Eurobank a.d. Beograd

BANK'S DATA AND INFORMATION

as at 31 December 2013

CONTENTS:

Pursuant to the Article 51a of the Law on Banks ("The Official Gazette", No 107/2005 and 91/2010) and the "Decision on the disclosure of data and information by banks" ("The Official Gazette", No 45/2011)

EUROBANK EFG A.D. Beograd discloses the following:

DATA AND INFORMATION
as at 31 December 2013

1. NAME AND BANK'S HEAD OFFICE

Eurobank a.d. Beograd (hereinafter: Bank) has been established by merger of EFG Eurobank a.d. Beograd and Nacionalna Štedionica Banka a.d. that was completed on 20 October 2006.

The Shareholders' Assembly of the Nacionalna Štedionica Banka a.d. Beograd and the Shareholders' Assembly of the EFG Eurobank a.d. Beograd that were held on 28 July 2006, have adopted the Decision on Merger of the Nacionalna Štedionica Banka a.d. Beograd with EFG Eurobank a.d. Beograd.

Process of merger with acquisition was finalized on 20 October 2006 with "Decision on merger with acquisition of Nacionalna Štedionica Banka a.d. Beograd with EFG Eurobank a.d. Beograd" issued by Business Register Agency.

On the same date, the Business Registers Agency issued a decision regarding change of the Bank's name to Eurobank EFG Štedionica a.d. Beograd.

The Bank is registered in Serbia for carrying out payment, credit and deposit operations in the country and abroad. The bank operates in accordance with Law on Banks based on principles of liquidity, safety and profitability.

In October 2009 the Bank has changed its registered office to Vuka Karadžića 10, Belgrade. Previous registered office of the Bank was in Kolarčeva 3 in Belgrade.

As at 31 December 2008, the Bank has changed business name to "Eurobank EFG A.D. Beograd". Previous business name of the Bank was "Eurobank EFG Štedionica A.D. Beograd".

As at 24 October 2012 the Bank has changed its business name to "Eurobank a.d." Previous business name of the Bank was "Eurobank EFG A.D. Beograd".

As at 31 December 2013 the Bank had 1,548 employees (31 December 2012: 1,513 employees). The Bank's network comprises of 99 branches (31 December 2011: 102 branches).

The Bank's Registration number is 17171178. The Bank's Tax identification number is 100002532.

2. RISK MANAGEMENT STRATEGY AND POLICIES

2.1. Strategic risk management framework

The Bank risk management system is established in accordance with the requirements of the National Bank of Serbia, Basel II, International Financial Reporting standards (IFRS/IAS), mother Bank and the standards of the banking sector. The Bank continually adapts risk management methods and principles to the best practices, striving for efficient monitoring and quality management of all risks related to Bank operations.

The strategic management framework of risk the Bank is exposed to or may be exposed to in its operations is determined by:

- ✓ Risk Management Strategy
- ✓ Capital Management Strategy
- ✓ Risk management policies, procedures and methodologies.

The strategies, along with the attending acts, are determined in such way so as to consider the particular traits of the Bank, and business and macroeconomic environment in which the Bank operates.

Board of Directors is responsible for understanding the nature and the level of risks the Bank is exposed to in its operations, as well as for the establishing and monitoring of a single Bank risk management system. Also, it ensures the Bank Executive Board identifies the risks the Bank is exposed to, as well as that is carries out control of those risks in accordance with the approved policies and procedures.

Executive Board is responsible for particular implementation of strategies, policies and other internal acts of the Bank as well as maintenance and improvement of the efficiency of internal controls built into the risk management system with the aim of achieving business goals.

Audit Committee analyses and adopts the proposals of policies and procedures related to risk management and internal controls, which are submitted to the Board of Directors for review and approval. In addition, Audit Committee (AC) analyses and monitors application and adequate implementation of the adopted risk management policies and procedures and if necessary recommends the ways in which they can be improved.

Assets and Liabilities Committee manages overall capital (actual, planned, stressed), and coordinates business units with regards to measuring capital needs, relocation of the capital and the like.

Risk Committee, as a body appointed by the Board of Directors to monitor and manage risks, is responsible for implementation of the risk management strategies and policies.

The responsibility of the Bank bodies within whose competencies is the management of the risks the Bank is exposed to, is to continually monitor changes in regulations, to analyse their impact on the risk at the Bank level, and to undertake measured for harmonising operations and procedures with the new regulations within the controlled risk. In addition, the introduction of new services is followed by the necessary market and economic analyses in order to optimize income and risk ratio.

2.2 Risk Management Strategy

Strategy describes the Bank's risk management framework and therefore represents the basic and the most important set of rules in the risk management area. It also describes the role of risk management in the Bank as envisaged by the Board of Directors, where it is defined as the crucial function that ensures the efficiency and safety of the Bank's business operations. Standards of efficient and sustainable risk management and control comply with relevant legal framework, ethical standards and are proportionate to the Bank's size, its organisation scheme, and scope of operations.

The Bank Risk Management Strategy is determined and adopted by the Bank Board of Directors whereas the Bank Executive Board and Risk Management Division are responsible for its implementation. The strategy is reviewed regularly (at least once a year), especially if there were significant changes in the Bank business policy and strategy, i.e. in the event of significant chnages of the macroeconomic environment in which the Bank operates.

All other Bank acts referring to the risk management must be aligned with the Risk Management Strategy. The Division Heads are responsible for harmonisation of the detailed processess and procedures with the rules defined in the Strategy.

The basic Risk Management Strategy principle is the optimisation of the Bank risk profile through continous focus on the following:

- Clear internal organisation and complete division of duties within risk competencies with clearly defined, transparent and consistent lines of responsibility
- Compliance with the law and regulations
- Compliance with the good market principles
- All encompassing integrations into all Bank business activites
- Clearly defined reporting lines with the aim of improving decision-making efficiency which considers all significant information that may impact the Bank risk exposure.

Bank Executive Board and all employees must adhere to the basic risk management principles defiend in the Risk Management Strategy, Bank policies and procedures and base their decisions on them.

2.3. Bank risk profile and risk tolerance

Risk profile represent a spectrum, i.e. overall picture of the risks the Bank is exposed to or may be exposed to in its operations. The Bank reaches its risk profile after the analysis and self-assessment of the exposure towards all risk types, and the risk profile includes the assessment of the material significance threshold of (measurable and non-measurable) types of risk the Bank is exposed to or may be exposed to in its operations.

The Bank risk profile is in corelation with the bankrisk tolerance in the following respect:

- The ability to undertake in realtion of the level of the available Bank capital
- Dependence of the business strategy and the Bank risk profile.

Through the risk management strategy the Bank primarily determines its total risk tolerance i.e. it establishes the necessary, acceptable and maximum risk levels which it is willing to undertake. Risk levels established in this manner are defined in order to achieve the business goals determined in the Bank's business strategy, while specifying the corrective measures should the levels be exceeded. The Bank describes its risk tolerance by means of its total risk appetite.

The risk appetite represents a method the Bank uses for establishing and maintaining the balance between the (current/target) return and risk, and it takes into consideration the entire range of potential outcomes during the implementation of the Bank's business plan. The Bank risk appetite has been established on the basis of the specially structured questions posed to the Bank's senior management in order to ensure the understanding and implementation of the determined appetite on all levels within the Bank, and the Bank shall adjust the said risk appetite on the annual level. When determining the risk appetite (as a kind of reference point for the strategic goals of the Bank's operations), the following aspects are taken into consideration: profit, income, assets, capital, liquidity, reputation, (target hypothetical) external rating, zero tolerance risks, organizational limitations, comparison with direct competitors.

Risk tolerance is dependent upon the Bank ability to achieve income growth and strategic goals while maintaining the appropriate level of capital adequacy.

The Bank established a system of limits for risk monitoring and they represent a part of the risk management strategy. The established limits were determined according to the correspondet usage of the regualtory capital aand in the event of their breach the competent bodies will be informed and corrective measures undertaken. The Executive Board reports on a quarterly level to the Board of Directors on the utilization of these limits. The determined system of limits is regularly reviewed, at least once a year.

The Bank is fully aware of the need to identify, measure and assess, monitor and control the risk and the need to provide sufficient capital to adequately cover the risks that may arise.

2.4. Risk Management Policies

Bank activities are exposed to different financial risks and those activities require analysis, assessment, acceptance, and management of a certain degree of risk exposure or a combination of risk exposures. Bank risk management is realized through a separate Risk Management Division. The Bank in its internal acts prescribes procedures for risk identification, measurement, assessment as well as risk management in accordance with regulations, standards and business practices.

Risk management policies are designed in such way so as to identify and analyze these risks, to set out adequate risk limitations and controls as well as to achieve risk monitoring and adherence to the limits prescribed with the help of a reliable and updated information system. Risk management policies prescribe procedures and measures for management of individual risks.

2.4.1. Credit risk

Credit Risk refers to the possibility of occurrence of negative effects on the Bank financial results and capital due to the failure of debtors to meet their obligations towards the Bank. In order to manage credit risk, the Bank considers and consolidates all elements of credit risk exposure.

The Bank approves loans in accordance with business policy and by adjusting maturity dates of loans approved and interest rates with the purpose of loans, type of the loan or client and creditworthiness of its clients.

The bank developed and adopted a credit policy for each lending unit. Each credit policy of Eurobank a.d. (hereinafter: the Credit Policy) defines basic concepts, guidelines and rules that ensure the proper management of the process of approving, disbursing, monitoring and collection of loans and other exposures.

Credit Policy defines:

- the goals of the credit policy,
- the basic concepts of credit policy,
- lending principles,
- the organization of credit operations,
- responsibilities and decision making,
- the procedure for granting loans and other placements,
- credit risk,
- collateral instruments,
- procedures for collection of outstanding amounts.

In order to implement the relevant Credit Policy, the Bank also passed other necessary acts, decisions, rules, procedures, etc.

Each business unit is obligated to implement Bank credit policies and procedures based on their authorisations with regards to loan approval as delegated to them by the Board of Directors. Each business unit is responsible for the quality and success of its credit portfolio, as well as for monitoring and control of all credit risks in their portfolios including those subject to central approval.

