 | v |
| 1.4. | Retained earnings from previous years | 0 | g |
| 1.5. | Profit of the current year | 0 | d |
| 1.6. | Minority participations in subordinate companies | 43,100 | đ |
| 1.7. | Other positive consolidated reserves | 35,740 | e |
| 2. | DEDUCTIBLES FROM CORE CAPITAL | 2,479,660 | |
| 2.1. | Losses from previous years | 0 | ž |
| 2.2. | Loss of the current year | 0 | z |
| 2.3. | Intangible assets | 351,824 | i |
| 2.4. | Acquired own shares, except cumulative preferential shares | 0 | j |
| 2.5. | Amount of shares received in pledge, except cumulative preferential shares | 0 | k |
| 2.6. | Regulatory value adjustments: | 2,127,835 | |
| 2.6.1. | Unrealised losses on securities available for sale | 1,837 | l |
| 2.6.2. | Other net negative revaluation reserves | 0 | lj |
| 2.6.3. | Gains on bank liabilities measured at fair value due to the change in bank's credit rating | 0 | m |
| 2.6.4. | Required reserve from profit for estimated losses on balance-sheet assets and off-balance sheet items of the bank | 2,125,998 | |
| 2.7. | Other negative consolidated reserves | 0 | n |
| II | TOTAL SUPPLEMENTARY CAPITAL | 1,235,815 | |
| 1. | SUPPLEMENTARY CAPITAL BEFORE DEDUCTIONS | 1,235,815 | |
| 1.1. | Par value of paid in cumulative preferential shares | 0 | nj |
| 1.2. | Share premium on cumulative preferential shares | 0 | o |
| 1.3. | Part of revaluation reserves of the bank | 193,306 | p |
| 1.4. | Hybrid instruments | 0 | r |
| 1.5. | Subordinated liabilities | 1,042,509 | s |
| 1.6. | Over-allocation of impairment allowances, provisions and required reserves from profit relative to expected losses | 0 | |
| 2. | DEDUCTIBLES FROM SUPPLEMENTARY CAPITAL | 0 | |
| 2.1. | Acquired own cumulative preferential shares | 0 | t |
| 2.2. | Receivables in respect of balance-sheet assets and off-balance sheet items of the bank secured by a hybrid instrument or subordinated liability | 0 | |
| 2.3. | Amount of cumulative preferential shares received in pledge | 0 | ć |
| 2.4. | Amount of capital in excess of limitations on supplementary capital | 0 | |
| III | TOTAL CAPITAL | 13,424,918 | |
| 1. | TOTAL CAPITAL BEFORE DEDUCTIONS | 13,424,918 | |
| 2. | DEDUCTIBLES FROM CAPITAL | 0 | |
| | Of which reduction in core capital | 0 | |
| | Of which reduction in supplementary capital | 0 | |
| 2.1. | Direct or indirect investment in banks and other financial sector persons that exceed 10% of the capital of such banks and/or other financial sector persons | 0 | (u+f+h) |
| 2.2. | Investment in hybrid instruments and subordinated liabilities of other banks and financial sector persons in which the bank has direct or indirect investment that exceeds 10% of the capital of such persons | 0 | |
| 2.3. | Total amount of direct and indirect investment in banks and other financial sector persons in the amount of up to 10% of their capital, as well as investment in their hybrid instruments and subordinated liabilities that exceeds 10% of the sum of core and supplementary capital of the bank for which the calculation of capital is made | 0 | |
| 2.4. | The amount by which qualified participation in non-financial sector persons has been exceeded | 0 | |
| 2.5. | Under-allocation of impairment allowances, provisions and required reserves from profit relative to expected losses | 0 | |
| 2.6. | The amount of exposure to free deliveries if the counterparty failed to fulfil its obligation within four working days | 0 | |
| 2.7. | Receivables from and potential liabilities toward persons related to a bank or employees in the bank which the bank has negotiated under the terms that are more favourable than the terms negotiated with other parties | 0 | |
| IV | NOTES | 0 | |
| | Positive/negative difference between total impairment allowances for balance sheet assets, provisions for losses on off-balance sheet items and required reserves from profit on the one hand, and total estimated losses under IRB approach on the other | 0 | |
| | Amount of impairment allowances, provisions and required reserves from bank's profit | 0 | |
| | *Of which on a group basis* | 0 | |
| | *Of which on an individual basis* | 0 | |
| | Amount of expected losses under IRB approach | 0 | |
| | Gross amount of subordinated liabilities | 1,824,392 | |

