UNICREDIT BANK SRBIJA A.D., BEOGRAD

Unconsolidated Financial Statements
Year Ended December 31, 2018 and
Independent Auditors' Report

Translation of the Auditors' Report issued in the Serbian language

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INDEPENDENT AUDITOR'S REPORT

TO THE SHAREHOLDERS OF UNICREDIT BANK SRBIJA A.D., BEOGRAD

We have audited the accompanying unconsolidated financial statements of the bank "UniCredit Bank Srbija" a.d., Beograd, (hereinafter referred to as the „Bank") which comprise statement of the financial position as of December 31, 2018, and the income statement, statement of other comprehensive income, statement of changes in equityand statement of cash flows for the year then ended, and a summary of significant accounting policies contained in the notes to the unconsolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these unconsolidated financial statements in accordance with International Financial Reporting Standards, and for such internal controls as management determines are necessary to enable the preparation of unconsolidated financial statements that are free from material misstatements, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these unconsolidated financial statements based on our audit. We conducted our audit in accordance with Law on Auditing and audit standards applicable in the Republic of Serbia. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the unconsolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the unconsolidated financial statements. The procedures selected depend on auditor's judgment, including the assessment of the risk of material misstatement of the unconsolidated financial statement, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the unconsolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purposes of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the unconsolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

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INDEPENDENT AUDITOR'S REPORT (CONTINUED)

Opinion

In our opinion, the unconsolidated financial statements give a true and fair view of the financial position of the "UniCredit Bank Srbija" a.d., Beograd as of December 31, 2018, and its financial performance and cash flows for the year ended in accordance with International Financial Reporting Standards.

Emphasis of matter

For the current reporting period, the Bank started applying the new IFRS 9 Standard – *Financial Instruments*. In accordance with the new standard, the Bank chose the option without changing the comparative data for 2017, therefore comparative data are presented in accordance with IAS 39 *Financial Instruments – Recognition and Measurement*.

The effects of adjusting the carrying amount of financial assets and liabilities at the date of the first application of the standard are recognized as correction of the retained earnings and are disclosed in Note 2(g) to the unconsolidated financial statements.

Our opinion is not qualified in respect of this matter.

Other issues

As disclosed in Note 2(a) to the unconsolidated financial statements, the Bank is a parent entity and its consolidated financial statements prepared in accordance with International Financial Reporting Standards have been issued separately. The consolidated financial statements of the Bank as at 31, December 2018 were the subject of audit and in our audit report issued on February 14, 2019, we expressed unqualified opinion.

Financial statements of the Bank for 2017 were audited by other auditor who, in his Report on February 23, 2018, expressed unqualified opinion on financial statements.

Belgrade, February 14, 2019

PKF BEOGRAD

Petar Grubor
Certified auditor

STATEMENT OF FINANCIAL POSITION
As of December 31, 2018
(Thousands of RSD)

	Note	2018	2017
Cash and assets held with the central bank	3.l, 22	53,405,309	29,661,017
Receivables under derivatives	3.m, 23	682,823	185,204
Securities	3.k, 3.p, 24	101,927,293	84,345,367
Loans and receivables from banks and other financial organisations	3.k, 3.o, 25	20,974,936	11,825,650
Loans and receivables from clients	3.k, 3.o, 26	255,642,820	232,553,107
Change in fair value of hedged items	3.n, 27	222,773	192,251
Receivables under hedging derivatives	3.n, 28	2	9,195
Investments in subsidiaries	3.z, 29	112,644	112,644
Intangible assets	3.r, 3.t, 30	1,617,855	1,162,458
Property, plant and equipment	3.q, 3.t, 31	1,589,673	1,551,389
Investment property	32	1,331	1,364
Deferred tax assets	3.j, 33	239,899	171,179
Other assets	34	982,931	977,727
Total assets		**437,400,289**	**362,748,552**
Liabilities under derivatives	3.m, 35	723,632	207,003
Deposits and other liabilities to banks, other financial organisations and central bank	3.k, 3.u, 36	133,078,135	99,533,573
Deposits and other financial liabilities to clients	3.k, 3.u, 37	220,931,036	186,658,833
Liabilities under hedging derivatives	3.n, 38	488,580	448,794
Subordinated liabilities	3.u, 39	-	2,718,490
Provisions	3.v, 3y, 40	1,131,110	1,072,531
Current tax liabilities	3.j, 21.4	461,958	178,821
Deferred tax liabilities	3.j, 33	381	-
Other liabilities	41	2,756,959	2,590,012
Total liabilities		**359,571,791**	**293,408,057**
Share capital	43.1	24,169,776	24,169,776
Profit	43.1	9,221,647	6,633,319
Reserves	43.1	44,437,075	38,537,400
Total equity		**77,828,498**	**69,340,495**
Total liabilities and equity		**437,400,289**	**362,748,552**

Belgrade, February 14, 2019

Signed by the management of UniCredit Bank Srbija A.D., Beograd:

Feza Tan
Management Board Chairperson

Sandra Vojnović
Management Board Member
Head of the Strategy and Finance Division

Mirjana Kovačević
Head of Accounting Department

INCOME STATEMENT
Year Ended December 31, 2018
(Thousands of RSD)

	Note	2018	2017
Interest income	3.d, 7	16,211,037	14,849,191
Interest expenses	3.d, 7	(2,531,688)	(2,700,513)
Net interest income		**13,679,349**	**12,148,678**
Fee and commission income	3.e, 8	4,782,251	4,298,028
Fee and commission expenses	3.e, 8	(1,289,437)	(1,348,524)
Net fee and commission income		**3,492,814**	**2,949,504**
Net gains from change in fair value of financial instruments	3.f, 9	145,562	203,908
Net gains from derecognition of the financial instruments measured at fair value	3.g, 10	172,506	305,731
Net losses on hedging	3.h,11	(10,705)	(33,865)
Net exchange rate gains and gains from agreed currency clause	3.c, 12	1,415,932	1,371,936
Net expenses on impairment of financial assets not measured at fair value through income statement	3.k, 13	(2,904,225)	(2,704,361)
Net gains from derecognition of the financial instruments measured at amortised cost	3.i, 14	2,099,033	12,760
Net gains from derecognition of investments in associated companies and joint ventures	15	-	120,379
Other operating income	16	46,642	41,947
Total net operating income		**18,136,908**	**14,416,617**
Staff costs	17	(3,021,454)	(2,816,321)
Depreciation expenses	3.q, 3.r, 18	(579,879)	(535,679)
Other income	19	88,730	82,011
Other expenses	20	(4,582,729)	(4,048,987)
Profit before taxes		**10,041,576**	**7,097,641**
Income tax	3.j, 21	(819,929)	(464,322)
Profit after taxes		**9,221,647**	**6,633,319**
Earnings per share			
Basic earnings per share (in RSD, rounded)	43.2	3,906	2,810
Diluted earnings per share (in RSD, rounded)	43.2	3,906	2,810

Belgrade, February 14, 2019

Signed by the management of UniCredit Bank Srbija A.D., Beograd:

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Head of the Strategy and Finance Division

Mirjana Kovačević
Head of Accounting Department

STATEMENT OF OTHER COMPREHENSIVE INCOME
Year Ended December 31, 2018
(Thousands of RSD)

	Note	2018	2017
PROFIT FOR THE YEAR		**9,221,647**	**6,633,319**
Components of other comprehensive income that cannot be reclassified to profit or loss			
- Actuarial gains		6,592	9,856
Components of other comprehensive income that can be reclassified to profit or loss			
- Positive/(negative) effects of change in the value of debt instruments measured at fair value through other comprehensive income		651,976	(255,417)
Tax losses relating to other comprehensive income for the year	33.2	(989)	(1,478)
Total positive/(negative) other comprehensive income for the year	43.3	**657,579**	**(247,039)**
TOTAL POSITIVE COMPREHENSIVE INCOME FOR THE YEAR		**9,879,226**	**6,386,280**

Belgrade, February 14, 2019

Signed by the management of UniCredit Bank Srbija A.D., Beograd:

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Head of the Strategy and Finance Division

Mirjana Kovačević
Head of Accounting Department

STATEMENT OF CHANGES IN EQUITY
Year Ended December 31, 2018
(Thousands of RSD)

	Share capital and other equity	Own shares	Reserves from profit and other reserves	Revaluation reserves	Profit	Total
Opening balance as at 1 January of the previous year	23,607,620	562,156	32,020,480	1,787,359	6,226,600	64,204,215
Adjusted opening balance as at 1 January of the previous year	23,607,620	562,156	32,020,480	1,787,359	6,226,600	64,204,215
Total negative other comprehensive income for the period	-	-	-	(247,039)	-	x
Profit for the current year	-	-	-	-	6,633,319	x
Distribution of profit - increase	-	-	4,976,600	-	-	x
Distribution of profit, and/or coverage of losses - decreese	-	-	-	-	(4,976,600)	x
Dividend payments	-	-	-	-	(1,250,000)	x
Total transactions with owners	-	-	4,976,600	-	(6,226,600)	x
Balance as at 31 December of the previous year	23,607,620	562,156	36,997,080	1,540,320	6,633,319	69,340,495
Opening balance as at 1 January of the current year	23,607,620	562,156	36,997,080	1,540,320	6,633,319	69,340,495
Effects of the first implementation of new IFRS - increase	-	-	-	319,182	-	x
Effects of the first implementation of new IFRS - decrease	-	-	-	-	(455,405)	x
Adjusted opening balance as at 1 January of the current year	23,607,620	562,156	36,997,080	1,859,502	6,177,914	69,204,272
Total positive other comprehensive income for the period	-	-	-	657,579	-	x
Profit for the current year	-	-	-	-	9,221,647	x
Distribution of profit - increase	-	-	4,922,914	-	-	x
Distribution of profit, and/or coverage of losses - decreese	-	-	-	-	(4,922,914)	x
Dividend payments	-	-	-	-	(1,255,000)	x
Total transactions with owners	-	-	4,922,914	-	(6,177,914)	x
Balance as at 31 December of the current year	**23,607,620**	**562,156**	**41,919,994**	**2,517,081**	**9,221,647**	**77,828,498**

Belgrade, February 14, 2019

Signed by the management of UniCredit Bank Srbija A.D., Beograd:

Feza Tan
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Management Board Member
Head of the Strategy and Finance Division

Mirjana Kovačević
Head of Accounting Department

STATEMENT OF CASH FLOWS
Year Ended December 31, 2018
(Thousands of RSD)