When assuming credit risk, the Bank applies the following fundamental rules:

- A prerequisite for every financial transaction is the understanding of the economic background of the transaction.

- A loan is granted only when the Bank has sufficient information on the borrower's creditworthiness. The Bank will not grant a loan (or increase an existing one) to a borrower who is unwilling or unable to provide sufficient information.

- Collateral is accepted only to support an exposure. It cannot serve as a substitute for the borrower's ability to meet obligations (exception: Lombard loans, cash collateralized loans, etc.).

- The large and largest exposures towards any borrower (or group of related borrowers), exposures towards related persons as well as the total exposure of the Bank (both balance and off-balance), is kept within limits prescribed by the Law on Banks and relevant decisions of the National bank of Serbia.

- The Bank approves new loans or decides to extend or not to extend the existing ones based on the customer rating of the borrower and its development, as well as details and characteristics of the transaction.

- All Bank credit facilities are based on relevant approvals, which lay down the terms and other conditions for their implementation. The approval levels and limits are defined by the relevant Board of Directors Decision on approval levels.

For adequate credit risk management the Bank has formed an organization structure appropriate to the volume, type and complexity of the operations. This structure enables the accomplishment of determined goals and principles for credit risk management securing independence of organization units taking over the risk (Sales) and organization units controlling and managing risk (Risk Management).

Credit risk management processes include main bodies of the Bank: Board of Directors, Executive Board, Audit Committee, Risk Committee, Credit Committee and Regional Credit Committee, New Products Committee, NPL Committee.

The Bank has, with its internal documents and risk management strategy, policies and procedures, determined the responsibility of stated organization units and branches of the Bank in the credit process as well as monitoring process and management of approved loan investments and credit risk management arising from the given operation.

Identification of the credit risk is the basic step in credit risk management the Bank executes for the purpose of forming it on an optimum level. Credit risk identification is performed in the phase of initial contact with the client, in the phase of client file formation and during the duration of the Bank's investment. Relevant sectors performing the function of risk takeover establish the contact with the client, form its file and execute analysis of financial statement of the client, determined the influence of the exchange rate change with rules and principles described in Credit Policies, methodologies for the assessment of creditworthiness of the client and appropriate procedures of the Bank. On this occasion, relevant sectors take care on the updating of gathered data in submitting the request to the client. Also, relevant sectors are responsible for the execution of regular control of investments in the validity period.

With approved special purpose investments the Bank monitors dedicated usage of the disbursed funds.

With companies with approved long term investments the credit risk related with primary sources of payment is determined periodically during the business relation, and at least once per year. Grounded on standard contractual provisions the clients (companies) provide once per year financial statements that are the basis for continuous assessment of their creditworthiness.

In addition to the client's creditworthiness, risk limits are also determined taking into account various collateral instruments. Risk exposure to individual borrower, including banks, is limited and includes both balance and off-balance sheet risk exposures. The total risk exposure per individual client (or group of related parties) with regards to the limits, is considered and analysed prior to completion of the transaction.

For wholesale placements, there are five approval authority levels with the highest one being Board of Directors (or other nominated authority) in case of large exposures and exposures to related parties.

For retail placements, there are also different approval levels depending on the type of business (consumer lending, mortgage lending or SBB lending), with the highest authority being specific Credit Committee for each business type.

Risk Management Division has the right of vote in each committee. All decisions must be unanimous.

In order to ensure the safety of the business operations, and based on the estimated risks of potential losses, the Bank calculates provisions, which arise from loans and off-balance sheet exposures. Levels of provision are related to the risk grade of the placement.

Analysis of credit portfolio and process of monitoring of credit risk include continuous analysis of structure and quality of the entire credit portfolio of the Bank. Analysis of structure and quality of the entire portfolio is performed in the Credit Control Dept. The total portfolio of the Bank is analyzed, especially for investments in the Corporate Banking division, SBB Division and Household Lending Division. Analysis of the structure and quality of the entire portfolio of the Bank includes analysis of the concentration risk in the credit portfolio, as well as credit-foreign currency risk.

At the same time, the Bank systematically works on the optimization of existing processes and procedures of collection in order to enable collection costs reduction and enable increased supervision over them with simultaneous increase of collection rate and return.

Measurement of the credit risk the Bank performs based on quality and quantity indicators in accordance with the internally defined acts by which it expresses and monitors the level of credit risk.

The Bank measures credit risk by evaluating the financial status of the client that is creditworthiness, where the type of indicators used depends on the client type and specificity of its business and legal status. In addition to evaluation of financial status of the client measured through quality indicators (detailed in Methodology for Client Creditworthiness Assessment) the Bank uses a series of quality indicators such as the branch of industry in which the client operates, credit history, management quality, past cooperation and similar.

The assessment of the credit risk is performed by the Bank in accordance with:

- Provisions of the NBS determining the classification of balance assets and off-balance items of the Bank. In accordance with those provisions the Bank calculates special reserve for estimated losses and
- Internal model of the Bank for the assessment of the credit risk, regulating the calculation of correction for balance assets values and reserves for loss per out-of-balance items.

Assessment of the credit risk is performed within the Sales Sector and Credit Risk Management Department within the Risk Management Sector in the sense of independent assessment and control already performed assessment by the Sales Function (risk takeover function). Credit Control Department within the Risk Management Sector is responsible for the organization, application and monitoring of Bank's reserves policy, report preparation regarding credit risk and credit portfolio quality monitoring.

2.4.2. Credit-foreign currency risk

Credit-foreign exchange risk represent the probability the Bank will suffer loss due to default of the debtor in agreed terms, occurring due to negative influence of dinar exchange rate change to a financial status of the debtor.

The Bank manages credit-foreign exchange risk on the level of individual investments and at the level of entire loan portfolio. The bank determines, through its internal credit policies and Methodology for foreign currency risk evaluation, the basic financing rules and lending principles, investment monitoring and management of credit risk and, within it, the credit-foreign exchange risk.

Credit-foreign exchange risk is managed through credit assessment and the analysis of negative influence of exchange rate movements on the debtor's financial status. The Bank analyses the credit-foreign exchange risk exposure of the debtors (legal and physical entities) whose obligations towards the Bank are contracted in the foreign currency or in dinars with currency clause. The Bank identifies the exposure to the credit-foreign exchange risk at the level of an individual investment and at each placement approval through the analysis of the client's financial statements and determination of the influence of exchange rate movements in accordance with rules and principles described in Credit Policies and Foreign Currency Risk Assessment Methodology.

Risk Management Division/Credit Risk Dept monitors the Bank's exposure at each request for an increase of exposure and is responsible for performing analysis of the Bank's exposure to credit-foreign exchange risk per each individual placement in accordance with the prescribed credit policies and Foreign Currency Risk Assessment Methodology. Credit Control Department is in charge of monitoring the dinar rate changes and in case of rate depreciation as stated above, to suggest appropriate classification for clients meeting given criteria.

2.4.3. Concentration risk

Concentration risk is the risk directly or indirectly arising from exposure of the Bank to the same or similar source of risk, or the same or similar risk type. The sources of concentration risk:

- Large and the largest exposure, exposure to related persons and total exposure of the Bank
- Bank exposure to a certain client, industrial sector or region/country
- Indirect credit exposure being the result of credit risk reduction measures (including for example risk form large indirect exposure towards the debtor with one collateral)

For adequate concentration risk management the Bank applies rules and principles defined by the Decision on Risk Management as well as provisions determined in internally defined credit policies and guidelines for identification, measurement and evaluation of concentration risk. In internal documents, Risk Management Strategy, credit policies and Guidelines for concentration risk management, the Bank has determined the responsibility of organisational units and bodies of the Bank in the credit process as well as in the monitoring process and management of approved placements and credit risk arising from the business operations. Within the Guidelines for concentration risk management the Bank has clearly defined principles and processes in limit determination and control of the said limits regarding the concentration risk.

Concentration risk identification is performed within the credit process at each placement approval and is monitored over the course of its duration. Concentration risk identification is initially performed by the sales units and then the relevant departments within the Risk Management Division (Credit Control Department and Credit Risk Department) as an independent identification and control of already identified concentration risk. The competent departments within the Risk Management Division are responsible for monitoring concentration risk at the level of the whole Bank's portfolio.

Concentration risk measurement and assessment is performed by the sales units and Risk Management Division. For the purpose of assessment and management of the concentration risk the Bank applies determined limits defined by the Risk Management Decision as well as using appropriate limits of exposure determined by internal policies and guidelines, enabling diversification of the credit portfolio.

Competent divisions determine the exposure to concentration risk when assessing creditworthiness and solvency of each individual client and are responsible for application and monitoring of the above mentions concentration limits at each placement approval and for monitoring the exposure over the course of its duration. If at any time the Bank is may run a risk to exceed the prescribed limits (or if it exceeds the limit), Risk Management Division informs the Executive Board and Credit Committee who immediately undertake necessary corrective measures.

The Bank continuously monitors the exposure towards clients, industrial sectors, and regions/countries and assesses the effect of potential positive or negative movements in relation to them. Board of Directors, at the suggestion of the Executive Board, decides on the maximum exposure limits towards a sector or a region/country.

Risk mitigation includes diversification, transfer, reduction and/or avoidance of risk and the Bank performs it considering its risk profile and risk taking affinity.

2.4.4. *Market risk*

The Bank is exposed to market risk representing the risk that the fair value or future cash flows of financial instruments will fluctuate due to changes in market prices. Market risks arise from open positions arising from interest rate, currency and equity products, all of which are exposed to general and specific movements and changes in the level of volatility of market rates or prices such as interest rates, foreign exchange rates and share prices.

Foreign exchange risk - Exposure to foreign currency risk is monitored on regular basis by complying with the requirements of the National Bank of Serbia. The Bank maintains its foreign currency position by granting loans that are indexed in foreign currency. The Bank also actively manages the foreign currency risk by careful estimation of the open foreign currency positions and compliance with the risk ratios prescribed by the National Bank of Serbia as well as the limits prescribed in the internal acts enacted by the Bank's management and Risk Committee. Bank is using scenario analysis for measurement of FX risk.