# Inset cons. 2 - Form PI-FIKAP consolidated

**Main features of financial instruments included in calculation of Banking Group's capital**

| No. | Instrument features | The share capital of the Bank | The subordinated loan granted by Erste Group Bank AG, Vienna | Minority interest in a subsidiary S-Leasing |
|---|---|---|---|---|
| **1.** | **Issuer** | **Erste Bank ad Novi Sad** | **Erste Bank ad Novi Sad** | **S-Leasing doo Beograd** |
| **2.** | **Treatment as per legislation** | | | |
| 2.1. | Treatment as per the Decision on Capital Adequacy of Banks | Core capital instrument | Supplementary capital instrument | Core capital instrument |
| 2.2. | Individual/group/individual and group level of inclusion of instrument in capital on group level | Individual and group | Individual and group | Group |
| 2.3. | Type of instrument | Ordinary shares | Subordinated debt issued in the form of financial instrument | Minority participations |
| **3.** | **Amount recognised for the purpose of calculating regulatory capital (in RSD thousand, as at the last reporting date)** | Amount of 10,164,474 thousand RSD is recognized for the purposes of calculating regulatory capital (nominal value plus share premium in the amount of 124,474 thousand RSD). | Amount of 1,042,509 thousand RSD recognised as suplementary capital. This amount is calculated by applying the appropriate reduction weights for commitments in the last five years before maturity in accordance with the Capital Adequacy Decision. | Minority interest in the capital (25%) is recognised in total amount of 43,100 thousand RSD (includes share capital, retained earnings from previous years and the deduction for losses in the current year). |
| **4.** | **Nominal value of instrument** | 10,040,000 thousand RSD | EUR 15,000,000 | The total paid up capital amounts to 67,500 thousand RSD, of which 25% are in the minority participation. |
| **5.** | **Accounting classification** | Share capital | Liability – depreciated amount | Minority participations |
| **6.** | **Initial date of issuance of instrument** | 1st issue: 4.012.090 RSD 23/11/2004<br>2nd issue: 1.369.980 RSD 15/06/2006<br>3rd issue: 1.735.310 RSD 28/12/2006<br>4th issue: 2.922.620 RSD 19/12/2007 | 27-Dec-11 | 1st issue: 6.538.920 RSD 17/06/2003<br>2nd issue: 33.716.916 RSD 29/06/2009<br>3rd issue: 4.076.256 RSD 27/09/2011<br>4th issue: 16.122.628 RSD |
| **7.** | **Instrument with or with no maturity date** | No maturity date | With maturity date | No maturity date |
| 7.1. | **Original maturity** | No maturity date | 27-21-2021 | No maturity date |
| **8.** | **Does the issuer have call option** | No | No | No |
| 8.1. | First day of activating call option right activation | - | - | - |
| 8.2. | Subsequent dates of call option activation (if applicable) | - | - | - |
| **9.** | ***Coupons/dividends*** | | Refering to interest on subordinated loan | |
| 9.1. | Fixed or variable dividends/coupons | Variable | Variable | Variable |
| 9.2. | Full, partial or no discretion regarding the time of payment of dividends/coupons | Full discretion | No discretion | Full discretion |
| 9.3. | Full, partial or no discretion regarding the amount of dividends/coupons | Full discretion | No discretion | Full discretion |
| 9.4. | Step up option | No | No | No |
| 9.5. | Non-cumulative or cumulative dividends/coupons | Non-cumulative | Non-cumulative | Non-cumulative |
| **10.** | **Convertible or non-convertible instrument** | Non-convertible | Non-convertible | Non-convertible |
| 10.1. | If convertible, terms under which conversion may take place | - | - | - |
| 10.2. | If it is convertible, specify if it is partially or fully convertible | - | - | - |
| 10.3. | If it is convertible, rate of conversion | - | - | - |
| 10.4. | If it is convertible, mandatory or voluntary conversion | - | - | - |
| 10.5. | If it is convertible, specify instrument to which it is converted. | - | - | - |
| 10.6. | If it is convertible, the issuer of the instrument to which it is converted. | | | |
| **11.** | **Write-off option** | No | No | No |
| 11.1. | If there is write-off option, specify terms under which the write-off may take place. | - | - | - |
| 11.2. | If there is write-off option, specify if partial or full | - | - | - |
| 11.3. | If there is write-off option, spefify if temporary or permanent write-off | - | - | - |
| 11.4. | If the write-off is temporary,specify terms of re-recognition | - | - | - |
| **12.** | **Type of an instrument which will be paid off directly before the said instrument during** | Minority participations | Other | Subordinated debt issued in the form of financial instrument |