	Note	2018	2017
Cash inflows from operating activities		**26,570,905**	**25,127,550**
Interest receipts		11,964,294	11,980,152
Fee and commission receipts		4,767,353	4,462,450
Receipts of other operating income		9,839,258	8,684,828
Dividend receipts and profit sharing		-	120
Cash outflows from operating activities		**(16,876,528)**	**(18,953,313)**
Interest payments		(2,361,834)	(2,541,375)
Fee and commission payments		(1,297,270)	(1,356,084)
Payments to, and on behalf of employees		(2,887,513)	(2,963,865)
Taxes, contributions and other duties paid		(477,323)	(533,970)
Payments for other operating expenses		(9,852,588)	(11,558,019)
Net cash inflows from operating activities before an increase or decrease in financial assets and financial liabilities		**9,694,377**	**6,174,237**
Decrease in financial assets and increase in financial liabilities		**76,488,298**	**42,447,037**
Decrease in receivables under securities and other financial assets not intended for investment		682,803	-
Increase in deposits and other financial liabilities to banks, other financial organizations, central bank and clients		75,600,206	42,447,037
Increase in other financial liabilities		205,289	-
Increase in financial assets and decrease in financial liabilities		**(51,467,520)**	**(30,726,233)**
Increase in loans and receivables from banks, other financial organizations, central bank and clients		(51,375,973)	(30,726,233)
Decrease in liabilities under hedging derivatives and change in fair value of hedge items		(91,547)	-
Net cash inflow from operating activities before income taxes		**34,715,155**	**17,895,041**
Income taxes paid		(606,120)	(320,025)
Dividends paid		(1,255,000)	(1,250,000)
Net cash inflow from operating activities		**32,854,035**	**16,325,016**
Cash inflows from investing activities		-	120,379
Other inflows from investing activities		-	**120,379**
Cash outflows from investing activities		**(14,512,169)**	**(3,834,761)**
Outflows per investments in investment securities		(13,397,250)	(3,066,018)
Purchases of intangible assets, property, plant and equipment		(1,114,919)	(768,743)
Net cash outflow from investing activities		**(14,512,169)**	**(3,714,382)**
Cash outflows from financing activities		**(10,521,642)**	**(6,543,717)**
Outflows for repayment of subordinated liabilities		(2,811,628)	-
Outflows for repayment of borrowings		(7,710,014)	(6,543,717)
Net cash outflow from financing activities		**(10,521,642)**	**(6,543,717)**

STATEMENT OF CASH FLOWS (Continued)
Year Ended December 31, 2018
(Thousands of RSD)

	Note	2018	2017
Total cash inflows		103,059,203	67,694,966
Total cash outflows		(95,238,979)	(61,628,049)
Net cash increase		7,820,224	6,066,917
Cash and cash equivalents, beginning of year	3.l, 44	22,805,898	16,817,106
Foreign exchange losses		(853)	(78,125)
CASH AND CASH EQUIVALENTS, END OF YEAR	3.l, 44	30,625,269	22,805,898

Belgrade, February 14, 2019

Signed by the management of UniCredit Bank Srbija A.D., Beograd:

Feza Tan
Management Board Chairperson

Sandra Vojnović
Management Board Member
Head of the Strategy and Finance Division

Mirjana Kovačević
Head of Accounting Department

NOTES TO THE UNCONSOLIDATED FINANCIAL STATEMENTS
December 31, 2018
All amounts expressed in thousands of RSD, unless otherwise stated.

1. BANK'S ESTABLISHMENT AND ACTIVITY

UniCredit Bank Srbija a.d. Beograd (the: "Bank") was originally established as HVB Banka Jugoslavija ("HVB") in 2001 after obtaining an operating license from the National Bank of Yugoslavia on July 2, 2001. On October 1, 2005, a status change of merger and acquisition of entities HVB Banka Srbija i Crna Gora A.D. Beograd, as the Acquirer and Eksport-Import banka Eksimbank A.D. Beograd, as the Acquiree was registered. The Bank changed its name to UniCredit Bank Srbija a.d. Beograd on March 30, 2007.

The Bank is a member of UniCredit Group. In accordance with the reorganisation of the Banking Group's activities in Central and Eastern European countries, under the Demerger and Takeover Agreement executed by and between UniCredit Bank Austria AG and UCG Beteillingsverwaltung GmbH on August 31, 2016 and Merger and Acquisition Agreement executed by and between UCG Beteillingsverwaltung GmbH and UniCredit SpA on September 30, 2016, UniCredit Bank Austria AG transferred its sole (100%) ownership of the Bank to the Austrian holding company UCG Beteillingsverwaltung GmbH. Through merger of UCG Beteillingsverwaltung GmbH with UniCredit SpA, UniCredit SpA became the sole shareholder of UniCredit Bank Srbija a.d., Beograd.

The Bank is registered in the Republic of Serbia to provide banking services associated with payment transfers, lending and depositary activities in the country and abroad as well as other activities defined by Law on Banks and Articles of Association of the Bank.

In January 2016 the Bank became the sole owner of entities UniCredit Leasing Srbija d.o.o., Beograd and UniCredit Partner d.o.o., Beograd.

As of December 31, 2018, the Bank was comprised of the Head Office in Belgrade and 72 branch offices located in towns throughout the Republic of Serbia (December 31, 2017: 71 branch offices).

As of December 31, 2018, the Bank had 1,280 employees (December 31, 2017: 1,254 employees).

2. BASIS OF PREPARATION AND PRESENTATION OF THE FINANCIAL STATEMENTS AND ACCOUNTING CONVENTION

(a) *Basis of Preparation and Presentation of Financial Statements*

Legal entities and entrepreneurs incorporated in Serbia are required to maintain their books of account, to recognize and value assets and liabilities, income and expenses, and to present, submit and disclose financial statements in conformity the Law on Accounting (hereinafter referred to as: the "Law", Official Gazette of the Republic of Serbia no. 62/2013 and 30/2018). As a large legal entity, the Bank is required to apply International Financial Reporting Standards ("IFRS"), which as per the aforementioned law comprise the following: the Framework for the Preparation and Presentation of Financial Statements (the "Framework"), International Accounting Standards ("IAS"), International Financial Reporting Standards ("IFRS"), as well as the related interpretations issued by the International Financial Reporting Interpretations Committee ("IFRIC") and additional related interpretations issued by the International Accounting Standards Board ("IASB"), the translations of which to the Serbian language were approved and issued by the competent Ministry of Finance. In addition, in accordance with the Amendments and Supplements to the Law on Banks (Official Gazette of the Republic of Serbia no. 14/2015), upon preparation of the annual financial statements, banks in the Republic of Serbia are obligated to apply the International Financial Reporting Standards, subsequent revisions and amendments thereto and related interpretations as from their issue date by the competent authorities.

The accompanying financial statements are presented in the format prescribed under the Decision on the Forms and Contents of the Items in the Forms of the Financial Statements of Banks (Official Gazette of RS nos. 101/2017, 38/2018 and 103/2018).

The Bank separately prepares and presents its consolidated financial statements in accordance with the International Financial Reporting Standards. The Bank holds a sole (100%) equity interest in the subsidiaries UniCredit Leasing d.o.o., Beograd and UniCredit Partner d.o.o., Beograd. In the accompanying unconsolidated financial statements the Bank's equity investments in subsidiaries are stated at cost. The Bank's consolidated financial statements for 2018 were issued on February 14, 2019.

2. BASIS OF PREPARATION AND PRESENTATION OF THE FINANCIAL STATEMENTS AND ACCOUNTING CONVENTION (Continued)

(a) Basis of Preparation and Presentation of Financial Statements (Continued)

These financial statements were prepared at historical cost principle, except for the measurement of the financial assets and liabilities at fair value through profit or loss and financial assets at fair value through other comprehensive income in current year, i.e., financial assets and liabilities at fair value through profit or loss and financial assets available for sale in the previous year

Historical cost is generally based on the fair value of consideration paid in exchange for goods and services.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between the market participants at the measurement date under current market conditions regardless of whether that price is directly observable or estimated using another valuation technique. Upon estimating the fair value of assets or liabilities, the Bank takes into account characteristics of assets or liabilities that other market participants would also consider upon determining the price of assets or liabilities at the measurement date. Fair value for measurement and/or disclosure purposes in the accompanying financial statements was determined in the aforesaid manner, except for share-based payment transactions, which are in the scope of IFRS 2, leasing transactions, which are in the scope of IAS 17, and measurements that have some similarities to fair value but are not fair value, such as the net realizable value in IAS 2 or value in use in IAS 36.

In addition, for financial reporting purposes, fair value measurements are categorized into Level 1, 2 or 3 based on the degree to which the inputs to the fair value measurements are observable and the significance of the inputs to the fair value measurement in its entirety, which are described as follows:

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date;
- Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly; and
- Level 3 inputs are unobservable inputs for the asset or liability.

In the preparation of the accompanying financial statements, the Bank adhered to the accounting policies described in Note 3.

The Bank's financial statements are stated in thousands of dinars (RSD). Dinar is the official reporting currency in the Republic of Serbia.

Published standards/amendments to existing standards and interpretations that are effective in the current period are disclosed in note 2(b). Published standards/amendments to existing standards and interpretations that have not yet effective are disclosed in note 2(c).

(b) Application of new standards and amendments to the existing standards effective for the current year

In 2018 the Bank has adopted the following new standards and amendments to the existing standards which became effective for reporting periods on or after January 1, 2018:

- IFRS 9 "Financial Instruments";
- IFRS 15 "Revenue from Contracts with Customers" and interpretations;
- Amendments to IFRS 7 R "Financial instruments: Disclosures";
- Amendments to IFRS 4 "Insurance Contracts" - Applying IFRS 9 "Financial Instruments" with IFRS 4 "Insurance Contracts";
- IFRIC 22 "Foreign Currency Transactions and Advance Consideration";
- Amendments to IAS 40 "Investment Property" - Transfers of Investment Property;
- Amendments to IFRS 2 "Share-based Payment" - Classification and Measurement of Share-based Payment Transactions;
- Amendments to IFRS 1 and IAS 28 due to "Improvements to IFRSs (cycle 2014-2016)".

2. BASIS OF PREPARATION AND PRESENTATION OF THE FINANCIAL STATEMENTS AND ACCOUNTING CONVENTION (Continued)

(b) Application of new standards and amendments to the existing standards effective for the current year (Continued)

Below are detailed explanations of the effect of the application of IFRS 9 and IFRS 15 to the Bank's financial statements.