Interest rate risk - Interest rate risk is the exposure of bank's financial condition to adverse movements in interest rates. Generally, there are two ways on which the bank could be affected by changes in interest rates. Firstly, changes in interest rates are affecting the value of banks assets, liabilities and off-balance sheet items, and secondly, it impacts banks future cash flows. Interest rate risk could come in the variety of forms, including repricing risk, yield curve risk, basis and optionality risk. The Bank's interest rates are set taking into account the market interest rates and other factors (such as cost of risk, expected level of provisions, etc.) and the Bank regularly adjusts them.

The purpose of the interest rate management activities is to optimize the net interest income, and to maintain the interest margins on a consistent level in accordance to the Bank's business strategy. The management is based on maturities matching of the assets, liabilities and off balance sheet items, on the basis of: macro and micro economic estimations, estimations of the conditions for achieving liquidity, and the estimation of the interest rates' trends.

For purpose of measurement of interest rate risk, Bank is using sensitivity analysis by applying duration-based sensitivity weights, followed with stress tests incorporating various changes in interest rate variables. The Bank is managing interest rate risk through set of interest rate exposure limits.

Sensitivity analysis - The management of interest rate risk and currency risk against gap limits is supplemented by monitoring the sensitivity of the Bank's income statements to various interest rate and foreign currency rate scenarios. The sensitivity of the income statement is the effect of the assumed changes in interest rates and FX rate on the net interest income for one year.

2.4.5. Operational risk

Operational risk is the risk of negative effects on the financial result and capital of the bank caused by (intentional and unintentional) omissions, inadequate internal procedures and processes, inadequate management of the information system and other systems in the bank, as well as by unforeseeable external events. Part of this risk is legal risk.

Operational risk is not merely limited to risk from the financial loss but also to other positive or negative effects on the Bank's objectives (reputation, business efficacy etc.).

The Bank identifies and monitors events and causes due to which operating risk related losses may arise and considers all relevant internal and external factors.

They are monitored per business lines and per operational loss event types, and regularly reviewed in order to take corrective actions where necessary.

All operational risk events are recorded in the operational risk data base –D-B application created at the level of Eurobank Group.

The Bank measures i.e. assesses operational risk considering the possibility or the frequency of the risk occurring, as well as the potential effect on the Bank, with particular attention given to events that are unlikely to occur, but should they occur they would cause significant material losses.

The Bank assesses whether it is exposed to may be exposed to operational risk arising from implementation of new products and services, and it also assesses activities entrusted or which it intends to entrust to third parties.

In order to mitigate operating risk, the Bank procures an insurance policy for criminal/professional responsibility, responsibility of unit heads and officers, as well as general insurance policies for operating risk insurance – insurance of cash assets and insurance of real estate and fixed assets.

2.4.6. Liquidity risk

Liquidity risk is the risk that the Bank is unable to meet its payment obligations which can have a negative result on the Bank's financial results and equity. The Bank manages liquidity risk by obtaining different funding sources that include:

- customer's deposits with different maturities
- deposits from the money market and available lines with financial institutions
- available lines form the majority shareholder
- available lines from international financial institutions
- share capital

Sources of liquidity are regularly reviewed so as to maintain a wide diversification by currency, geography, provider, product and term.

The matching and controlled mismatching of the maturities and interest rates of assets and liabilities is fundamental to the Management of the Bank. It is unusual for banks to be completely matched, as transacted business is often of uncertain term and of different types. An unmatched position potentially enhances profitability, but also increases the risk of losses.

The maturities of assets and liabilities and the ability to replace, at an acceptable cost, interest bearing liabilities as they mature, are important factors in assessing the liquidity of the Bank and its exposure to changes in interest rates and exchange rates.

Diversity and stability of core deposit base involves an analysis allowing for Bank to more effectively controls and measures deposit based liquidity and more accurately measures liquidity risk by defining deposit inputs.

Liquidity requirements to support calls under guarantees and standby letters of credit are considerably less than the amount of the commitment because the Bank does not generally expect the third party to draw funds under the agreement. The total outstanding contractual amount of commitments to extend credit does not necessarily represent future cash requirements, as many of these commitments will expire or terminate without being funded.

Liquidity risk measurement includes assessment of the risk under normal market conditions and under stress scenarios. Scenarios, which are defined based on historical data and case studies, should allow the bank to evaluate the potential adverse impact these factors can have on its liquidity position. Liquidity risk is monitored through set of short term limits. Following NBS methodology, the Bank had defined minimum level of liquidity expressed as short term liquidity ratio. For internal methodology purposes, limit framework includes ratios as limit definition of acceptable levels of short term liquidity mismatches.

2.5. The manner of organization of risk management processes

Risk management processes include the Bank's main managining bodies, units responsible for risk identification, measurement, monitoring, limit setting and reporting, control units as well as business units understaking the exposure to risk and also charged with assesing those risks.

The organisational structure of the Risk Management Depatment is as follows:

- Credit Risk Department (CRD)
- Credit Control Department (CCD)
- Non-Performing Loans Department (NPL)
- Opeartional Risk Departmetn (ORD)
- Market Risk Department (MRD)

Credit Control Department and **Credit Risk Department** oversee the Bank's credit risk and carry out the following activities:

- Formulating credit policies in consultation with business units, covering collateral requirements, credit assessment, risk grading and reporting, documentary and legal procedures, and compliance with regulatory and statutory requirements. This task is performed by Credit Control Department.

- Credit Risk Department assesses all credit exposures in excess of designated limits, prior to facilities being committed to customers by the business unit concerned, and provides independent credit opinion. Renewals and reviews of facilities are subject to the same review process.

- Limiting the sector and geographic concentration of risk exposure, as well as exposure towards a single client for placements to banks and clients; also the exposure related to credit rating and market liquidity for investment securities.

- Developing and maintaining the Bank's risk grading policy in order to categorize exposures according to the degree of risk of financial loss faced and to focus management on the attendant risks. The risk grading system is maintained by Credit Control Department. The risk grading system is used in determining where impairment allowance may be required against specific credit exposures. The current risk grading framework for wholesale placements consists of eleven grades and for retail exposures of fourteen grades (delinquency based) reflecting varying degrees of risk of default and the availability of collateral or other credit risk mitigation. Risk grades are subject to regular reviews.

- Reviewing compliance of business units with agreed exposure limits, including those for selected industries, country risk and product types is the responsibility of Credit Control Department. Regular reports are provided to various Bank bodies on the credit quality of portfolios and appropriate corrective action is taken. One of its main tasks is providing advice, guidance and specialist skills to business units to promote best practice throughout the Bank in the management of credit risk.

The Board of Directors has delegated responsibility for the approval of credit exposures to several different levels in accordance with the limits set forth by the Board. The underlying foundation of the credit processes is the application of the "four-eye principle" on one side from the Business Units and on the other side from Risk Management Division for all exposures above the business unit level of approval. In case of exposures approved within the business unit level of ap0proval, the "four-eye principle" is ensured within that business unit.

Business Units, under the Corporate Banking Division, incorporate the following:

- Large Corporate (LC) Department
- Small & Medium Enterprises (SME) Department

Business Units, responsible for retail lending operations, incorporate the following:

- Household Lending Division
- SBB Division

NPL Department has the main responsibility in collection of outstanding receivalbles form loans which, according to Bank definition, are considered non-performing placements.

Operational Risk Department supports organisational units in terms of identification, assessment, mitigation, monitoring and reporting on operational risks.

In addition, the Operational Risk Dept. main responsibilities are the application of an overall operational risk framework the Bank will adhere to as well as the reporting of the Head of Risk Management Division, Executive Board, Risk Committee, Audit Committee, Operational Risk Committee, and Operational Risk Division in Athens.

Bank organizational units are primarily responsible for managing operating risks in their area of business. Each organizational unit of the Bank is responsible, on a daily basis, to manage its operational risks and is obliged to:

- Identify, assess and control operating risks to which it is exposed and to apply risk mitigation techniques;
- Mitigate risk exposures;
- Assess the efficiency of controls in place;
- Report on all relevant questions;
- Have the same approach and use the same techniques and methods in order to facilitate the identification, assessment and monitoring of the operational risk.

Each organizational unit appoints an experienced employee to manage operating risk. The employee acts as the operational risk manager for his unit and liaises with Operational Risk Department. These employees are called operating risk partners.

Depending on their needs, each organizational unit may form a separate part for operational risk management.

Market Risk Department (MRD), as a part of Risk Management Division, is responsible for independent measuring, monitoring and control of market risks, liquidity risk, country and investment risk. Responsibilities of the Dept. include:

- Independent measuring I monitoring of market risk
- Independent reporting to higher management within Bank and Group,
- Application of market risk policies and procedures,
- Compliance with Group market risk policies and procedures
- Independent control activities in relation to funds and liquidity
- Monitoring of trading, investment and counterparty limits

Within department, independent market risk reports are prepared, that are presented to higher level management of Bank and Group, including Assets and Liabilities Committee (ALCO) and Risk Committee, as Committee with highest level for market control and management with following responsibilities with respect to market risks:

- Approval of market risk limits and methodologies for measurement of risk,
- Approval of market Risk Policy and overall control structure,
- Monitoring of compliance with Group Policy and Procedures,
- Control of market risk profile and resolution of key questions related to market risks

Bank ensures that all outstanding material positions that are exposed to market risks are included into system for market risk measurement.

Scope and types of risk reports

Credit Control Department, which is a part of the Risk management Department, identifies measures, assesses, monitors and reports on credit exposure at portfolio level i.e. of the Bank as a whole. Credit Control Department monitors, measures and reports on credit risk locally and at the Group level, defining reports according to needs of end users of those reports, Credit risk reports to Executive Board and Group are prepared monthly and quarterly depending on the defined dynamics and Group guidelines.