## Inset cons. 3 - Form PI-UPK consolidated

**TABLE S1. Comparison of reports compiled for the needs of supervision of the Banking Group on a consolidated basis and consolidated financial reports of the Banking Group compiled in compliance with the IAS/IFRS:**

| Designation of item | Item | Consolidated balance sheet as disclosed in financial reports | Consolidated balance sheet under regulatory method and scope of consolidation |
|---|---|---|---|
| **A** | **ASSETS** | | |
| A.I | Cash and assets with the central bank | 18,523,428 | 18,523,428 |
| A.II | Pledged financial assets | | |
| A.III | Financial assets recognised at fair value through income statement and held for trading | 8,363,472 | 8,363,472 |
| A.IV | Financial assets initially recognised at fair value through income statement | | |
| A.V | Financial assets available for sale | 3,446,272 | 3,446,272 |
| A.VI | Financial assets held to maturity | 7,008,412 | 7,008,412 |
| A.VII | Loans and receivables from banks and other financial organisations | 2,733,309 | 2,733,309 |
| A.VIII | Loans and receivables from clients | 79,043,876 | 79,043,876 |
| A.IX | Change in fair value of hedged items | | |
| A.X | Receivables arising from hedging derivatives | | |
| A.XI | Investments in associated companies and joint ventures | 118 | 118 |
| A.XII | Investments into subsidiaries | | |
| A.XIII | Intangible assets | 351,826 | 351,826 |
| A.XIV | Property, plant and equipment | 741,139 | 741,139 |
| A.XV | Investment property | 238,508 | 238,508 |
| A.XVI | Current tax assets | 17,163 | 17,163 |
| A.XVII | Deferred tax assets | 161,764 | 161,764 |
| A.XVIII | Non-current assets held for sale and discontinued operations | 443 | 443 |
| A.XIX | Other assets | 658,957 | 658,957 |
| **A.XX** | **TOTAL ASSETS (AOP items from 0001 to 0019 in the balance sheet)** | **121,288,687** | **121,288,687** |
| **P** | **LIABILITIES** | | |
| **PO** | **LIABILITIES** | | |
| PO.I | Financial liabilities recognised at fair value through income statement and held for trading | 94,235 | 94,235 |
| PO.II | Financial liabilities initially recognised at fair value through income statement | | |
| PO.III | Liabilities arising from hedging derivatives | | |
| PO.IV | Deposits and other liabilities to banks, other financial organisations and central bank | 34,001,077 | 34,001,077 |
| PO.V | Deposits and other liabilities to other clients | 68,295,393 | 68,295,393 |
| PO.VI | Change in fair value of hedged items | | |
| PO.VII | Own securities issued and other borrowings | | |
| PO.VIII | Subordinated liabilities | 1,824,946 | 1,824,946 |
| PO.IX | Provisions | 551,405 | 551,405 |
| PO.X | Liabilities under assets held for sale and discontinued operations | | |
| PO.XI | Current tax liabilities | | |
| PO.XII | Deferred tax liabilities | | |
| PO.XIII | Other liabilities | 440,944 | 440,944 |
| **PO.XIV** | **TOTAL LIABILITIES (AOP items from 0401 to 0413 in the balance sheet)** | **105,208,000** | **105,208,000** |
| | **CAPITAL** | | |
| PO.XV | Share capital | 10,164,475 | 10,164,475 |
| PO.XVI | Own shares | | |
| PO.XVII | Profit | 1,226,785 | 1,226,785 |
| PO.XVIII | Loss | | |
| PO.XIX | Reserves | 4,645,736 | 4,645,736 |
| PO.XX | Unrealized losses | | |
| PO.XXI | Non-controlling participation | 43,691 | 43,691 |
| PO.XXII | **TOTAL CAPITAL (result of adding up and/or subtracting the following balance sheet items: 0415-0416+0417-0418+0419+0420) ≥ 0** | **16,080,687** | **16,080,687** |
| PO.XXIII | **TOTAL CAPITAL SHORTFALL (result of adding up and/or subtracting the following balance sheet items: 0415-0416+0417-0418+0419+0420) < 0** | | |
| PO.XXIV | **TOTAL LIABILITIES (result of adding up and/or subtracting the following balance sheet items: 0414+0421-0422)** | **121,288,687** | **121,288,687** |
| **В.П.** | **OFF-BALANCE SHEET ITEMS** | | |
| В.П.А. | Off-balance sheet assets | 143,595,947 | 143,595,947 |
| В.П.П. | Off-balance sheet liabilities | 143,595,947 | 143,595,947 |