(i) IFRS 9: "Financial Instruments"

IFRS 9 replaces IAS 39 for reporting periods on or after January 1, 2018. As permitted by the standard, the Bank has chosen the option not to change comparative data for 2017. Accordingly, comparative data for 2017 are presented in accordance with IAS 39 and are therefore not comparable to data presented for 2018. The effects of adjusting the carrying amount of financial assets and liabilities at the date of first application of the standard are recognized through retained earnings as a correction of the opening balance for 2018 and are disclosed in Note 2(g).

Key requirements of IFRS 9:

o *Classification and Measurement of Financial Instruments*

IFRS 9 introduces significant changes in the classification and measurement of financial instruments in comparison with IAS 39.

The classification and measurement of financial assets, other than equity instruments and derivatives, is based on a business model based on which the Bank manages financial assets and characteristics of the contractual cash flows (SPPI criteria). The new standard introduces three basic categories of financial assets: financial assets at amortized cost, financial assets at fair value through other comprehensive income, and financial assets at fair value through profit or loss, thus replacing categories of financial assets under IAS 39 (loans and receivables, financial assets held-to-maturity, available-for-sale financial assets and financial assets at fair value through profit or loss). In addition, under IFRS 9, if the equity instrument is not held for trading, an irrevocable election may be made at initial recognition that such an instrument is measured at fair value through the other comprehensive income, whereby only dividend income is recognized in the income statement.

In relation to the classification and measurement of financial liabilities, IFRS 9 retains the basic requirements of IAS 39. However, in relation to the measurement of financial liabilities initially designated at fair value through profit or loss, IFRS 9 requires that the amount of the change in the fair value of a financial liability arising from a change in credit risk is shown in other comprehensive income, unless the presentation of the effect of a change in the credit risk of the liability would create or enlarge an accounting mismatch in the income statement. The changes in the fair value of liabilities attributable to credit risk are not subsequently reclassified to the income statement. According to IAS 39, the entire amount of a change in the fair value of the financial liability designated at fair value through profit or loss is recorded in the income statement.

o *Impairment of Financial Instruments*

In relation to impairment of financial assets, IFRS 9 requires the implementation of the expected credit loss model (ECL) as opposed to an incurred credit loss model in accordance with IAS 39. IFRS 9 requires the Bank to determine ECL for loans and other debt instruments other than instruments that are measured at fair value through profit or loss, as well as for financial guarantees and assumed irrevocable liabilities based on undrawn loans and commitments. In accordance with IFRS 9, credit losses are recognized earlier than in accordance with IAS 39, since it is no longer necessary for a credit event to occur before recognition of credit losses.

o *Hedge Accounting*

IFRS 9 introduced new rules for hedge accounting in relation to hedge relationship and testing hedge effectiveness. As permitted by the IFRS 9, the Bank has chosen to continue to apply IAS 39 in relation to hedge accounting.

Changes in accounting policies relating to classification and measurement, impairment of financial instruments and other requirements of IFRS 9 are presented in detail in Note 3(k). The quantitative effects of the first application of IFRS 9 as at January 1, 2018 are disclosed in Note 2(g).

2. BASIS OF PREPARATION AND PRESENTATION OF THE FINANCIAL STATEMENTS AND ACCOUNTING CONVENTION (Continued)

(b) Application of new standards and amendments to the existing standards effective for the current year (Continued)

(ii) IFRS 7 R "Financial instruments: Disclosures"

In order to disclose the differences between IFRS 9 and IAS 39, the existing IFRS 7 "Financial Instruments: Disclosures" has been amended, which the Bank has applied, together with IFRS 9, for the year beginning on January 1, 2018. Amendments include transitional disclosures as shown in Note 2(g), detailed qualitative and quantitative information on ECL calculation, such as assumptions and data used, are shown in Notes 3(k)(viii) and 4(b). The reconciliation of the final carrying amount of the impairment allowances in accordance with IAS 39 and the opening balance of the impairment allowances in accordance with IFRS 9 is presented in Note 2(g) (ii).

(iii) IFRS 15 "Revenue from Contract with Customers"

IFRS 15 is effective for the reporting periods on or after January 1, 2018, replacing the previous set of international accounting principles and interpretations on revenue recognition and, in particular, IAS 18.

IFRS 15 provides for:
• two approaches for the revenue recognition ("at point in time" or "over time");
• a new model for the analysis of the transactions ("five steps model") focused on the transfer of control; and
• a request for a more detailed disclosure to be included in the notes to the financial statements

The adoption of the new accounting standard could determine: (i) the reclassification between lines of income statement used for presenting revenues, (ii) changes in the timing recognition of such revenue, when the contract with the customer contains several performance obligation that must be accounted for separately under the accounting standard and/or (iii) a different measurement of revenue to reflect their variability.

Based on the analysis performed, no significant economic and financial impacts of the adoption of IFRS 15 have been identified.

(c) New standards and amendments to existing standards that have been issued but are not yet effective

On the date of the approval of these financial statements, the following standards, amendments to existing standards and new interpretations were issued but are not yet effective:

- IFRS 16 "Leases" (effective for annual periods beginning on or after January 1, 2019),
- IFRS 17 "Insurance Contracts" (effective for annual periods beginning on or after January 1, 2021),
- Amendments to IFRS 9 "Financial Instruments" - Prepayment Features with Negative Compensation (effective for annual periods beginning on or after January 1, 2019);
- Amendments to IAS 19 "Employee Benefits" - Plan Amendment, Curtailment or Settlement (effective for annual periods beginning on or after January 1, 2019);
- Amendments to IAS 28 "Investments in Associates and Joint Ventures" - Long-term Interests in Associates and Joint Ventures (effective for annual periods beginning on or after January 1, 2019);
- Amendments to various standards due to "Improvements to IFRSs (cycle 2015-2017)" (effective for annual periods beginning on or after January 1, 2019);
- IFRIC 23 "Uncertainty over Income Tax Treatments" (effective for annual periods beginning on or after January 1, 2019)
- Amendments to IFRS 3 "Business Combinations",
- Amendments to IAS 1 and IAS 8: "Material Definition",
- Amendments to IFRS Conceptual Framework.

The Bank's management has elected not to adopt these new standards, amendments to existing standards and new interpretations before they enter into force. The management anticipates that the adoption of these standards, amendments to existing standards and new interpretations will have no material impact on the financial statements of the Bank in the period of initial application, except for IFRS 16. The expected effects of the first application of IFRS 16 to the Bank's financial statements are explained in more detail below.

2. BASIS OF PREPARATION AND PRESENTATION OF THE FINANCIAL STATEMENTS AND ACCOUNTING CONVENTION (Continued)

(c) New standards and amendments to existing standards that have been issued but are not yet effective (Continued)

(i) Effects of the first application of IFRS 16 „Leases”

IFRS 16, effective from January 1, 2019, replaces the existing set of international accounting principles and interpretations on leasing, in particular IAS 17.

IFRS 16 introduces a new definition for leases. Accounting treatment of leasing contracts for lessor remains different for operating and financial leases. With reference to the accounting treatment to be applied by the lessee, the new accounting standard sets, for all the leasing typologies, the recognition as an asset. The asset is the right of use of the underlying asset and, at the same time, a liability for the future payments requested by the lease contract is recognized. At the initial recognition such asset is measured on the basis of the lease contract cash flows. After the initial recognition the right of use will be measured on the basis of the rules set for the assets by IAS 16, IAS 38 or by IAS 40 and, therefore, applying the cost model, less any accumulated depreciation and any accumulated impairment losses, the revaluation model or the fair value model as applicable.

The Bank has carried out activities aimed to ensure compliance with this standard, in particular with reference to the calculation and accounting for the right of use and lease liability, that represent the main difference compared to the current accounting model required by IAS 17. The activities aimed to the development of rules, principles and information systems to be used for the proper evaluation of new assets and liabilities and the subsequent calculation of the related economic effects are under finalization. The Bank has decided, as allowed by the Standard, not to apply IFRS 16 provisions to leases of intangible assets, short-term leases (leases with a shorter duration than 12 months), and low-value assets leases.

In order to calculate the lease liability and the related right of use asset, the Bank proceeds with discounting the future lease payments at a proper discount rate. In this respect, future lease payments to discount are determined based on contractual provisions and net of VAT as the obligation to pay such a tax starts when the invoice is issued by the lessor and not at the starting date of the lease contract. To perform the mentioned calculation lease payments have to be discounted at the interest rate implicit in the contract or, if it is not available, at the incremental borrowing rate. The latter is determined on the basis of the cost of funding for liabilities of similar duration and similar security of those implicit in the lease contract.

In determining the lease term it is necessary to consider the non-cancellable period, established in the contract, in which the lessee is entitled to use the underlying asset taking also into account potential renewal options if the lessee is reasonably certain to renew. In particular, with regard to those contracts that allows the lessee to renew the lease contract after a first set of years, the lease term is determined taking into account factors such as the length of the first period, the existence of dismissal plans for the asset leased and any other circumstance indicating the reasonable certainty of the renewal.

The Bank decided not to change the comparative data and, at the time of first application of IFRS 16, the value of the right of use would be equal to the lease liability. The effect of the first application of IFRS 16 on the Common Equity Tier 1 Capital ratio (CET 1) would be -0.29%.

(d) Comparative Information

Comparative information in the accompanying financial statements represents the data from the Bank's financial statements for 2017, prepared in accordance with IAS 39 (while financial statements for 2018 are prepared in accordance with IFRS 9).

(e) Use of Estimates

Preparation of the financial statements in accordance with IFRS requires the Bank's management to make the best possible estimates and reasonable assumptions that affect the application of the accounting policies and the reported amounts of assets and liabilities, as well as income and expenses. Actual amounts of assets and liabilities may vary from these estimates.
These estimations and underlying assumptions are subject to regular review. The revised accounting estimates are presented for the period in which they are revised as well as for the following periods.

(f) Statement of Compliance

The Bank's financial statements have been prepared in accordance with the International Financial Reporting Standards ("IFRS) issued by the International Accounting Standards Board ("IASB").

NOTES TO THE UNCONSOLIDATED FINANCIAL STATEMENTS
December 31, 2018
All amounts expressed in thousands of RSD, unless otherwise stated.