Market risk department, within the scope of its competence, is preparing independent reports, including various stress tests, related to market risks, liquidity risk, country and investment risk, on a daily, weekly, monthly or quarterly level, which are presented to higher management of the Bank and Group, including Executive Board, Asset Liability Committee (ALCO) and Risk Committee.

Operating Risk Department regularly prepares reports on operating risk events and submits them to the Bank's management, Operating Risk Committee, Risk Committee, and Audit Committee, as well as other reports on request.

3. BANK EQUITY

3.1. Description of the main characteristics of all elements included in capital calculation

The Bank's total capital comprises of tier 1 and tier 2 capital, elements which reduce tier 1 capital and deductible items.

Tier 1 capital: share capital from ordinary shares, share premium, statutory reserves and retained loss, capital gains/losses from purchased own shares and intangible investments as deductible items of tier 1 capital.

Tier 2 capital: nominal value of paid-in cumulative preference shares and part of positive revaluation reserves calculated on the basis of available for sale securities, related to treasury bills of the Republic of Serbia.

Deductible items comprise intangible investments and special reserves for estimated losses form balance assets and off balance items.

Deductible items: direct or indirect investments in banks or other financial institutions in excess of 10% of the capital of these entities, as well as 10% of the capital of the Bank carrying out the investment. The Bank does not own hybrid instruments or subordinated instruments; hence, apart from revaluation reserves it does have other elements of tier 2 capital.

Special reserves for estimated losses from balance assets and off balance items are calculated according to methodology prescribed by NBS Decision on classification of balance sheet assets and off balance sheet items ("The Official Gazette of RS" No. 94/2011, 57/2012 i 123/2012, 43/2013 i 113/2013).

According to this Decision, the Bank is obliged to calculate on a quarterly basis reserves for estimated losses from balance assets and off balance items. If this amount exceeds the amount of allowances for impairment charged to income statement then the Bank is obliged to determine necessary reserve for estimated losses form balance assets and off balance items.

As at 31.12.2013, special reserve for estimated losses form balance assets and off balance items in its entirety, represents tier 1 deductible item according to the article 12 of the Decision on capital adequacy ("The Official Gazette of RS" No. 46/2011 i 6/2013).

All amounts are expressed in 000 RSD unless stated otherwise

3.2. The amount of base capital and additional capital, with a breakdown of individual elements and all deductibles

The Bank's equity as at 31. 12. 2013 had the following structure:

Position	31.12.2013
Elements included in Tier I capital	**41,032,734**
The nominal value of paid-in shares, other than cumulative preference shares	25,422,400
Share premium	6,051,999
Reserves from profit	9,558,335
Retained earnings from previous years	0
The elements that reduce capital	**21,921,924**
Intangible assets	1,697,050
The amount of action taken in the Bank's lien, other than cumulative preference shares	0
Unrealized losses on securities available for sale	0
Other net negative revaluation reserve	32,681
Required reserves for estimated losses on balance sheet assets and off balance sheet items of the Bank	20,192,194
Elements to be included in additional capital	**189,991**
The nominal value of the cumulative preference shares paid	4,800
Part of the revaluation reserves of the Bank	185,191
Deduction from capital	**20,479**
of which: reduction of share capital	10,239
of which: impairment of additional capital	10,239
Total tier I capital	**19,100,571**
Total additional capital	**179,752**
Total equity	**19,280,322**

All amounts are expressed in 000 RSD unless stated otherwise

4. CAPITAL REQUIREMENTS AND INTERNAL CAPITAL ADEQUACY ASSESSMENT PROCESS

4.1. Capital adequacy ratio

One of the main goals of risk management is to maintain capital adequacy. Capital adequacy is maintained in accordance with regulations at the level which must exceed 12%.

Position	31.12.2013.
Risk weighted assets	**85,118,297**
Market risk exposure	**1,483,670**
Operational risk exposure	**12,347,286**
Total risk weighted assets	**98,949,252**
Capital adequacy ratio	**19.49%**

4.2. Regulatory capital requirements

In accordance with the Decision on capital adequacy, the Bank calculates capital requirement for the following risks:

- credit risk – by applying a standardized approach;
- market risk – by applying a standardized approach;
- operating risk – by applying basic indicator approach;
- counterparty risk – by applying a complex approach;
- delivery/settlement risk.

All capital requirements in the amount of RSD 11,873,910 thousand are covered by the Bank's tier 1 capital.

All amounts are expressed in 000 RSD unless stated otherwise

Class of exposure (standardised approach[1])	31 December 2013
Capital requirement for credit risk	**10,170,283**
Exposures to the governments and central banks	0
Exposures to territorial autonomy and local self-government	36
Exposures to public administrative bodies	0
Exposures to international development banks	0
Exposures to international organizations	0
Exposures to banks	140,506
Exposures to the companies (excluding overdue unpaid claims and exposures secured by mortgages on real estate)	4,513,838
Exposures to physical persons (excluding overdue unpaid claims and exposures secured by mortgages on real estate)	2,275,289
Exposures secured by mortgages on real estate	2,439,230
Overdue unpaid claims	191,432
High risk exposures	0
Exposure based on covered bonds	0
Exposure on the basis of covered investments in open-end investment funds	0
Other exposures (excluding overdue unpaid claims and exposures secured by mortgages on real estate)	609,952
(2.) Capital requirement for counterparty risk	43,913
(3.) Capital requirement for settlement risk / delivery based on unsettled transactions	**0**
(4.) The total amount of capital requirements for credit risk, counterparty risk and the risk of settlement / delivery of outstanding transactions on the basis of a standardized approach (12% of the credit risk-weighted exposures)	**10,214,196**
Market risk	**178,040**
(1.) The capital requirement for the price risk on debt securities	81,560
specific	0
general	81,560
(2.) The capital requirement for the price risk on the basis of equity securities	2,339
specific	0
general	2,339
(3.) Capital requirement for foreign exchange risk	94,141
(4.) The capital requirement for commodities risk	0
Operational risk	**1,481,674**
(1) Capital requirement for operational risk calculated using the basic indicator approach	**1,481,674**

[1] Table presents capital requirements in accordance with the Decision on Capital Adequacy

4.3. Internal capital adequacy assessment process

Internal capital adequacy assessment process (ICAAP) aims to identify and assess the risks the Bank is exposed to in its business operations; to determine the material significance of the risk and their allocation; to assess the adequacy of the established systems of monitoring and of the risk mitigations/avoidance techniques; to quantify the Internal capital of the Bank, all of it with the purpose to ensure continuous capital adequacy and compliance of the Bank's business operations to its chosen risk profile.

The Bank bases the above mentioned internal capital adequacy assessment process in the internally determined policy which reflects the specific traits of the Bank itself namely its size, organisation, and scope of operations, as well as the quality and quantity of the available competences and data, while the Bank's capital adequacy is assessed from the viewpoint of the Bank's business operations. ICAAP Policy, as all other risk management related internal acts, is in compliance with the framework and guidelines established in the Risk Management Strategy.

Within ICAAP the Bank has established Capital Management Strategy and Capital Management Plan. Capital Management Plan includes:

- Strategic goals and the timeframe for their realisation considering the influence of the macroeconomic environment and the phases of the economic cycle;
- The manner of organisation of the available internal capital management process;
- Procedures for planning of the adequate level of the available internal capital;
- The manner of achieving and maintaining of the adequate level of the available internal capital which may support factors such as expected growth of placements, future funding sources and their use, the dividend policy as well as any change of the minimum amount of the regulatory capital;
- Business plan in the event of occurrence of unforeseeable circumstances which may affect and available internal capital.

The Bank has ensured the continued implementation and application of ICAAP, as well as the means to document the process adequate to the nature, scope and complexity of the Bank's activities, and in accordance with the risk management strategy and policies as well as capital management strategy. In a broader sense, the ICAAP includes all Bank's activities related to management of risk within the Bank, from the daily risk management to the strategic management of the Bank's capital.

The main objective of ICAAP is to ensure in long term the sufficient capital to cover all materially significant risks which the Bank is exposed to or may be exposed to in its operations, as well as the adequacy of its structure and capital level in pointedly unfavourable ("stress") conditions by means of introduction and application of appropriate processes, procedures and systems. Additional objective of ICAAP is to manage the relation between risk and profit based on the Bank's risk takeover practice analysis as well as the efficiency of own capital usage by establishing a system of:

- Risk limits;
- Allocation of total internal capital requirements and
- Strategic planning.

In order to realise all stated objectives, the Bank has founded its ICAAP process on the comprehensive consolidation of activities regarding the management of risks, capital, business operations, and liquidity maintenance. These activities primarily relate to planning and continuous supervision, as well as continuous improvement of ICAAP in order to ensure high standards of assessment and capital management of the Bank.

Overseeing of the ICAAP process and the ultimate responsibility for its functioning is in the hands of the Board of Directors. Board of Directors plays a leading role in the development of the Bank as the institution aware of the risk which it is exposed to in its business operations and in maintaining the group strategy of risk management at a highly sophisticated level. Their vision and management are reflected in the Bank's risk appetite which is defines as a set of comprehensive measured describing the level of risk the Bank is willing to accept.

ICAAP phases

ICAAP comprises the following phases:

- ***Identification of materially significant risks***

One of the main components of ICAAP process is identification and assessment of momentary and potential risks which the Bank is exposed to with a view to their material significance. Through this approach the Bank streamlines the available resources and management's attention to those risks which could eventually endanger its operations or capital positions, while at the same time ensuring an adequate control over all materially significant risks. Materially significant risks are measured quantitatively or qualitatively depending on the nature of the risk itself. In accordance with the provisions of the Methodology for assessment of materially significant risks, the Bank specifies material significance of each individual risk by setting the minimum materiality threshold with regards to the assessment of the likelihood of the risk occurring and based on the assessment of the intensity of its effect. Internally assessed risk profile, which the Bank establishes after analysing material significance and self-assessment of risk exposure, contains the following materially significant risks.