**Table S2. Breakdown of elements in the consolidated Balance Sheet with references to Capital positions in form PI-KAP (Inset cons. 1)**

| of item | Item | Balance sheet | References |
|---|---|---|---|
| **A** | **ASSETS** | | |
| A.I | Cash and assets with the central bank | 18,523,428 | |
| A.II | Pledged financial assets | | |
| A.III | Financial assets recognised at fair value through income statement and held for trading | 8,363,472 | |
| A.IV | Financial assets initially recognised at fair value through income statement | | |
| A.V | Financial assets available for sale | 3,446,272 | |
| A.VI | Financial assets held to maturity | 7,008,412 | |
| A.VII | Loans and receivables from banks and other financial organisations | 2,733,309 | |
| A.VIII | Loans and receivables from clients | 79,043,876 | |
| A.IX | Change in fair value of hedged items | | |
| A.X | Receivables arising from hedging derivatives | | |
| A.XI | Investments in associated companies and joint ventures | 118 | |
| | *Of which direct or indirect investments in banks and other financial sector person persons* | | **u** |
| A.XII | Investments into subsidiaries | | |
| | *Of which direct or indirect investments in banks and other financial sector persons* | | **f** |
| A.XIII | Intangible assets | 351,826 | **i** |
| A.XIV | Property, plant and equipment | 741,139 | |
| A.XV | Investment property | 238,508 | |
| A.XVI | Current tax assets | 17,163 | |
| A.XVII | Deferred tax assets | 161,764 | |
| A.XVIII | Non-current assets held for sale and discontinued operations | 443 | |
| A.XIX | Other assets | 658,957 | |
| | *Of which direct or indirect investment in banks and other financial sector entities that exceed 10% of the capital of such banks and/or other financial sector entity* | | **h** |
| **A.XX** | **TOTAL ASSETS (AOP items from 0001 to 0019 in the balance sheet)** | **121,288,687** | |
| **P** | **LIABILITIES** | | |
| **PO** | **LIABILITIES** | | |
| PO.I | Financial liabilities recognised at fair value through income statement and held for trading | 94,235 | |
| PO.II | Financial liabilities initially recognised at fair value through income statement | | |
| PO.III | Liabilities arising from hedging derivatives | | |
| PO.IV | Deposits and other liabilities to banks, other financial organisations and central bank | 34,001,077 | |
| PO.V | Deposits and other liabilities to other clients | 68,295,393 | |
| PO.VI | Change in fair value of hedged items | | |
| PO.VII | Own securities issued and other borrowings | | |
| | *Of which liabilities arising from hybrid instruments* | | **r** |
| PO.VIII | Subordinated liabilities | 1,824,946 | |
| | *Of which subordinated liabilities included in bank's supplementary capital* | 1,042,509 | **s** |
| PO.IX | Provisions | 551,405 | |
| PO.X | Liabilities under assets held for sale and discontinued operations | | |
| PO.XI | Current tax liabilities | | |
| PO.XII | Deferred tax liabilities | | |
| PO.XIII | Other liabilities | 440,944 | |