2. BASIS OF PREPARATION AND PRESENTATION OF THE FINANCIAL STATEMENTS AND ACCOUNTING CONVENTION (Continued)

(g) Transitional disclosure

Below are the effects of application of IFRS 9 to the Bank's financial statements.

(i) The adjustment of the net book value by category of financial instruments in accordance with IAS 39 and IFRS 9 as at January 1, 2018 is shown in the following table:

		New classification and measurement of financial instruments			Effect		
	December 31 2017	At fair value through profit or loss	At fair value through OCI - debt instruments	At amortized cost	Remeasurement of credit losses	Remeasurement based on reclassification	January 1st 2018
Cash and assets held with central bank	29,661,017	-	-	29,661,017	43	-	29,661,060
Receivables under derivatives	185,204	185,204	-	-	-	-	185,204
Securities							
Securities held to maturity	77,886	-	-	77,886	1,522	-	79,408
Securities held for trading	2,095,845	2,095,845	-	-	-	-	2,095,845
Securities available for sale	82,171,636	-	82,171,636	-	-	-	82,171,636
Loans and receivables from banks and other financial organizations	11,825,650	-	-	11,825,650	(2,126)	-	11,823,524
Loans and receivables from clients	232,553,107	-	-	232,553,107	(135,875)	-	232,417,232
Change in fair value of hedged items	192,251	192,251	-	-	-	-	192,251
Receivables under hedging derivatives	9,195	9,195	-	-	-	-	9,195
Investments in subsidiaries *	112,644	-	-	-	-	-	112,644
Intangible assets *	1,162,458	-	-	-	-	-	1,162,458
Property, plant and equipment *	1,551,389	-	-	-	-	-	1,551,389
Investment property*	1,364	-	-	-	-	-	1,364
Deferred tax assets *	171,179	-	-	-	-	-	171,179
Other assets	977,727	-	-	977,727	(1,223)	(4,992)	971,512
Total assets	**362,748,552**	**2,482,495**	**82,171,636**	**275,095,387**	**(137,659)**	**(4,992)**	**362,605,901**

* Balance sheet positions that are not subject to classification and measurement in accordance with IFRS 9.

NOTES TO THE UNCONSOLIDATED FINANCIAL STATEMENTS
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All amounts expressed in thousands of RSD, unless otherwise stated.

2. BASIS OF PREPARATION AND PRESENTATION OF THE FINANCIAL STATEMENTS AND ACCOUNTING CONVENTION (Continued)

(g) Transitional disclosure (continued)

		New classification and measurement of financial instruments			Effect		
	December 31 2017	At fair value through profit or loss	At fair value through OCI - debt instruments	At amortized cost	Remeasurement of credit losses	Remeasurement based on reclassification	January 1 2018
Liabilities under derivatives	207,003	207,003	-	-	-	-	207,003
Deposits and other liabilities to banks, other financial organisations and central bank	99,533,573	-	-	99,533,573	-	-	99,533,573
Deposits and other financial liabilities to clients	186,658,833	-	-	186,658,833	-	-	186,658,833
Liabilities under hedging derivatives	448,794	448,794	-	-	-	-	448,794
Subordinated liabilities	2,718,490	-	-	2,718,490	-	-	2,718,490
Provisions	1,072,531	-	-	1,072,531	(6,428)	-	1,066,103
Current tax liabilities *	178,821	-	-	-	-	-	178,821
Other obligations	2,590,012	-	-	2,590,012	-	-	2,590,012
Capital							
Share capital*	24,169,776	-	-	-	-	-	24,169,776
Profit*	6,633,319	-	-	-	(450,413)[1)]	(4,992) [2)]	6,177,914
Reserve*	38,537,400	-	-	-	319,182	-	38,856,582
Total liabilities	362,748,552	655,797	-	292,573,439	(137,659)	(4,992)	362,605,901

* Balance sheet positions that are not subject to classification and measurement in accordance with IFRS 9.

The total effect of the first application of the standard amounts to RSD 455,405 thousand against the retained earnings of which:
1) The effect from the measurement of credit losses in accordance with the "expected loss" model under IFRS 9 instead of the "incurred loss" model according to IAS 39 amounts to RSD 450,413 thousand;
2) The effect on the reclassification and measurement of other equity investments amounts to RSD 4,992 thousand. Namely, the Bank has no change in the method of classification and measurement of financial instruments except other equity investments that the Bank measures at fair value through other comprehensive income. However, as the Bank estimates that the "cost" method is the best approximation of fair value, they are carried by "cost" i.e. at net present value as at December 31, 2017 was zero. For the amount of RSD 4,992 thousand, the impairment loss was reversed in favor of retained earnings, and in the same amount, the adjustment of the value of investments was carried out within retained earnings, so, cumulatively, there is no effect.

All amounts expressed in thousands of RSD, unless otherwise stated.

2. BASIS OF PREPARATION AND PRESENTATION OF THE FINANCIAL STATEMENTS AND ACCOUNTING CONVENTION (Continued)

(g) *Transitional disclosure (Continued)*

(ii) Reconciliation of the carrying amount of the impairment allowance under IAS 39 and the opening balance of impairment allowance under IFRS 9 is given in the following table:

		New classification and measurement of financial instruments			Effect		
	December 31 2017	At fair value through profit or loss	At fair value through OCI - debt instruments	At amortized cost	Remeasurement of credit losses	Remeasurement based on reclassification	January 1 2018
Cash and assets held with central bank	196	-	-	196	(43)	-	153
Securities							
Securities held to maturity	1,648	-	-	1,648	(1,522)	-	126
Securities held for trading	-	-	-	-	-	-	-
Securities available for sale	-	-	-	-	319,182[1)]	-	319,182
Loans and receivables from banks and other financial organizations	8,517	-	-	8,517	2,126	-	10,643
Loans and receivables from clients	9,373,710	-	-	9,373,710	135,875	-	9,509,585
Other assets	32,412	-	-	32,412	1,223	-	33,635
Total assets	9,416,483	-	-	9,416,483	456,841	-	9,873,324
Provisions for losses on off-balance sheet items	324,841	-	-	-	(6,428)[2)]	-	318,413
Total effect of the first application of IFRS 9	-	-	-	-	450,413	-	-

The Bank recognized the effects of credit loss measurement in accordance with IFRS 9 in the total amount of RSD 450,413 thousand which were recorded:
1) against the retained earnings amount of RSD 137,659 thousand relating to financial assets measured at amortized cost and RSD 319,182 thousand relating to securities measured through other comprehensive income;
2) in favour of retained earnings amount of RSD 6,428 thousand relating to off-balance sheet items.

NOTES TO THE UNCONSOLIDATED FINANCIAL STATEMENTS
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All amounts expressed in thousands of RSD, unless otherwise stated.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting policies of Bank according to IFRS 9 applied for current year and the accounting policies according to IAS 39 applied for previous year, are explained in detail below.

(a) Consolidation

The Bank holds sole (100%) equity interests in entities UniCredit Leasing Srbija d.o.o., Beograd and UniCredit Partner d.o.o., Beograd. Equity investments in subsidiaries are presented at cost in these unconsolidated financial statements. The Bank prepares and issues consolidated financial statements separately.

(b) Going Concern

The Bank's financial statements have been prepared under going concern assumption, which entails that the Bank will continue its operations for an indefinite period in the foreseeable future.

(c) Foreign Exchange Translation

Transactions denominated in foreign currencies are translated into dinars at official exchange rates effective at the date of each transaction.

Monetary assets and liabilities denominated in foreign currencies, as well as those indexed to a currency clause, are translated into dinars by applying the official exchange rates prevailing at the reporting date.

Foreign exchange positive or negative effects arising upon the translation of transactions during the year, and translation of the assets and liabilities denominated in foreign currencies at the reporting date, are credited or charged to the Bank's income statement as net foreign exchange gains or losses and positive/negative currency clause effects.

The official middle exchange rates determined by the National Bank of Serbia and applied in the translation of the statement of financial position components into dinars for the following major currencies were as follows:

	31.12.2018.	31.12.2017.
USD	103.3893	99.1155
EUR	118.1946	118.4727
CHF	104.9779	101.2847

(d) Interest income and expense

(i) The effective interest method

According to IFRS 9 and IAS 39, interest income and expense is recognized in the income statement in the period to which they relate and are calculated using the effective interest method for all interest bearing financial instruments measured at amortized cost and at fair value through profit or loss. Interest income on financial assets at fair value through other comprehensive income under IFRS 9, similar to financial assets that were classified as available-for-sale or held to maturity under IAS 39, are also accounted for using the effective interest method.

The effective interest rate is the rate at which future cash flows are discounted over the expected life of the financial asset or liability (or, where appropriate, for a short period) to its present value. When calculating the effective interest rate, the Bank estimates future cash flows taking into account all contractual terms relating to a financial instrument, but not future losses that may arise.

The calculation of the effective interest rate includes all paid or received fees and transaction costs, which are an integral part of the effective interest rate.

Transaction costs are costs directly attributable to the acquisition or the issuance of a financial asset or liability. These include fees and commissions paid to agents, advisers, brokers and dealers, fees from regulatory agencies and stock exchanges, as well as taxes and fees related to the transfer. Transaction costs do not include premiums or discounts, financing costs or internal administrative costs or maintenance costs. Only transaction costs that are certain or determinable are included in the amortized cost at the initial recognition of a financial asset. If the Bank receives a fee from a client that offsets similar charges paid by the Bank, only the net amount is included in the amortized value of the asset. If transaction costs are not material compared to the fair value of the related financial asset at initial recognition, they can be recognized as cost/income of a period.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(d) Interest income and expense (Continued)

(i) The effective interest method (continued)

Fees that are integral part of the effective interest rate of a financial instrument include:
a) "origination fee" - fee charged by the Bank in connection with the issuance or acquisition of a financial asset. Such fees include fees for evaluation of the financial position of the borrower, evaluating and recording guarantees, collateral and other security arrangements, negotiating the terms of the instrument, preparing and processing documents and closing the transaction,
b) "commitment fee" - fee received for the issue of a loan when it is probable that the loan arrangement will be realized,
c) "origination fee" - fees payable on the basis of the issue of financial liabilities that are measured at amortized cost.

The Bank calculates interest income by using the effective interest rate on the gross carrying amount of financial assets other than those that are credit-impaired. Regular interest income from impaired financial assets is calculated based on the net value of the financial asset using the effective interest rate method. Calculation of penalty interest income from impaired financial assets is suspended from the moment when the client becomes credit-impaired and recorded therefrom within off-balance sheet items, except for a portion of the legal penalty interest on written-off placements without debt acquittal, where the Bank decided to cease further calculation and recording of interest within the off-balance sheet items as from the moment of write-off of loans without debt acquittal.