- ✓ Credit risk
- ✓ Operational risk
- ✓ Market risk
- ✓ Credit-foreign currency risk
- ✓ Concentration risk[2]
- ✓ Interest rate risk (in the banking book)
- ✓ Price risk arising from securities
- ✓ Country risk

[2] Concentration risk which relates to Bank exposure towards one entitiy or a group of related entities (large exposures).

- ✓ Liquidity risk
- ✓ Compliance risk
- ✓ Residual risk
- ✓ Reputation risk
- ✓ Strategic risk
- ✓ Management risk
- ✓ Business risk

For all identified materially significant risks the Bank primarily uses adequate risk control and management measures since it understands that the proactive approach in the management of certain types of risks serves as the best protection against those risks. Also, the Bank understands that it is not quite convenient to use the capital as a security against all identified and material risks (capital relevance, i.e. risk sensitivity). Therefore, the Bank has classified all material risks into:

- ✓ **Capital-Relevant –** those types of material risks which are regarded by the Bank as the risks against which it must provide business operation protection in the form of capital and
- ✓ **Control-Relevant – t**hose types of risks which, despite their materiality, do not require explicit capital protection, i.e. the Bank processes them through the adequate control and management framework.

Within ICAAP, the Bank identified the following materially significant and capital-relevant risks and calculated internal capital requirements for those risks in accordance with the internal methodologies:

- ✓ Credit risk
- ✓ Operational risk
- ✓ Market risk
- ✓ Credit-foreign currency risk
- ✓ Concentration risk
- ✓ Interest rate risk (in the banking book)
- ✓ Strategic risk
- ✓ Management risk
- ✓ Business risk

Materially significant risks for which the Bank, in order to protect against the potential negative effects they may have on the Bank operations, implements control-monitoring mechanisms and does not calculate internal capital requirements are the following:

- ✓ Country risk
- ✓ Liquidity risk
- ✓ Compliance risk
- ✓ Residual risk
- ✓ Reputation risk

- ***Calculation of capital requirements for individual risks relevant to the Bank***

Risk Management Strategy, through which the Bank primarily determines its total risk taking affinity, is the basis for calculation of the internal capital requirements of the Bank, and consequently for planning of the Bank's capital needs. In order to calculate the internal capital requirements for materially significant risks that are relevant in terms of capital, the Bank uses the following approaches:

- **Credit risk**: simple (standardised) approach, according to the Decision of the National Bank of Serbia, determining the calculation of the capital adequacy and capital requirements for risk under Basel 2 Pillar 1, which the Bank adjusts to its internally determined risk appetite. Internal capital requirements for risks from First Pillar are based on the intent to maintain the level of capital that (approximately) suits the AA+ banks (S&P) or Aa1 (Moody's) rating (targeted external rating) which corresponds to the aggregate annual VaR with 99,96% reliability level in accordance with the adopted Bank's risk appetite. The final capital requirement for this risk the Bank determines after stress testing carried out by applying regression models and appropriate scenarios. The Bank analyses the effect of the negative macroeconomic scenarios to credit risk from the aspect of the impact of this risk on the available internal capital. Stress scenarios are primarily defined as shocks to necessary reserve for credit losses. Due to structure of the available internal capital and potential effect the change of the necessary reserve would have on the regulatory capital, the Bank measures the effect of stress test on the available internal capital. Risk Management Division analyses various types of stress scenarios that may affect P&L which include the effects that may arise from the credit risk due to increase of the NPL loans, credit-foreign currency risk, and concentration risk.

- **Market risk:** simple (standardised) approach, according to the Decision of the National Bank of Serbia, determining the calculation of the capital adequacy and capital requirements for risk under Basel 2 Pillar 1, which the Bank adjusts to its internally determined risk appetite. Internal capital requirements for risks from First Pillar are based on the intent to maintain the level of capital that (approximately) suits the AA+ banks (S&P) or Aa1 (Moody's) rating (targeted external rating) which corresponds to the aggregate ten-day VaR with 99,96% reliability level in accordance with the adopted Bank's risk appetite. Market risk refers to trading book price risk and foreign currency risk of total positions of the balance sheet. Internal capital for market risk represents the sum of internal capital for price risk in trading book and internal capital for currency risk determined based on the internally adjusted requirement. Final capital requirement for the total market risk is determined based on the performed stress testing. Stress testing is carried out with regards to interest rates, equity prices, and foreign exchange rate in order to assess the impact of significant changes of financial variables on the value of the Bank portfolio and available internal capital.

- **Operational risk:** simple (standardised) approach, according to the Decision of the National Bank of Serbia, determining the calculation of the capital adequacy and capital requirements for risk under Basel 2 Pillar 1, which the Bank adjusts to its internally determined risk appetite. Internal capital requirements for risks from First Pillar are based on the intent to maintain the level of capital that (approximately) suits the AA+ banks (S&P) or Aa1 (Moody's) rating (targeted external rating) which corresponds to the aggregate annual VaR with 99,96% reliability level in accordance with the adopted Bank's risk appetite. The final capital requirement for this risk the Bank determines after stress testing carried out by applying scenario analysis.

- **Credit-foreign exchange risk:** the Bank assess the internal capital requirement for this risk based on the expertly set factor (FX add-on factor – FXAOF) used to adjust the internal capital for foreign risk. The Bank assesses this factor based on the determined average percentage of non-payment due to currency mismatch of placements, since it incorporates the effect of domestic currency exchange rate variability on the ability of clients to settle their obligations towards the Bank. The effect of the stress test on the credit-foreign currency risk is determined through credit risk stress test.

- **Concentration risk:** The Bank assesses internal capital requirement for concentration risk based on the Herfindahl-Hirschman Index (HHI) which is calculated for Individual risk concentrations, and in accordance with the Methodology for calculation of the capital requirement for materially significant risks. The Bank included the impact of the concentration risk stress testing within its credit risk stress testing.

- **Interest rate risk in the banking book:** when calculating internal capital requirement for interest rate risk in the banking book, the Bank applies a simplified approach to assess the change of economic value of the banking book for the following year determined on the basis of the projected data on interest rate gap and expertly set risk weigh for the standard interest rate shock. Final capital requirement for this risk the Bank determined after performed stress testing by applying an approach based on the application of maximum changes in the historical market interest rates for each of the defined time zones of the yield curve in the last seven years and this approach is used only in case of the currencies where significant exposure to the interest rate risk is present

- **Strategic, business and management risk:** in evaluating the appropriate amount of internal capital requirement for these components of its risk profile the Bank uses internally assessed percentage of reserves of 5% necessary to cover this risk which was assessed as materially significant but which cannot be precisely quantified. Determined percentage of reserves is then applied to calculated internal capital requirements necessary for covering quantifiable risks and in this manner the capital requirement for strategic, business and management risk is determined, Since the strategic buffer is applied to the total internal capital requirements for materially significant risks, the capital requirements for the strategic, management and business risks are increased after the calculation of the effects of stress tests for all materially significant risks.

The Bank determined the approaches used in calculation of the internal capital requirement for materially significant and capital-relevant risks in the ICAAP process, and in accordance with NBS Decision, within its Methodology for determining the internal capital requirements for materially significant risks.

- ***Determining total internal capital requirement***

Total internal capital requirement of the Bank is obtained through simple aggregation of internally assessed components of the total internal capital requirement after stress testing of each of the materially significant and capital relevant risks. The Bank has determined the approaches used in stress testing for materially significant risk in the ICAAP process within its stress testing methodologies. In order to ensure the comprehensiveness of the stress testing process, the Bank considers several perspectives and uses a variety of techniques. Those include quantitative and qualitative techniques which support and complement the use of models and extend stress testing to areas where efficient risk management envisages the greater use of own estimations. Stress tests are carried out in order to assess the adjustability of the Bank's capital position to possible systemic deterioration of the business environment. In this manner, the total internal capital necessary to cover unexpected losses arising from the Bank's risk profile is determined. The Bank also establishes predictions with regards to capital expenditure and its general availability, and then integrates the results of these projections in the strategic planning process. In this manner, the adequacy of the existing plans in the event of unforeseen circumstances occurring is reviewed and a set of valid action plans is developed in order to mitigate and/or avoid the effect of the stress test scenario results on the business operations Bank.

- ***Comparison of the capital calculated in accordance with the Decision regulating the capital adequacy of the Bank and the available internal capital of the Bank***
- ***Comparison of the minimum capital requirements calculated in accordance with the same Decision and the internal capital requirements for individual risks***
- ***Comparison of the sum of minimum capital requirements calculated in accordance with the same Decision and the total capital requirements.***

ICAAP established a continuous management of all categories of materially significant risks and a permanent assessment of the appropriate risk management frameworks. The aim is to identify optimum manner in which the risk management structure can be strengthened, existing policies and procedures improved, new risk mitigation and/or avoidance techniques established and the existing manner of calculation of the Bank's internal capital enhanced. The Bank's management is responsible for managing risk and capital, including the Bank's compliance with the regulatory requirements and internal policies and procedures.

The Bank carries out ICAAP process based on the following documents and decisions/guidelines:

- Decision on risk management by Banks, "RS Official Gazette", No. 45/2011, 94/2011, 119/2012, 123/2012, 23/2013, 43/2013, and 92/2013
- Decision on the Classification of Bank Balance Sheet Assets and Off-balance Sheet Items, "RS Official Gazette", No. 94/2011, 57/2012 and 123/2012
- Decision on Capital Adequacy for Banks, "RS Official Gazette", 46/2011 and 6/2013
- ICAAP policy
- Methodology for assessment of materially significant risks
- Methodology for determining internal capital requirements for materially significant risks
- Methodology for stress testing of credit risk and available internal capital
- Methodology for stress testing of market, interest rate and liquidity risk
- Methodology for stress testing of operational risk

5. CREDIT RISK

5.1. Description of approach and method the Bank uses to calculate allowances for impairment of balance assets and provisions for losses from off balance sheet items

The term past due uncollected receivables means those placements registered as being past due for more than 90 days or those placements for which there is a high probability the debtors will not settle their obligations fully and/or in a timely manner.