| **PO.XIV** | **TOTAL LIABILITIES (AOP items from 0401 to 0413 in the balance sheet)** | 105,208,000 | |
| | **CAPITAL** | | |
| **PO.XV** | **Share capital** | **10,164,475** | |
| | *Of which nominal value of paid-in shares, except cumulative preferential shares* | 10,040,000 | **a** |
| | *Of which share premium on share capital, except cummulative preferential shares* | 124,475 | **b** |
| | *Of which nominal value of cumulative preferential shares* | | **nj** |
| | *Of which share premium on cumulative preferential shares* | | **o** |
| **PO.XVI** | **Own shares** | | |
| | *Of which acquired own shares, except cumulative preferential shares* | | **j** |
| | *Of which acquired own cumulative preferential shares* | | **t** |
| **PO.XVII** | **Profit** | **1,226,785** | |
| | *Of which retained earnings from previous years (Erste Bank)* | | **g** |
| | *Of which profit of the current year* | 1,191,045 | |
| | *Of which profit of the current year for which the General Assembly of the Bank adopted a decision on allocation to the core capital* | | **d** |
| | *Of which loss in the current year (75% S-leasing)* | | **z** |
| | *Of which other positive consolidated reserves* | 35,740 | **e** |
| **PO.XVIII** | **Loss** | | |
| | *Of which losses from previous years* | | **ž** |
| **PO.XIX** | **Reserves** | **4,645,736** | |
| | *Of which reserves from profit which represent element of core capital* | 4,425,448 | **v** |
| | *Of which other negative consolidated reserves* | | **n** |
| | *Of which other net negative revaluation reserves* | | **lj** |
| | *Of which gains on bank liabilities measured at fair value due to the change in bank's credit rating* | | **m** |
| | *Of which positive revaluation reserves created on the basis of effects of changes in fair value of fixed assets, securities and other assets which are, in accordance with IFRS/IAS, credited to these reserves.* | 193,306 | **p** |
| | *Of which unrealised losses on securities available for sale* | 1,837 | **l** |
| | *Of which tax liabilities* | 28,544 | |
| **PO.XX** | **Unrealised losses** | **275** | |
| **PO.XXI** | **Non-controlling participation** | | |
| | *Of which minority participation in subordinated companies* | 43,691 | |
| **PO.XXII** | **TOTAL CAPITAL** (result of adding up and/or subtracting the following balance sheet items: 0415-0416+0417-0418+0419+0420) ≥ 0 | **43,100** | **đ** |
| **PO.XXIII** | **TOTAL CAPITAL SHORTFALL** (result of adding up and/or subtracting the following balance sheet items: 0415-0416+0417-0418+0419+0420) < 0 | 591 | |
| **PO.XXIV** | **TOTAL LIABILITIES** (result of adding up and/or subtracting the following balance sheet items: 0414+0421-0422) | **16,080,687** | |
| **В.П.** | **OFF-BALANCE SHEET ITEMS** | | |
| В.П.А. | Off-balance sheet assets | 121,288,687 | |
| | *Of which amount of shares received in pledge, except cumulative preferential shares* | | |
| | *Of which amount of cumulative preferential shares received in pledge* | 143,595,947 | |
| В.П.П. | Off-balance sheet liabilities | | **k** |