Impaired loans and receivables are those loans and receivables to clients who are in the status of default (internal ratings 8-, 9 and 10), i.e. classified in Stage 3 under IFRS 9. If the status of the financial asset is improved in the sense that it is no longer impaired Bank returns to the calculation of interest income on a gross basis. For financial assets classified under IFRS 9 in "purchased or originated credit - impaired", the Bank calculates interest income using credit-adjusted effective interest rate on amortized cost of the asset. Credit-adjusted effective interest rate is the interest rate that, on initial recognition, discounts expected cash flows including credit losses to the amortized value of the POCI financial asset.

(ii) Presentation

Interest income and expenses recognized in profit or loss include:

- interest on financial assets and financial liabilities that are measured at amortized cost calculated using the effective interest rate method;
- interest on securities measured at fair value through other comprehensive income (i.e. available for sale financial assets in accordance with IAS 39) calculated using the effective interest rate method; and
- interest on coupon securities held for trading.

Interest income and expense from all trading assets and liabilities (other than interest on coupon securities) are deemed secondary to the trading activities of the Bank and are presented together with all other changes in the fair value of trading assets and liabilities within net gains on financial assets held for trading.

(e) Fee and Commission Income and Expenses

Fee and commission income and expenses that are integral parts of the effective interest rate of a financial asset or liability are included in the calculation of the effective interest rate and therefore stated within interest income and expenses.

Fees that are not integral part of the effective interest rate of a financial instrument and are accounted for in accordance with IFRS 15 include:
a) fees charged for the servicing of a loan ("monitoring" or "management" fee);
b) "commitment fee" - fee for issuing loans when it is unlikely that the loan arrangement will be realized; and
c) loan syndicated fees received by the Bank as a transaction agent/arranger.

In accordance with IFRS 15, two approaches for the recognition of fee and commission income are provided: "at point in time" and "over time". Fee and commission income includes revenues from international and domestic payment services, issuance of guarantees, letters of credit and other banking services.

Fee and commission expenses mostly relate to fees for transactions and services provided and are recorded upon receipt of services.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(f) Net Gains/Losses from Change in Fair value of Financial Instruments

Net gains/losses from change in the fair value of financial instruments include the effects of adjusting the fair value of derivatives, except hedging derivatives, as well as the effects of adjusting the fair value of financial assets and financial liabilities carried at fair value through profit or loss.

(g) Net Gains/Losses from Derecognition of the Financial Instruments measured at Fair value

Net gains/losses from derecognition of the financial instruments measured at fair value include the effects of the derecognition of financial assets and financial liabilities measured at fair value through profit or loss, as well as financial assets measured at fair value through other comprehensive income.

(h) Net Gains/Losses from Hedging

Net gains/losses from hedging include net/losses on changes in fair value of hedging derivatives as well as changes in fair value of loans, receivables and securities as hedged items arising from the risks against which the items are hedged.

(i) Net Gains/Losses from Derecognition of the Financial Instruments measured at Amortised Cost

Net gains/losses from derecognition of the financial instruments measured at amortised cost include the effects arising from derecognition of financial assets at amortized cost.

(j) Income Tax Expenses

Tax expense comprises current taxes and deferred taxes. Current taxes and deferred taxes are recognized in profit or loss except to the extent that they relate to items recognized directly in equity or in other comprehensive income.

(i) Current Income Tax

Current tax is expected tax payable or receivable on the taxable income for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to the tax payable in respect of previous years. Current income tax represents an amount calculated in accordance with the Republic of Serbia Corporate Income Tax Law. The prescribed tax rate for 2018 equals 15%. The taxable base is the profit before taxes shown in the statutory statement of income and adjusted for differences that are specifically defined under statutory tax rules of the Republic of Serbia.

The Corporate Income Tax Law was amended at the end of 2018, while the majority of changes relating to the determination, calculation and payment of taxes is applicable starting from 2019.

Exceptionally, the new rules provided in Article 25a of the Law are applicable from the date of entry into force of the Law, i.e. to the determination, calculation and payment of income tax for 2018. The amendment applied in determining the income tax for 2018, which is significant for determining the taxable profit of the Bank for 2018, is:

- recognition of the effects of the first-time adoption of IFRS, based on which correction of opening balance in the Statement of financial position is done, i.e. it is included as income and expenses in the tax balance.

(ii) Deferred Income Taxes

Deferred income tax is recognized in respect of temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Deferred taxes are measured at the tax rates that are expected to be applied to the temporary differences when they reverse, based on the laws that have been enacted by the reporting date.
Based on their future tax consequences, temporary differences can be:
• taxable temporary differences, which will result in taxable amounts in determining taxable profit (tax loss) of future periods when the carrying amount of the asset is recovered or liability is settled in accordance with the appropriate tax regime, or
• deductible temporary differences that will result in amounts that can be deducted in determining the taxable profit (tax loss) of the future period in which the carrying amount of the asset will be recovered or the liability settled in accordance with the appropriate tax regime.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(j) Income Tax Expenses

(iii) Other Taxes and Contributions

According to the relevant legislation in the Republic of Serbia, the Bank pays various taxes, contributions, and duties, such as property tax, payroll contributions charged to the employer and other public duties. These are included under other expenses within the income statement.

(k) Financial Assets and Liabilities

(i) Recognition and Initial Measurement

The Bank initially recognizes financial assets and liabilities at the settlement date.

A financial asset or liability is measured initially at fair value plus transaction costs that are directly attributable to its acquisition or issue, except for financial assets and liabilities at fair value through profit or loss, whose measurement does not include these costs.

(ii) Classification and Subsequent Measurement

Financial assets

Until January 1, 2018, in accordance with IAS 39, the Bank classified its financial assets and liabilities into the following categories:
- loans and receivables;
- held-to-maturity financial assets;
- financial assets and liabilities at fair value through profit or loss; and
- financial assets available for sale.

Please refer to accounting policies 3(o) and 3(p).

From January 1, 2018, in accordance with IFRS 9, the Bank classified financial assets at initial recognition into the following categories:
- financial assets at amortized cost,
- financial assets at fair value through other comprehensive income, and
- financial assets at fair value through profit or loss.

The requirements regarding the classification of debt and equity instruments are described below:

Debt instruments

Debt instruments are those instruments that fulfil the definition of a financial liability from the perspective of the issuer, such as loans, securities, and other similar receivables.

Classification and measurement of debt instruments depend on two basic criteria:
1) the business model for managing the financial asset and
2) characteristic of contractual cash flows of a financial asset (the so-called SPPI criteria).

<u>Business model</u>
The business model reflects the way in which the Bank manages its financial assets in order to generate cash flows. This implies an assessment of whether the Bank's objective is to collect cash flows from the holding of a financial asset or the purpose is to generate cash flows both on the basis of holding and on the basis of the sale of a financial asset. If neither of these is applicable (e.g. a financial asset held for trading), the financial asset is held in the "other" business model and classified at fair value through profit or loss. The business model assessment is performed at the level of a group of financial assets such as portfolio or sub portfolio level, taking into account all relevant and objective information such as sales of assets that were realized in the past, management's intentions regarding future sales, risk management, valuation performance of assets and their reporting to management and others. The assessment of the business model is based on realistic future expectations. Reclassification of a financial asset is made if the business model under which the asset is managed is changed. The Bank does not expect frequent changes in business models.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(k) Financial Assets and Liabilities (continued)

(ii) Classification and subsequent measurement (continued)

Financial assets (continued)

SPPI criteria

If a business model is to hold asset to collect contractual cash flows or to both collect cash flows and sell financial assets, the Bank assesses whether the contractual cash flows of the financial asset represent only the principal and interest payment ("SPPI test"). For the purpose of this assessment, "principal" is defined as the fair value of a financial asset at the date of initial recognition. "Interest" is defined as consideration for the time value of money, the accepted level of credit risk of the borrower, other basic lending risks as well as profit margin. If the contractual terms of a financial asset include exposure to risks that are not in accordance with the underlying loan arrangement, a financial asset is classified and measured at fair value through profit or loss.

Based on the above criteria, debt instruments are classified into the following asset categories:

1) Financial assets at amortized cost
A financial asset that is held under a business model whose objective is to hold financial assets in order to collect contractual cash flows and contractual cash flows represent only the payment of principal and interest, and is not irrevocably classified as financial asset at fair value through profit or loss, is measured at amortized cost. The amortized value of these financial assets is subsequently adjusted for estimated impairment as explained in Note 3(k)(viii). Interest income from these financial assets is recognized using effective interest rate method and is included in the "Interest Income" position in the income statement.

2) Financial assets at fair value through other comprehensive income
A financial asset that is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets and whose contractual cash flows represent only the payment of principal and interest, and is not irrevocably classified as financial asset at fair value through profit or loss, is valued at fair value through other comprehensive income. The effects of the change in fair value in the subsequent measurement of these assets are recorded in the other comprehensive income. As with financial assets at amortized cost, the impairment, interest income and foreign exchange gains/losses are recognized in the income statement. Upon derecognition, cumulative gains and losses previously recognized in the other comprehensive income, are reclassified and reported within the line item "Net gains/losses from derecognition of financial assets measured at fair value" in the income statement. Interest income from these financial assets is recognized at the effective interest rate method and is included in the "Interest Income" position in the income statement.

3) Financial assets at fair value through profit or loss
A financial asset that does not meet the criteria for classification at amortized cost or at fair value through other comprehensive income is measured at fair value through profit or loss.
In addition, in this group of financial assets are classified:
• held for trading financial assets if they are acquired for purpose of selling or repurchasing it in the near term or when they are initially recognized as part of a portfolio of financial instruments that are managed together in order to achieve short-term profit;
• the financial assets that the Bank, upon initial recognition, designates at fair value through profit or loss, independently of the business model and cash flow characteristics, with the aim of eliminating or significantly reducing the so-called "accounting mismatch".
Subsequent changes in fair value of these assets are recorded through profit or loss within the line item "Net gain/loss on the change in the fair value of financial instruments". Interest income from coupon funds held for trading is recognized at the effective interest rate method and included in the "Interest Income" position in the income statement.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(k) Financial Assets and Liabilities (continued)

(ii) Classification and subsequent measurement (continued)

Financial assets (continued)

Equity instruments

Equity instruments are instruments that fulfil the definition of equity from the issuer's perspective, or instruments that do not contain the contractual obligation of payment and represent a share in the net assets of the issuer. The Bank's equity instruments are measured at fair value through other comprehensive income, except when they are traded, in which case they are measured at fair value through profit or loss. Such a classification is done for each equity instrument individually. Equity instruments at fair value through other comprehensive income are recognized initially at fair value plus transaction costs directly attributable to their acquisition, unless the Bank assesses in some cases that the cost is the best estimate of fair value.