For placements in default status the assessment of impairment is carried out, individually for placements that are individually significant, and collectively for placements that are not individually significant.

When calculating capital requirement for credit risk, the Bank distributes into Past due uncollected receivables class all individual receivables with regards to which the debtor is in default for more than 90 days in a materially significant amount, whereas the length of default is determined in the manner prescribed by the Decision on classification of balance assets and off-balance items of banks.

Allowances for impairment

Impaired loans and securities are such loans and securities with respect to which the Bank determines it is not probable to collect all due principal and interest according to the provisions of the loan /securities agreement. Individually impaired assets are those assets which were individually assessed as impaired and with regards to which estimated losses were recognised. For individually assessed items, the loans are treated as impaired as soon as there is an objective proof the estimated loss was incurred.

The Bank establishes allowance for impairment losses that represents its estimate of incurred losses in its loan portfolio. The main components of this allowance are specific loss components that relate to individually significant exposures, and a collective loan loss allowance established for groups of homogeneous assets in respect of losses that have been incurred but have not been identified on loans subject to individual assessment for impairment.

Impairment of wholesale placements

For exposures to borrowers with a rating from 8 to 10, individual impairment analysis is carried out and NPV charge calculated in accordance with IAS 39 requirements considering the cash flows that may arise form collateral activation. Unsecured potion of the placement represents the expected loss for a particular loan and comprises the basis for determining adequate impairment rate.

Impairment of retail placements

The classification of retail clients is based on the full delinquency analysis. The required impairment is computed by applying the appropriate rate to the net exposure per each product group and per each delinquency bucket. In case of individually impaired loans, future expected cash-flows are discounted in accordance with IAS 39 requirements, in order to arrive to appropriate level of impairment.

Special reserves

For both wholesale and retail placements, as per the regulatory requirements of the National Bank of Serbia, the Bank also calculates reserves for estimated losses as defined by the Decision on the Classification of Banks Balance Sheet Assets and Off-Balance Sheet Items, and other relevant regulations of the National Bank of Serbia.

Write-off policy

The Bank writes off a loan / security balance (and any related allowances for impairment losses) when it is determined that the loans / securities are uncollectible. This determination is reached after considering information such as the occurrence of significant changes in the borrower / issuer's financial position such that the borrower / issuer can no longer pay the obligation, or that proceeds from collateral will not be sufficient to collect entire exposure. For unsecured retail loans, write off decisions generally are based on a product specific past due status. Any write-off is approved by the relevant body in accordance with the decision of Board of Directors.

5.2. Exposures after write offs excluding the effects of risk mitigating techniques, as well as average exposures during the period per risk classes

The following table summarises gross amount of exposure per risk classes and risk categories before the application of risk mitigating techniques per risk classes:

All amounts are expressed in 000 RSD unless stated otherwise

Risk classes	Balance exposure		Off balance items		Financial derivatives	
	Total amount	Average amount	Total amount	Average amount	Total amount	Average amount
Exposures to the governments and central banks	51,452,289	49,766,385	0	0	5,003,411	5,194,628
Exposures to territorial autonomy and local self-government	608	360.30	0	0	0	0
Exposures to international development banks	19,219	26,063.29	0	0	0	0
Exposures to banks	1,342,422	16,413,775	1,097	1,161	208,034	213,180
Exposures to the companies (excluding overdue unpaid claims and exposures secured by mortgages on real estate)	30,298,199	27,391,891	16,583,546	19,614,002	53,890	59,230
Exposures to physical persons (excluding overdue unpaid claims and exposures secured by mortgages on real estate)	26,198,749	25,510,734	6,338,020	6,251,621	0	0
Exposures secured by mortgages on real estate	22,618,399	24,106,636	647,905	703,105	0	0
Overdue unpaid claims	24,927,515	22,184,056	291,099	675,882	0	0
Other exposures[3] (excluding overdue unpaid claims and exposures secured by mortgages on real estate)	9,914,087	10,458,089	3,780	1,565,811	0	0
Total	**166,771,488**	**175,857,990**	**23,865,448**	**28,811,582**	**5,265,335**	**5,467,038**

[3] Other exposures mostly relates to Property, plan and equipment, and cash in hand and in vault

All amounts are expressed in 000 RSD unless stated otherwise

5.3. Geographical distribution per risk classes

Risk class	Greece	Germany	Serbia	Other
Exposures to the governments and central banks	-	-	56,455,700	-
Exposures to territorial autonomy and local self-government	-	-	608	-
Exposures to international development banks		-	-	19,219
Exposures to banks	919,177	94,017	533,228	5,132
Exposures to the companies (excluding overdue unpaid claims and exposures secured by mortgages on real estate)	-	-	45,036,297	1,899,338
Exposures to physical persons (excluding overdue unpaid claims and exposures secured by mortgages on real estate)	-	-	32,536,770	-
Exposures secured by mortgages on real estate	-	-	23,266,305	-
Overdue unpaid claims	-	-	25,218,615	-
Other exposures (excluding overdue unpaid claims and exposures secured by mortgages on real estate)	-	-	9,917,867	-
Total	**919,177**	**94,017**	**192,965,390**	**1,923,689**

5.4. Distribution of credit risk exposures per sector or counterparty according to risk classes

Exposure towards countries and central banks

Sector	Balance exposures	Off balance items	Financial derivatives
State bodies and organizations	21,497,447	0	-
Central bank	29,954,842	-	5,003,411
Total	**51,452,289**	**0**	**5,003,411.15**

Exposure towards autonomous provinces and local self government

Sector	Balance exposures	Off balance items	Financial derivatives
Local governments - bodies and public service unit of local government	608	-	-
Total	**608**	**-**	**-**

All amounts are expressed in 000 RSD unless stated otherwise

Exposure towards international development banks

Sector	Balance exposures	Off balance items	Financial derivatives
Foreign banks	19,219		
Total	**19,219**	**0**	**0**

Exposure towards banks

Sector	Balance exposures	Off balance items	Financial derivatives
Banks in the country and other monetary intermediation	527,884	1,097	
Insurance	3,949	-	
Foreign banks	810,589	-	208,034
Total	**1,342,422**	**1,097**	**208,034**

Exposure towards companies (excluding overdue unpaid claims as well exposures secured by mortgages)

Sector	Balance exposures	Off balance items	Financial derivatives
Agriculture, forestry, fishing	784,971	20,000	-
Mining, manufacturing, water supply, waste water, controlling the process of removing waste and similar activities	8,918,864	1,330,641	35,255
Electrical power supply, gas, and air conditioning	1,000,000	0	
Construction	615,848	3,302,884	-
Wholesale and retail trade, repair of motor vehicles and motorcycles	12,416,133	5,769,002	18,635
Transportation and warehousing, accommodation and food services, information and communication	1,155,229	2,816,711	-
Real estate, professional, scientific, innovation and technical activities, administrative and support service activities, arts, entertainment and recreation, other service activities	4,593,236	808,198	-
Entrepreneurs	186,111	8,657	-
Foreign legal entities other than banks	200,623	1,905,053	-
Other	427,183	622,398	-
Total	**30,298,198**	**16,583,544**	**53,890**

All amounts are expressed in 000 RSD unless stated otherwise

Exposure towards physical entities (excluding overdue unpaid claims and exposures secured by mortgages over real estate)

Sector	Balance exposures	Off balance items	Financial derivatives
Agriculture, forestry, fishing	91,903	19,612	-
Mining, manufacturing, water supply, waste water, controlling the process of removing waste and similar activities	732,640	175,675	-
Electrical power supply, gas, vapour and air conditioning	3,981	225	
Construction	235,881	34,481	-
Wholesale and retail trade, repair of motor vehicles and motorcycles	1,190,398	310,086	-
Transportation and warehousing, accommodation and food services, information and communication	261,558	87,924	-
Real estate, professional, scientific, innovation and technical activities, administrative and support service activities, arts, entertainment and recreation, other service activities	239,472	82,245	-
Entrepreneurs	1,753,460	367,900	-
Natural persons	21,605,859	5,221,269	-
Registered farmers	162	0	-
Other	83,437	38,603	-
Total	**26,198,751**	**6,338,020**	**-**

* Exposure towards physical entities includes exposures towards small and medium enterprises and registered agricultural producers according to Decision on capital adequacy.

All amounts are expressed in 000 RSD unless stated otherwise

Other exposures (excluding overdue unpaid claims and exposures secured by mortgages over real estate)

Sector	Balance exposures	Off balance items	Financial derivatives
Agriculture, forestry, fishing	15,167	-	
Mining, manufacturing, water supply, waste water, controlling the process of removing waste and similar activities	3,198	-	
Construction	5,822	-	
Wholesale and retail trade, repair of motor vehicles and motorcycles	61,830	-	
Transportation and warehousing, accommodation and food services, information and communication	4,382	-	
Real estate, professional, scientific, innovation and technical activities, administrative and support service activities, arts, entertainment and recreation, other service activities	18,082	-	
Entrepreneurs	32,328	-	
Compulsory social security fund	44,694	-	
Physical persons	381,420	-	
Other	9,347,163	3,781	
Total	**9,914,086**	**3,781**	**-**

*Position Other is mostly comprised of Plant, property and equipment and cash in hand and in vault

All amounts are expressed in 000 RSD unless stated otherwise

Exposures secured by mortgages over real estate

Sector	Balance exposures	Off balance items	Financial derivatives
Agriculture, forestry, fishing	6,478	3,629	-
Mining, manufacturing, water supply, waste water, controlling the process of removing waste and similar activities	399,079	72,974	-
Construction	62,613	12,857	-
Wholesale and retail trade, repair of motor vehicles and motorcycles	528,343	503,543	-
Transportation and warehousing, accommodation and food services, information and communication	150,468	7,280	-
Real estate, professional, scientific, innovation and technical activities, administrative and support service activities, arts, entertainment and recreation, other service activities	82,904	12,648	-
Entrepreneurs	359,969	21,041	-
Physical persons	20,991,827	7,629	-
Other	36,718	6,303	-
Total	**22,618,399**	**647,904**	**-**

All amounts are expressed in 000 RSD unless stated otherwise

Exposures related to overdue unpaid claims

Sector	Balance exposures	Off balance items	Financial derivatives
Agriculture, forestry, fishing	94,182	-	-
Mining, manufacturing, water supply, waste water, controlling the process of removing waste and similar activities	2,182,997	2,856	-
Construction	2,918,630	12,731	-
Wholesale and retail trade, repair of motor vehicles and motorcycles	3,665,149	3,522	-
Transportation and warehousing, accommodation and food services, information and communication	589,795	7	-
Real estate, professional, scientific, innovation and technical activities, administrative and support service activities, arts, entertainment and recreation, other service activities	352,782	1,040	-
Entrepreneurs	4,750,981	17,575	-
Physical persons	4,606,782	250,349	-
Registered farmers	183,831	8	-
Other	5,582,387	3,011	-
Total	**24,927,516**	**291,099**	**-**

* Position Other includes exposures arising from legal entities in bankruptcy

All amounts are expressed in 000 RSD unless stated otherwise

5.5. Exposures in relation to which allowances for impairment were made, due uncollected receivables and allowances for impairment per sectors

The Bank allocates to due uncollected receivables all individual receivables for which the debtor is in default more than 90 days in materially significant amount. The length of default and if the amount is materially significant is determined by the decision on classification of balance assets and off balance items.