# Inset cons. 4 - Form PI-AKB consolidated

**Data on total capital requirements and capital adequacy ratio on consolidated basis**

(RSD thousand)

| No | Name | Amount | Coverage by core capital | Coverage by supplementary capital |
|---|---|---|---|---|
| | | 1 | 2 | 3 |
| I | CAPITAL | *13,424,918* | | |
| 1. | TOTAL CORE CAPITAL | 12,189,103 | | |
| 2. | TOTAL SUPPLEMENTARY CAPITAL | 1,235,815 | | |
| II | CAPITAL REQUIREMENTS | 9,342,906 | | |
| 1. | CAPITAL REQUIREMENTS FOR CREDIT RISK, COUNTERPARTY RISK AND SETTLEMENT/DELIVERY RISK IN CASE OF FREE DELIVERIES | 8,237,366 | *8,237,366* | |
| 1.1. | Standardised approach (SA) | 68,644,720 | | |
| *1.1.1.* | *Exposures to central governments and central banks* | *0* | | |
| *1.1.2.* | *Exposures to territorial autonomies and local self-government units* | *779,097* | | |
| *1.1.3.* | *Exposures to public administrative bodies* | *13,030* | | |
| *1.1.4.* | *Exposures to multilateral development banks* | *0* | | |
| *1.1.5.* | *Exposures to international organisations* | *0* | | |
| *1.1.6.* | *Exposures to banks* | *555,203* | | |
| *1.1.7.* | *Exposures to corporates* | *43,639,632* | | |
| *1.1.8.* | *Retail exposures* | *16,325,274* | | |
| *1.1.9.* | *Exposures secured by real estate collateral* | *5,498,439* | | |
| *1.1.10.* | *Past due items* | *303,474* | | |
| *1.1.11.* | *High-risk exposures* | *0* | | |
| *1.1.12.* | *Exposures in the form of covered bonds* | *0* | | |
| *1.1.13.* | *Exposures in the form of open-end investment funds* | *0* | | |
| *1.1.14.* | *Other exposures* | *1,530,570* | | |
| 1.2. | Internal Ratings Based Approach (IRB) | | | |
| *1.2.1.* | *Exposures to central governments and central banks* | | | |
| *1.2.2.* | *Exposures to banks* | | | |
| *1.2.3.* | *Exposures to corporates* | | | |
| *1.2.4.* | *Retail exposures* | | | |
| *1.2.4.1.* | *Retail exposures secured by real estate collateral* | | | |
| *1.2.4.2.* | *Qualifying revolving retail exposures* | | | |
| *1.2.4.3.* | *Other retail exposures* | | | |
| *1.2.5.* | *Equity exposures* | | | |
| *1.2.5.1.* | *Approach applied:* | | | |
| *1.2.5.1.1.* | *Simple Risk Weight Approach* | | | |
| *1.2.5.1.2.* | *PD/LGD Approach* | | | |
| *1.2.5.1.3.* | *Internal Models Approach* | | | |
| *1.2.5.2.* | *Types of equity exposures* | | | |
| *1.2.5.2.1.* | *Exchange traded equity exposures* | | | |
| *1.2.5.2.2.* | *Non-exchange traded equity exposures in sufficiently diversified portfolios* | | | |
| *1.2.5.2.3.* | *Other equity exposures* | | | |
| *1.2.5.2.4.* | *Equity exposures to which a bank applied Standardised Approach to credit risk* | | | |
| *1.2.6.* | *Exposures to other assets* | | | |
| *2* | CAPITAL REQUIREMENTS FOR SETTLEMENT/DELIVERY RISK ARISING FROM UNSETTLED TRANSACTIONS | 0 | *0* | |
| 3 | CAPITAL REQUIREMENTS FOR MARKET RISKS | 140,979 | *140,979* | |
| 3.1. | Capital requirements for price, foreign exchange and commodity risks calculated under standardised approaches | 140,979 | *140,979* | |
| *3.1.1.* | *Capital requirements for price risk arising from debt securities* | *103,527* | *103,527* | |
| *3.1.2.* | *Capital requirements for price risk arising from equity securities* | *0* | *0* | |
| *3.1.3.* | *Capital requirements for foreign exchange risk* | *37,453* | *37,453* | |
| *3.1.4.* | *Capital requirements for commodity risk* | *0* | *0* | |
| 3.2. | Capital requirements for price, foreign exchange and commodity risks calculated under the Internal Models Approach | 0 | *0* | |
| 4 | CAPITAL REQUIREMENTS FOR OPERATIONAL RISK | 964,560 | *964,560* | |
| 4.1. | Capital requirements for operational risk calculated under the Basic Indicator Approach | 964,560 | *964,560* | |
| 4.2. | Capital requirements for operational risk calculated under the Standardised Approach | 0 | *0* | |
| 4.3. | Capital requirements for operational risk calculated under the Advanced Approach | 0 | *0* | |
| 5 | COVERAGE OF CAPITAL REQUIREMENTS | *9,342,906* | *9,342,906* | |
| III | CAPITAL ADEQUACY RATIO (%) | *17.24* | *0* | |

# 7. REFERENCE ON OTHER AND NON-DISCLOSED ITEMS

Disclosures on credit risk required in situations when a bank applies IRB approach for capital requirements calculation, prescribed by Decision on Disclosure of Data and Information by Banks, are not applicable as the Bank uses standardised approach for capital requirements calculation as at 31st December 2015.

Disclosures on market risks prescribed by 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.

Disclosures on operational risk prescribed by 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.

Novi Sad, 24 May 2016

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