The effects of the change in the fair value of equity instruments that are measured at fair value through other comprehensive income in subsequent measurement are recognized in the other comprehensive income and are never reclassified to the income statement, even if asset is derecognized. The provisions of IFRS 9 regarding impairment of financial assets relate only to debt instruments. For equity instruments at fair value through other comprehensive income, the effects of impairment are not recognized through the income statement, but all changes in fair value are recorded through other comprehensive income. Dividends are recognized in the position "Other operating income" in the income statement when the Bank's right to receive a dividend is established.

Effects of a change in the fair value of equity instruments at fair value through profit or loss are recorded under the item "Net gains on the change in the fair value of financial instruments" in the income statement.

Financial liabilities

There were no changes in the classification of financial liabilities as of January 1, 2018. The Bank classifies financial liabilities, except for irrevocable commitments for loans and financial guarantees, as liabilities measured at amortized cost or as fair value through profit or loss (see Note 3(u)).

Financial liabilities at fair value through profit or loss include derivatives, financial liabilities held for trading (e.g. short positions in a trading book) and other financial liabilities that are designated at fair value through profit or loss on initial recognition. However, in relation to the measurement of financial liabilities initially designated at fair value through profit or loss, IFRS 9 requires that the changes in fair value of a financial liability that relate to changes in the Bank's own credit risk are presented in other comprehensive income, unless the presentation of the effect of the change in credit risk of the liability would cause or increase accounting inconsistency in the income statement. The changes in the fair value of liabilities arising from credit risk are not subsequently reclassified to the income statement.

(iii) Derecognition

Financial assets

The Bank derecognizes a financial asset when:
• the contractual rights to the cash flows from the financial asset expire;
• when the Bank transfers substantially all the risk and rewards of the financial asset or a it neither transfers nor retains substantially all the risk and rewards of ownership of the financial asset but does not retain control over a financial asset;
• significantly modified contractual terms of a financial asset (see Note 3(k)(iv)).

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(k) Financial Assets and Liabilities (continued)

(iii) Derecognition (continued)

Financial assets (continued)

On derecognition of a financial asset, the difference between the carrying amount of the asset (or the carrying amount allocated to the portion of the asset transferred), and the sum of the consideration received (including any new asset obtained less any new liability assumed) and any cumulative gain or loss that had been recognized in other comprehensive income is recognized in profit or loss.

The Bank enters in transactions whereby it transfers assets recognized on its statement of financial position, but retains either all or substantially all of the risks and rewards of the transferred assets or a portion of them. If all or substantially all risks and rewards are retained, then the transferred assets are not derecognized. Transfers of assets with retention of all or substantially all risks and rewards include, for example, repurchase transactions.

When assets are sold to a third party with a concurrent total rate of return swap on the transferred assets, the transaction is accounted for as a secured financing transaction similar to repurchase transactions as the Bank retains all or substantially all the risks and rewards of ownership of such assets.

In transactions in which the Bank neither retains nor transfers substantially all the risk and rewards of ownership of a financial asset and it retains control over the asset, the Bank continues to recognize the asset to the extent of its continuing involvement, determined by the extent to which it is exposed to changes in the value of transferred asset.

Financial liabilities

The Bank derecognizes a financial liability when its contractual obligations are discharged or cancelled or have expired.

(iv) Modification

Derecognition due to significant modification of contractual terms

In cases of change in contractual terms, the Bank assesses whether cash flows have been significantly modified. If the cash flows of a financial asset/liability are significantly modified in relation to originally contracted, asset/liability is derecognized and new financial asset/liability is recognized at fair value increased for eventual transaction costs. Any difference between the carrying amount of the existing asset/liability and fair value of a new financial asset/liability is recognized in the income statement within the “Net gains/losses from derecognition of the financial instruments recognized at fair value” and “Net gains/losses from derecognition of the financial instruments recognized at amortised cost”.

From January 1, 2018, under significant modification of cash flows, the Bank considers: changes of contracts due to commercial reasons that are in accordance with market conditions, changes in currency or debtor, as well as changes that introduce contractual provisions that lead to non-compliance with the SPPI criteria. In accordance with IFRS 9, a new financial asset is classified in Stage 1 for ECL measurements, unless it is asset which represents POCI (Purchased or originated credit impaired).

Modifications of a financial asset that do not lead to derecognition

Amendments to the contracts due to the financial difficulties of the borrower are not considered significant modification and do not lead to derecognition of a financial asset.

In accordance with IFRS 9, from January 1, 2018, the Bank determines the new gross carrying amount of a financial asset and recognizes Modification gain/loss in the income statement (position “Net income/expenses on impairment of financial assets not recognised at fair value through income statement”). The gross carrying amount of the financial asset is classified as the present value of the modified cash flows discounted at the original effective interest rate. Eventual transaction costs adjust the carrying amount of a modified financial asset and are amortized over its useful life.

Until January 1, 2018, changes in contractual terms due to the financial difficulties of the debtor influenced the calculation of impairment that was measured using the original interest rate and the effects were recorded as expenses/income on the basis of impairment.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(k) Financial Assets and Liabilities (continued)

(v) Offsetting

Financial assets and liabilities are offset and the net amount presented in the statement of financial position only when the Bank has a legal right to set off the recognized amounts and when it intends to settle liabilities on a net basis or to simultaneously realize the asset and settle the obligation.

Income and expenses are disclosed by net principle only in cases where it is permitted under IFRS or for gains and losses arising from a group of similar transactions such as in the Bank's trading activity.

(vi) Amortized Cost Measurement

The amortized cost of a financial asset or liability is the amount at which the financial asset or liability is measured at initial recognition, minus principal repayments, plus or minus the cumulative amortization using the effective interest method of any difference between the initial amount recognized and the maturity amount, less any reduction for impairment.

(vii) Fair Value Measurement

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction in the principal (or most advantageous) market at the measurement date under current market conditions regardless of whether that price is directly observable or estimated using another valuation technique.

When available, the Bank measures the fair value of an instrument using quoted prices in an active market for that instrument. A market is regarded as active if quoted prices are readily and regularly available and represent actual and regularly occurring market transactions on an arm's length basis.

If a market for a financial instrument is not active, the Bank establishes fair value using a valuation technique. Valuation techniques include using recent arm's length transactions between knowledgeable, willing parties (if available), reference to the current fair value of other instruments that are substantially the same, discounted cash flow analyses and other optional models. The chosen valuation technique makes maximum use of market inputs, relies as little as possible on estimates specific to the Bank, incorporates all factors that market participants would consider significant in setting a price, and is consistent with accepted economic methodologies for pricing financial instruments.

Inputs to valuation techniques reasonably represent market expectations and measures of the risk-return factors inherent in the financial instrument. The Bank calibrates valuation techniques and tests them for validity using prices from observable current market transactions for the same instrument, based on other available observable market data.

Assets and long positions are measured at a bid price and liabilities and short positions are measured at an asking price. When the Bank has position with offsetting risks, mid-market prices are used to measure the offsetting risk positions and a bid or asking price adjustment is applied only to the net open position as appropriate. Fair values reflect the credit risk of the instrument and include adjustments for the credit risk of the Bank and counterparty where appropriate. Fair value estimates obtained from models are adjusted for any other factors, such as liquidity risk or model uncertainties to the extent that the Bank believes a third-party market participant would take them into account in pricing a transaction.

The best evidence of the fair value of a financial instrument at initial recognition is the transaction price, i.e. the fair value of the consideration given or received. However, in some cases, the fair value of that instrument is evidenced by comparison with other observable current market transactions for the same instrument (i.e., without modification or repackaging) or based on a valuation technique whose variables include only data from observable markets, then the difference is recognized in profit or loss on initial recognition of the instrument. In other cases the difference is not recognized in profit or loss immediately but is recognized over the life of the instrument on an appropriate basis or when the instrument is redeemed, transferred or sold, or the fair value becomes observable.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(k) Financial Assets and Liabilities (continued)

(viii) Impairment Identification and Measurement

Impairment Identification and Measurement (accounting policy effective for periods starting from January 1, 2018)

In accordance with IFRS 9, upon impairment of financial instruments existence of objective evidence of impairment is not necessary for recognition of credit losses. Expected credit losses are also recognized for unimpaired financial assets. In other words, the Bank calculates provisions for credit losses for all credit exposures other than those already measured at fair value through profit or loss (including both performing and non-performing financial assets).

Expected credit losses are recalculated on each reporting date in order to reflect the changes occurred in credit risk since the initial recognition of a financial instrument. Such an approach results in earlier recognition of credit losses as it is necessary to recalculate losses over a 12-month period for all credit exposures (the so-called Stage 1). It is necessary to recalculate lifetime expected credit losses for all exposures that have significant increase in credit risk (so-called Stage 2).

In calculating the expected credit losses, the Bank uses future information and macroeconomic factors, i.e. the Bank does not only consider historical information adjusted to reflect the effects of the present conditions and information providing objective evidence of the financial asset being impaired or actual losses incurred, but are also consider reasonable and supportable information as well, which include projections of future economic conditions in calculation of expected credit losses, both at individual and at collective levels. The amount of provisions for credit losses will increase with deterioration of the projected economic conditions and decrease with their improvement.

<u>Basic principles and rules of the Bank in calculating of provisions under IFRS 9</u>

The Bank calculates a twelve-month expected credit loss or lifetime expected credit loss of financial instrument, depending on the significance of a change in its credit risk since its initial recognition.

For these purposes, the Bank applies the following three stages of impairment:

• Stage 1 includes all new financial assets at initial recognition and instruments without significant credit quality deterioration since their initial recognition or instruments within the low credit risk category;
• Stage 2 includes financial instruments with significant credit quality deterioration since their initial recognition, with no objective evidence of impairment loss;
• Stage 3 includes financial assets where there is objective evidence of impairment at the reporting date.