Sector	Balance sheet exposures for which provisions where made	Provisions of balance sheet assets	Overdue unpaid claims	off balance sheet assets for which provisions where made	Provisions for off balance sheet items
Agriculture, forestry, fishing	976,891	41,839	94,182	0	0
Mining, manufacturing, water supply, waste water, controlling the process of removing waste and similar activities	12,074,240	1,018,756	2,185,853	1,053,064	6,241
Electrical power supply, gas, vapour and air conditioning	1,003,981	5,005	0	0	0
Construction	3,665,350	585,516	2,931,361	2,264,026	14,297
Wholesale and retail trade, repair of motor vehicles and motorcycles	15,285,387	1,459,483	3,668,671	4,337,979	24,238
Transportation and warehousing, accommodation and food services, information and communication	2,142,844	241,268	589,803	2,680,189	18,899
Real estate, professional, scientific, innovation and technical activities, administrative and support service activities, arts, entertainment and recreation, other service activities	5,095,331	146,075	353,822	787,368	3,865
Entrepreneurs	6,983,468	3,056,954	4,768,556	1,573	3
Physical persons	47,197,692	2,882,004	4,857,094	0	0
Registered farmers	180,511	26,139	183,876	0	0
Other	5,717,129	3,943,237	5,585,397	2,057,496	11,914
Total	**100,322,824**	**13,406,277**	**25,218,615**	**13,181,696**	**79,457**

All amounts are expressed in 000 RSD unless stated otherwise

5.6. Distribution of all exposures according to remaining maturity per risk classes

Risk class	Remaining maturity				
	Up to 30 days	30 - 90 days	91 - 180 days	181 - 365 days	Over 365 days
Exposures to the governments and central banks	33.010.439		6.378.706	576.125	16.490.430
Exposures to territorial autonomy and local self-government	402	0	0	0	206
Exposures to international development banks	1.394	4.182	4.182	6.162	3.299
Exposures to banks	1.528.545	0	0	0	23.008
Exposures to companies (including due uncollected receivables as well as receivables secured by mortgages over real property)	6.968.082	1.334.949	7.003.984	9.319.981	22.308.639
Exposures to physical persons (excluding overdue unpaid claims and exposures secured by mortgages on real estate)	92.596	136.600	270.850	919.155	31.117.569
Exposures secured by mortgages on real estate	355.485	75.417	106.429	75.586	22.653.388
Overdue unpaid claims	19.210.413	3.560	106.513	39.639	5.858.490
Other (excluding overdue unpaid claims and exposures secured by mortgages on real estate)	9.903.412				14.455
Total	**71.070.768**	**1.554.708**	**13.870.664**	**10.936.648**	**98.469.484**

All amounts are expressed in 000 RSD unless stated otherwise

5.7. Changes in allowance for impairment on balance assets and provisions on off balance items

Type of exposure	Opening balance 01.01.2013	Increasing provisions during the period	Reversal of provisions	Net exchange differences	Write offs	Closing balance 31.12.2013
Placements	8,870,130	2,072,025	(23,850)	64,319	(18,345)	10,964,279
Interest and fees	828,096	200,063	(1,976)	6,088	(1,957)	1,030,314
Other assets	76,665	16,256	-	837	(1,998)	91,760
Other placements	659,737	655,429	-	3,851	-	1,319,017
Assets received in claim of receivables	905		-			905
Off balance items	101,794	1,728	(24,672)	606		79,456

5.8. Distribution according to classification categories and data on calculated necessary reserves

Classified balance assets and off balance items

Classification category	Gross exposure	Calculated reserve	Necessary reserves
Category A	50.947.870	-	-
Category B	20.042.828	379.503	281.496
Category V	23.927.716	3.496.214	3.285.792
Category G	5.923.695	1.482.828	1.220.180
Category D	28.987.517	28.001.578	15.404.726
Total	129.829.626	33.360.123	20.192.194

All amounts are expressed in 000 RSD unless stated otherwise

5.9. Application of external ratings in the standardized approach of credit risk weighted assets calculation

As of 2012, the Bank applies credit rating by Moody's Investor Service Ltd. which obtained the approval of the National Bank of Serbia for validity of credit ratings, for those entities which have been rated by this agency. Mapping of ratings was carried out in the following manner:

Description	Credit quality level	Moody's rating
Mapping of long term credit ratings into levels of quality (for exposure towards states, central banks, banks and companies)	1	Aaa - Aa3
	2	A1 - A3
	3	Baa1 - Baa3
	4	Ba1 -Ba3
	5	B1 - B3
	6	Caa1 and lower
Mapping of short term credit ratings into levels of quality (for exposure towards banks or companies)	1	P-1
	2	P-2
	3	P-3
	4 - 6	NP
Mapping of investments into investment funds	1	Aaa - Aa3
	2	A1 - A3
	3 and 4	Baa1 - Baa3
	5 and 6	B1 and lower

In accordance with article 35 of the Decision on capital adequacy ("The Official Gazette of RS No. 46/2011, 6/2013), the Bank distributes the following risk weights in relation to exposures to foreign countries and central banks:

a) According to distribution of credit ratings into appropriate level of credit quality:

Export insurance premiums categories	1	2	3	4	5	6
Risk weight	0%	20%	50%	100%	100%	150%

b) According to distribution of credit ratings into lowest export insurance premiums categories:

Export insurance premiums categories	0	1	2	3	4	5	6	7
Risk weight	0%	0%	20%	50%	100%	100%	100%	150%

For exposures towards other banks which have been rated by eth chosen rating agency, the Bank distributes risk weights according to the credit rating into appropriate level of credit quality according to the following table:

All amounts are expressed in 000 RSD unless stated otherwise

a) For exposures with remaining maturity longer than 3 months:

Export insurance premiums categories	1	2	3	4	5	6
Risk weight	20%	50%	50%	100%	100%	150%

b) For exposures with remaining maturity less than 3 months:

Export insurance premiums categories	1	2	3	4	5	6
Risk weight	20%	20%	20%	50%	50%	150%

6. RISK MITIGATION TECHNIQUES AND METHODS USED BY THE BANK TO ENSURE AND MONITOR THE EFFICIENCY OF RISK MITIGATION

Risk mitigation activites are carried out when negative developments occur with regards to risk exposure. Each organisational unit involved in risk management may take corrective measures within its competences. However, their activites must be approved by an appropriate board or committee (ALCO or RC / Credit Risk Committee).

The Bank undertakes measures to mitigate credit risk in accordance with the section of the NBS Decision on capital adequacy related to credit risk mitigation techniques.

For a majority of exposures, the Bank requires collateral. Collateral generally is not held over loans and advances to banks. Most often the collateral consists of one or more of the following collateral instruments (or instruments for credit support):

- cash deposits in dinars and foreign currencies,
- guarantees from the government, government funds or first class banks,
- guarantees from parent companies, other legal entities and individual persons,
- letters of comfort from parent companies,
- mortgage over real estate,
- pledge over movable property,
- own blank bills of exchange,
- pledge over shares or ownership stakes
- a pledge over other securities (e.g. bonds) or precious metals,
- assignment of receivables (with or without notification) etc.,
- assignment of insurance policies.

The Bank reserves the right to request any other type of instruments (or variation of the above instruments) which it may deem necessary.

Estimates of fair value are based on the value of collateral assessed at the time of borrowing, and generally are updated periodically in accordance with the relevant credit policy.

Market value of the asset is fundamental and does not depend on the assets' application in obtaining a loan, whereas the value considered in credit risk mitigation is affected by different factors such as the structure of the transaction, currency matching, and the possibility of enforced collection.

6.1. Valuation of credit hedging instruments and their management

The Bank regulated in its internal acts the valuation of credit hedging instruments and their management.
Internal acts define as acceptable the relation between the placement amount and the value of collateral which is based on application of collateral factor for offered collateral, by means of which estimated value of collateral is adjusted and the value which the Bank can claim is determined,

6.2. Manner of balance and off balance netting

From 31.12.2013 the Bank is no longer using the netting agreement regarding mutual obligations and receivables arising from loans and deposits.

6.3. Description of basic elements of material hedging instruments

The Bank uses appropriate credit hedging instruments in order to decrease credit risk by adjusting risk weighted assets with the effects of credit risk mitigation techniques.

The appropriate credit hedging instruments in accordance with the Decision on capital adequacy which the Bank uses are material instruments credit hedging.

- Cash deposits with the bank
- Equity instruments issued by the Republic of Serbia.

The Bank did not apply non-material hedging instruments such as guarantees, other forms of sureties and counter guarantees.

The Bank applies a simple method to adjust risk weighted assets by means of collateral (financial assets). The simple method implies that credit risk of weight is replaced with risk weight of collateral. Decreases based on application of hedging instruments are applied to net exposure. Net exposure after the application of hedging instruments (effective value of exposure) cannot be higher than the amount of risk weighted assets before the application of hedging instruments.

6.4. Data on concentration of market or credit risk within the applicable techniques

With the aim of managing risk concentration within the frame of used credit risk mitigation techniques, the Bank monitors and manages the concentration of credit and market risk in the segment of large exposures by considering the issuers of appropriate instruments of security.

All amounts are expressed in 000 RSD unless stated otherwise

6.5. Exposure before and after the use of credit hedging for every level of credit quality, including exposures representing deductibles from capital

Level of credit quality	The weight of risk %	Exposures before use of credit hedging	Exposures after use of credit hedging
		31.12.2013.	**31.12.2013.**
1	**0%**	61,006,396	62,962,054
	10%	0	0
2	**20%**	629,365	909,071
	35%	2,232,424	2,214,767
3	**50%**	68,969	68,969
4	**75%**	28,459,527	28,066,447
5	**100%**	313,088,889	311,264,263
6	**150%**	973,888	973,888
Other weight of risk			
Deductibles from capital		1,717,529	1,717,529

6.6. Exposures after netting secured by instruments of material and by non material credit hedging, by classes of exposure

Risk class	Amount of exposure secured by instruments of material credit hedging	Amount of exposures secured by instruments of non material credit hedging
	31.12.2013.	**31.12.2013.**
Exposures to the companies (excluding overdue unpaid claims and exposures secured by mortgages on real estate)	1,802,087	-
Exposures to physical persons (excluding overdue unpaid claims and exposures secured by mortgages on real estate)	393,081	-
Exposures secured by mortgages on real estate	34,109	-
Overdue unpaid claims	5,506	-
Other (excluding overdue unpaid claims and exposures secured by mortgages on real estate)	580	-
Total	**2,235,363**	**-**

*Table presents new exposures after decrease for the amount of allowance for impairment and necessary statutory provision in accordance with Decision on capital adequacy.

7. COUNTERPARTY RISK

The Bank is obligated to calculate risk weighted assets for counterparty risk based on the following positions in the trading book and banking book:

- Financial derivatives,
- Credit derivatives,
- Repo and reverse repo transactions,
- lending or borrowing securities or merchandise,
- transactions from trade of securities,
- transactions with long term due date.

In accordance with NBS regulations, the Bank calculates risk weighted assets for derivatives which include currency and interest swap transaction by application of current exposure method prescribed by the Decision on capital adequacy. As at 31 December 2013, total amount of counterparty risk exposure was RSD 264.281 thousand, including RSD 32.046 thousand of positive fair value and RSD 232.235 thousand of potential credit exposure.

The total amount of counterparty exposure does not contain the amount from the reverse repo transactions with the National Bank of Serbi as per Article 426 of the Decision on the capital adequacy related to assigning 0% risk weight to all exposures towards the Repubilc of Serbia and the National Bank of Serbia.

The Bank does not have exposures from lending or borrowing securities or merchandise, transactions from trade of securities, credit derivatives from the trading book, as well as other transactions with long term due date.

8. MARKET RISKS

8.1. Type of applied approach for calculation of market risks

Capital requirement for Bank's market risks is calculated by application of the standardized approach, summing capital requirements for price, currency and commodity risk in accordance with the Decision on capital adequacy.

Capital requirement for price risk is calculated separately for bonds and equity instruments as the specific and general price risk.

- **Specific price risk from bonds** is calculated by distributing the net positions form the trading book into appropriate categories (according to the type of issuer/debtor, internal or external credit rating and the remaining maturity period) and multiplying them by risk weights prescribed by the National Bank of Serbia. The risk weighted positions are then summed, regardless whether the positions are long or short

- **General price risk from bonds** is calculated by applying the maturity method for each currency. By applying this method, the Bank allocated all net positions of bonds into maturity classes and zones prescribed by the National Bank of Serbia, then adds risk weight to maturity classes and zones and separately sums all risk weighted long positions and all risk weighted short positions. Afterwards, matched and/or mismatched positions per individual maturity classes and zones are calculated. The capital requirement for general price risk is calculated by maturity method as the sum of the following:

All amounts are expressed in 000 RSD unless stated otherwise

- 10% of the total sum of risk weighted matches positions in all maturity classes,
- 40% of risk weighted matched positions in the zone 1,
- 30% of risk weighted matched positions in the zone 2,
- 30% of risk weighted matched positions in the zone 3,
- 40% of risk weighted matched positions between zones 1 and 2
- 40% of risk weighted matched positions between zones 2 and 3
- 100% of the remaining mismatched risk weighted positions between the zones.

- **Price risk from equity instruments** is calculated as general and specific price risk, whereas the capital requirement for this type of risk represents the sum of capital requirements for general and specific risk multiplied by 1.5 and calculated per each country and currency. Capital requirement for specific price risk from equity instruments amounts to 4% of the total gross position of the Bank with regards to these equity instruments, and the capital requirement for general price risk amounts to 8% of the total net position of these equity instruments.

- **Currency risk** is calculated with regards to positions of FC assets and FC liabilities, whereas capital requirement is calculated by multiplying the sum of Net open FC position and absolute value of net open position in gold with 12% is this amount exceeds 2% of the Bank's capital.

- The Bank currently has no exposures arising from **commodity risk,** nor did it trade with such instruments.

8.2. Capital requirement for market risks

The Bank calculated the following amounts of capital requirement for market risks:

Capital requirement for market risks	Amount	Covered by base capital	Covered by additional capital
Capital requirement for price risk from bonds	81.560	81.560	-
Capital requirement for price risk from equity instruments	2.339	2.339	-
Capital requirement for market risk	94.141	94.141	-
Capital requirement for commodity risk	-	-	-
Total	**178.040**	**178.040**	**-**

8.3. Structure and amounts per type of capital requirement

Capital requirement for price risk from bonds as at 31.12.2013 was RSD 81.560 thousand, of which the capital requirement for RSD was RSD 10.296 thousand; for EUR, RSD 25.565 thousand; for CHF, RSD 17.647 thousand: for USD, RSD 864 thousand. The exposure from these positions was mostly related to interest swap transactions, swap transactions, T-bills of Ministry of Finance transactions and reverse repo transactions with NBS T-bills. The amount in its entirety relates to general price risk from bonds, whereas the Bank did not have capital requirement for specific price risk as at 31.12.2013. Capital requirement for price risk from equity instruments was RSD 2.340 thousand, of which RSD 520 thousand relates to specific price risk, and the remaining RSD 1.040 thousand to capital requirement for general price risk. The Bank's overall exposure relates to share positions, mostly shares of companies and insurance companies from Serbia.

In terms of currency risk, the Bank calculated capital requirement seeing that the sum of total net open FX position and absolute value of open net position in gold as at 31 December 2013 was RSD 784.511 thousand, representing 4.07% of the Bank's capital calculated on the same date.

The Bank did not have exposures arising from commodity risk.

9. OPERATIONAL RISK

9.1. Capital requirement for operational risk

In order to determine capital requirement for operational risk (Pillar 1), the Bank utilizes basic indicator approach according to which the capital requirement for operational risk is equal to the amount of 3-year average exposure indicator multiplied by capital requirement rate of 15%.

Total capital requirement for operational risk according to the Pillar 1 as at 31 December 2013 amounts to RSD 1,481,674 thousand.

10. INTEREST RATE RISK

10.1. Causes of interest rate risk and frequency of its measurement

Interest rate risk is the risk that Bank's financial position may be affected by adverse movements of interest rates. Generally, there are two ways in which the change of interest rate may affect the Bank. Firstly, change of interest rates affects the values of assets, liabilities and off balance items of the Bank; secondly, the changes of interest rate affect future cash flows. Interest rate risk may include maturity mismatch and repricing risk, yield curve risk, basis and option risk. Bank's interest rates are determined considering market interest rates and other factors (such as the risk price, expected level of provisioning, etc.) and the Bank regularly adjusts them.

Managing interest rate risk aims to optimize net interest income and maintain market interest rate at a consistent level in accordance with Bank's business strategy. Risk management is based on matching interest bearing assets, liabilities, and off-balance items on the basis of: macro and micro economic predictions, liquidity conditions predictions and interests rate trends predictions.

10.2. Main assumptions for measuring and assessing risk exposure

The basis for measurement of Bank's interest rate risk exposure, the Bank uses Gap analysis of balance and off balance positions applying sensitivity factors in relation to current market yield curve, as well as multiple scenarios which include the changes of levels and movements of interest rates. In addition, the Banka estimates the effect of early repayments or withdrawal of funds in terms of interest bearing positions on loans and deposits side with this embedded option. The assessment of credit risk is carried out on a monthly basis. The bank controls interest rate risk exposure through set of exposure limits.

11. Exposure form equity investments in banking book

The Bank has investments into company shares classified as available for sale in the amount of 0.05% of the total Bank portfolio, the investments not being the result of the intent to invest into such securities but of other strategic and business decisions. Consequently, the Bank reached the decision that such investments are not relevant in term of Bank data and information disclosures.

12. Disclosure of information related to banking group and relationship between parent bank and subsidiaries

As at 31 December 2013, the Bank does not have a share (interest) in capital of financial sector legal entities considered under the Law on Banks a banking group, resident of the Republic of Serbia.

13. Data and information not disclosed

The Bank did not disclose the following data:

- off balance items that cannot result in payment by the bank as those items are considered as low-risk categories according to the Decision on capital adequacy and have a risk weight of 0%. They are mostly comprised of accounting records and other off balance items: records of pledged securities, mortgages received as collateral, frozen bonds at the Central Registry – owners accounts, and off-balance receivables arsing from derivative transactions that do not constitute risk exposure and merely represent records of the said transactions.
- Shares of companies classified as available-for-sale since this type of investment is the result of the long term strategic business relations, and not of the Bank decision to invest into a legal entity's shares.

Filippos Karamanolis
President of the Executive Board

Predrag Janković
Head of Risk Management Division