Stage 1 and 2 include only performing financial assets. Stage 3 includes only non-performing financial assets.

For financial instruments at Stage 1, the 12-month expected credit losses are calculated.
For financial instruments at Stage 2, lifetime expected credit losses are calculated.
For financial instruments at Stage 3, lifetime expected credit losses are calculated and interest income is calculated on the net exposure.

Transfer of financial assets from Stage 1 to Stage 2 is carried out when the credit risk of financial assets has increased significantly since the moment of initial recognition. Transfer logic is based on quantitative and qualitative criteria and must be applied to all financial instruments. The probability of default (PD) is the main element on which the quantitative logic transfer criterion is based.

The four additional qualitative criteria that come after applying the quantitative criterion are:
• Classification in the status of restructured performing exposures (i.e. Forbearance classification) results in an automatic classification in Stage 2 for the next 9 months (beginning from the date of classification into that status). After that period, if there are no other significant signs of credit risk deterioration, the transaction may be returned to Stage 1;
• 30 days past due - when the transaction reaches 30 days of delay, it should be recognized at Stage 2;
• All performing exposures that are classified on watch list 2 are classified into Stage 2;
• All performing exposures assigned under the responsibility of the restructuring department are automatically classified into Stage 2.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(k) Financial Assets and Liabilities (continued)

(viii) Impairment Identification and Measurement (continued)

Impairment Identification and Measurement (accounting policy effective for periods starting from January, 1 2018) (continued)

In the impairment process, the Bank separately treats the purchase of already impaired assets of the so-called non-performing or NPL portfolios, or the approval of new loans to clients that are already impaired i.e. already have NPL status. Such assets are in accordance with the standard defined as so-called POCI (Purchased or originated credit impaired assets) and are separately measured by recognizing cumulative changes in lifetime expected credit losses since initial recognition. Favourable changes in lifetime expected credit losses are recognized as an impairment gain, if the lifetime expected credit losses are less than the amount of expected credit losses that were included in the estimated cash flows at initial recognition. Having in mind the business model, the Bank currently does not have identified assets in its portfolio that would be considered as POCI assets, i.e. there is no purchased NPL portfolio or additional materially significant financing of already existing NPL clients in its portfolio.

Impairment Identification and Measurement (accounting policy effective for periods until January 1, 2018)

At each reporting date the Bank assesses whether there is objective evidence that financial assets not carried at fair value through profit or loss are impaired. A financial asset or a group of financial assets are impaired when objective evidence demonstrates that a loss event has occurred after the initial recognition of the asset, and that the loss event has an impact on the future cash flows on the asset that can be estimated reliably.

Objective evidence that financial assets (including equity securities) are impaired can include significant financial difficulty of the borrower or issuer, default or delinquency by a borrower, restructuring of a loan or a receivable by the Bank on terms that the Bank would not otherwise consider, indications that a borrower or issuer will enter bankruptcy, the disappearance of an active market for a security, or other observable data relating to a group of assets such as adverse changes in the payment status of borrowers or issuers in the group, or economic conditions that correlate with defaults in the group. In addition, for an investment in an equity security, a significant or prolonged decline in its fair value below its cost is objective evidence of impairment.

The Bank considers evidence of impairment for loans and receivables and held-to-maturity investment securities at both a specific asset and collective level. All individually significant loans and receivables and held-to-maturity investment securities are assessed for specific impairment. All individually significant loans and receivables and held-to-maturity investment securities found not to be specifically impaired are then collectively assessed for any impairment that has been incurred but not yet identified. Loans and receivables and held-to-maturity investment securities that are not individually significant are collectively assessed for impairment by grouping together loans and receivables and held-to-maturity investment securities with similar characteristics.

In assessing collective impairment the Bank uses statistical modelling of historical trends of the probability of default, timing of recoveries and the amount of loss incurred, adjusted for management's judgment as to whether current economic and credit conditions are such that the actual losses are likely to be greater or less than suggested by historical modelling. Default rates, loss rates and the expected timing of future recoveries are regularly benchmarked against actual outcomes to ensure that they remain appropriate.

Impairment losses on assets carried at amortized cost are measured as the difference between the carrying amount of the financial asset and the present value of estimated future cash flows discounted at the asset's original effective interest rate. Impairment losses are recognized in profit or loss and reflected in an allowance account against loans and receivables. When a subsequent event causes the amount of impairment loss to decrease, the decrease in impairment loss is reversed through profit or loss.

Impairment losses on available-for-sale investment securities are recognized by transferring the cumulative loss that has been recognized in other comprehensive income to profit or loss as a reclassification adjustment. The cumulative loss that is reclassified from other comprehensive income to profit or loss is the difference between the acquisition costs, net of any principal repayment and amortization, and the current fair value, less any impairment loss previously recognized in profit or loss. Changes in impairment provisions attributable to time value are reflected as a component of interest income.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(k) Financial Assets and Liabilities (continued)

(ix) Write-off

The accounting policy related to the write-off of loans and receivables has not changed after the adoption of IFRS 9.

When certain financial assets are determined to be irrecoverable, these are written off. Write-off of a financial asset represents derecognition of such asset in the statement of financial position, where write-off of financial asset without debt acquittal, i.e. accounting write-off is distinguished from write-off with debt acquittal.

Financial assets are written-off without debt acquittal in instances where the Bank has estimated that asset will not be collected, but does not waive its contractual and legal rights in respect of the asset except for a portion of the legally prescribed penalty interest to the accrual of which the Bank would still be entitled even after the conducted write-off without debt acquittal, where the Bank has decided to cease further calculation and recording of interest as from the moment of such write-off. In these cases, the Bank estimates that it is economically justified to undertake further activities related to the collection of a financial asset (except for the aforementioned interest whose settlement and recording is suspended). Write-off without debt acquittal is recognized based on decisions from competent authorities and/or NBS decisions for financial assets with low collectability level that are completely impaired (100% written-down). Considering that the Bank does not waive the right to collect financial asset, write-off without debt acquittal, i.e. accounting write-off represents derecognition of financial asset in statement of financial position and recording those within the off-balance sheet items. At the moment when the Bank estimates that there is no justification for undertaking further activities related to the collection of a financial asset (terminated bankruptcy, liquidation, court decision, etc.), the decision of the competent authorities for the derecognition of the same from the off-balance sheet is issued.

The Bank writes off loans and receivables with debt acquittal when these are estimated as irrecoverable and that it is not economically justifiable to take further actions toward their collections. In such instances, the written-off financial assets are derecognized from the statement of financial position without any further recording.

In case of collection of written-off financial assets, income is recognized in income statement under “Net gains/expenses on impairment of financial assets not recognised at fair value through income statement”.

(l) Cash and Assets Held with the Central Bank

Cash and assets held with the central bank include cash on hand, balances held on the Bank’s gyro account, other cash funds and the obligatory foreign currency reserve held with the central bank. Cash and assets held with the central bank are stated at amortized cost within the statement of financial position.

For the purposes of cash flow statement preparation cash and cash funds include funds held on the accounts with foreign banks, while the obligatory foreign currency reserve held with the central bank is not included in the cash flow statement.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(m) Receivables or Liabilities under Derivatives

Derivatives are derivative financial instruments or other contracts that have three basic characteristics: their value changes depending on changes in some basic - core values, do not require any initial net investment or require relatively little net investment and settle on a date in the future. Derivatives include forward transactions, currency swaps, interest rate swaps as well as interest options. In the statement of financial position they are presented within assets if their fair value is positive i.e. within the liabilities if their fair value is negative. They are initially recognized at fair value and the effects of the change in fair value on subsequent measurement are presented in the income statement, within the line item "Net gains/losses on the change in the fair value of financial instruments".

(n) Derivatives Held for Hedges against Risks and Hedge Accounting

Derivatives held for risk management purposes include all derivative assets and liabilities that are not classified as trading assets or liabilities. Derivatives held for risk management purposes are measured at fair value in the statement of financial position.

The Bank designates certain derivatives held for risk management as hedging instruments in qualifying hedging relationships. On initial designation of the hedge, the Bank formally documents the relationship between the hedging instrument and hedged item, including the risk management objective and strategy in undertaking the hedge, together with the method that will be used to assess the effectiveness of the hedging relationship. The Bank makes as assessment, both at the inception of the hedge relationship as well as on an ongoing basis, as to whether the hedging instrument is expected to be highly effective in offsetting the changes in the fair value or cash flows of the respective hedged item during the period for which the hedge is designated, and whether the actual results of each hedge are within a range from 80% to 125%.

(i) Fair Value Hedges

When a derivative is designated as the hedging instrument in a hedge of the change in fair value of a recognized asset or liability that could affect profit or loss, changes in the fair value of the derivative are recognized immediately in profit or loss together with changes in the fair value of the hedged item that are attributable to the hedged risk.

If only certain risks attributable to hedged items are subject to hedging, the recognized changes in fair value of the hedged items that are not associated with the risk subject to hedging are recognized in accordance with the Bank’s policy on financial instrument measurement depending on the instrument classification.

(o) Loans and Receivables

From January 1, 2018, in accordance with IFRS 9, positions "Loans and receivables from banks and other financial organisations" and "Loans and receivables from clients" in the statement of financial position include financial assets that are measured at amortized cost or at fair value through income statement (see Note 3(k)(ii)). If they are measured at amortized cost, loans and receivables are presented net of allowances for impairment in the statement of financial position (Note 3(k)(viii)). Allowance for impairment is formed against the carrying amount of loans and receivables that are identified as being impaired in order to reduce their value to recoverable amount. If, in a subsequent period, the amount of impairment losses decreases, the previously recognized impairment loss is reversed by adjusting the allowance account. The amount of reversal is recognized in the income statement within the line item "Net income/expense from reduction in impairment/impairment of financial assets measured at fair value through income statement".

Until January 1, 2018, in accordance with IAS 39, the Bank classified as loans and receivables non-derivative financial assets with fixed or determinable payments that were not quoted in the active market and which the Bank did not intend to sell immediately or in the near future. Loans and receivables included placements granted to banks and placements to customers. Loans and receivables were initially measured at fair value plus direct transaction costs, and subsequently at amortized cost using the effective interest rate method. The amortised cost was calculated taking into account all issuing costs as well as discounts or premiums on settlement. Loans and receivables were presented net of specific and collective allowances for impairment. Specific and collective allowances are made against the carrying amount of loans and receivables that are identified as being impaired in order to reduce their value to recoverable amount.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(p) Securities

From January 1, 2018, in accordance with IFRS 9, the "Securities" position in the statement of financial position includes debt securities that can be classified into all three categories of financial assets depending on the business model and SPPI criteria. For classification and measurement see Note 3(k)(ii).

Until January 1, 2018, in accordance with IAS 39, the Bank classified debt securities as held to maturity securities, securities at fair value through profit or loss and securities available for sale. Initially, these securities were recognized at fair value plus transaction costs, except in the case of securities at fair value through profit or loss.

Securities, for which the management had both the intention and the ability to hold them up to maturity, were classified as held-to-maturity securities. They were carried at amortized cost using the effective interest method. In the case of selling a significant portion of these assets, IAS 39 required that the entire category be reclassified into securities available for sale, i.e. the Bank would not be able to classify securities as held to maturity for the current and the following two financial years. However, there have been cases where sales or reclassification did not jeopardize the classification, such as sales or reclassifications made close to maturity, or after the Bank has collected substantially all of the asset’s original principal or are the result of isolated events that were not under the control of the Bank.

Securities at fair value through profit or loss include securities held by the Bank for the purpose of trading in the near future or upon initial recognition are designated by the Bank as financial assets at fair value through profit or loss. Gains/losses arising from subsequent measurement at fair value are presented in the income statement.

Available-for-sale securities include securities that were intended to be held for an indefinite period of time and could have been sold in response to needs for liquidity or changes in interest rates, exchange rates or market prices. Unquoted equity securities whose fair value could not be reliably determined were an exception and were valued at cost net of impairment allowances. Impairment allowances are recognized in the income statement as a difference between the carrying amount of the financial asset and the present value of the expected future cash flows. All other securities available for sale are measured at fair value. Interest income on securities that are classified as available for sale is recognized in the income statement using the effective interest method. Dividend income from equity securities classified as available for sale is recognized when the Bank becomes entitled to the dividend. Foreign exchange gains and losses on securities available for sale are recognized in the income statement. Impairment losses are recognized in the income statement. Other fair value changes are recognized within the remaining result until the moment of sale or impairment of the securities, when cumulative gains and losses previously recognized in other comprehensive income, are reclassified to the income statement.

(q) Property, Plant and Equipment

(i) Recognition and Measurement

Items of property and equipment are measured at cost less accumulated depreciation and any accumulated impairment losses.

Cost includes expenditures that are directly attributable to the acquisition of the asset.

Purchased software that is integral to the functionality of the related equipment is capitalized as part of that equipment. When parts of an item of property or equipment have different useful lives, they are accounted for as separate items (major components) of property and equipment. Any gain or loss on disposal of an item of property and equipment is determined by comparing the proceeds from disposal with the carrying amount of the item or property and equipment, and is recognized net within other income/expenses in profit or loss.

NOTES TO THE UNCONSOLIDATED FINANCIAL STATEMENTS
December 31, 2018
All amounts expressed in thousands of RSD, unless otherwise stated.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(q) Property, Plant and Equipment (Continued)

(ii) Subsequent Expenditure

Subsequent expenditure is capitalized only when it is probable that the future economic benefits of expenditure will flow to the Bank.

The cost of replacing part of an item of property or equipment is recognized in the carrying amount of the item if it is probable that the future economic benefits embodied within the part will flow to the Bank and its cost can be measured reliably. The costs of the day-to-day servicing of property and equipment are recognized in profit or loss as incurred.

(iii) Depreciation

Items of property and equipment are depreciated from the month following the month when they become available for use. Depreciation is recognized in profit or loss on a straight-line basis over the estimated useful lives of each part of an item of property and equipment since this most closely reflects the expected pattern of consumption of the future economic benefits embodied in the asset. Leased assets are depreciated over the shorter of the lease term and their useful lives.

The depreciation rates used for the current and comparative periods are as follows:

Assets	**Estimated Useful Life (Years)**	**Minimum Annual Rate %**
Buildings	Maximum 50	2%
Furniture	Maximum 25	4%
IT equipment and electronic systems	Maximum 15	6.67%
Other	Maximum 10	10%

Depreciation methods, useful lives and residual values are reassessed at each financial year-end and adjusted as appropriate.

(r) Intangible Assets

Intangible assets comprise software, licenses and other intangible assets.

Intangible assets purchased by the Bank are stated at cost less accumulated amortization and any accumulated impairment losses.

Subsequent expenditure on intangible assets is capitalized only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure is expensed as incurred.

Amortization is recognized in profit or loss on a straight-line basis over the estimated useful life of an intangible asset, from the date that it is available for use. The estimated useful life of intangible assets is five years and amortization rate used equals 20%, except for the assets whose usage periods are contractually defined, when these assets are amortized over the contractually defined periods.

Amortization methods, useful lives and residual values are reassessed at each financial year-end and adjusted as appropriate.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(s) Leasing

Leasing is classified as financial in case all benefits and risks arising from the ownership of the leased object are transferred to the Bank. Leasing is classified as operating in case when the benefits and risks arising from the ownership of the lease are not transferred to the Bank.

(i) Operating leasing

All payments made during the year under operating lease are recorded as an expense in the income statement on a straight-line basis over the period of the lease. Lease incentives received are recognized as an integral part of the total lease expense, over the term of the lease.

(ii) Financial leasing - Bank as the Lessee

Leasing in which the Bank takes over substantially all the risks and rewards of ownership is classified as a financial lease. An asset acquired under a finance lease is initially measured at the lower of its fair value and present value of the minimum lease payments. Subsequent to initial recognition, the asset is recorded in accordance with the accounting policy applicable to that asset.

Minimum lease payments made under financial leases are apportioned between the finance expense and the reduction of the outstanding liability. The finance expenses are allocated to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability.

(iii) Financial leasing - Bank as the Lessor

The Bank recognizes financial assets leased in its statement of financial position in the amount equal to the net investment in the lease. The Bank transfers the risks associated with ownership to the lessees so that the lease receivables are regarded as repayment of principal and portion of the related financial income.

Recognition of financial income is based on the pattern that reflects the constant periodic rate of interest on the financial lease net investment outstanding. Lease payments related to the current period, net of service fees, are charged to the gross investment in the lease as the reduction in the principal and finance income unearned.

(t) Impairment of Non-Financial Assets

The carrying amounts of the Bank's non-financial assets, other than investment property and deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated. Indefinite-lived intangible assets are tested annually for impairment. An impairment loss is recognized if the carrying amount of an asset or a cash-generating unit exceeds its recoverable amount.

The recoverable amount of an asset or a cash-generating unit is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset or a cash-generating unit.

An impairment loss is recognized if the carrying amount of an asset exceeds its recoverable amount (as the difference between the two). Impairment losses are recognized in profit or loss.

Impairment losses recognized in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortization, if no impairment loss had been recognized.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(u) Deposits, Borrowings and Subordinated Liabilities

Deposits, borrowings from banks and customers and subordinated liabilities are the Bank's source of debt funding.

The Bank classifies equity instruments as financial liabilities or equity instruments in accordance with the substance of the contractual terms of the instruments.

Deposits, borrowings and subordinated liabilities are initially measured at fair value increased by directly attributable transaction costs and are subsequently measured at their amortized cost using the effective interest method.

(v) Provisions

A provision is recognized if, as a result of a past event, the Bank has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability. The Bank does not perform discounting of the future cash flows expected to arise in the near term.

(x) Financial Guarantees

Financial guarantee represent contracts whereby the Bank is obligated to make the designated payment to the guarantee holder for the loss incurred due to the designated debtor's failure to make the relevant payment in timely manner in accordance with the debt instrument terms.

Financial guarantee liabilities are initially recognized at their fair value, and the initial fair value is amortized over the life of the financial guarantee. The guarantee liability is subsequently carried at the higher of this amortized amount and the present value of any expected payment (when a payment under the guarantee has become probable). Financial guarantees are included within contingent liabilities.

(y) Employee Benefits

In accordance with regulatory requirements of the Republic of Serbia, the Bank is obligated to pay contributions to tax authorities and to various state social security funds, which guarantee social security insurance benefits to employees. These obligations involve the payment of contributions by the employer, in amounts computed by applying the specific, legally-prescribed rates. The Bank is also legally obligated to withhold contributions from gross salaries to employees, and on behalf of its employees, to transfer the withheld portions directly to government funds. These taxes and contributions payable on behalf of the employee and employer are charged to staff costs in the period in which they arise.

Pursuant to the Labour Law, the Bank has an obligation to disburse an employment retirement benefit to a retiree. Long-term provisions for retirement benefits payable upon fulfilment of the prescribed conditions stated at December 31, 2018 represent the present value of the expected future payments to employees determined by actuarial assessment using assumptions.
For determination of provisions for retirement benefits, Bank uses data such as mortality rate tables, employee turnover and disability rates, projected annual salary growth rate of 2%, annual discount rate 5 %. In addition, in 2018 the Bank accrued expenses for unused annual leaves (vacations).

(z) Investments in Subsidiaries

A subsidiary is an entity under the Bank's control. Control over subsidiaries is achieved if the Bank has exposure, or rights, to variable returns from its involvement with the investee and the ability to use its power over the investee to affect the amount of returns. Investments in subsidiaries are initially measured at cost in accordance with IFRS 10 and IAS 27. On each reporting date, the Bank assesses whether there is objective evidence that investments in subsidiaries are impaired. Impairment losses are recognized in the income statement.

4. FINANCIAL RISK MANAGEMENT

(a) Introduction and Overview

In its operations the Bank is particularly exposed to the following risks:

- Credit risk[1],
- Market risk[2],
- Operational risk[3],
- Liquidity risk,
- Risk of business compliance,
- Risk of money laundering and terrorist financing,
- Strategic risk,
- Business risk,
- Reputational risk,
- Interest rate risk in the banking book[4],
- The risk of the information system.

The Bank has established a process for collecting data, measuring and managing the individual risks that they make and are involved in the risk profile of the Bank. This process is ensured by a comprehensive annual risk assessment process.

Liquidity risk is the possibility of occurrence of negative effects on financial result and equity of the Bank caused by the Bank's inability to fulfil its due obligations as a result of withdrawal of existing sources of financing and/or impossibility of securing new sources of financing, or difficulties in converting assets into liquid funds due to market disturbances.

Interest rate risk is the risk of possible negative effects on the financial result and the Bank's equity based on positions in the banking book due to changes in interest rates. In the context of interest rate risk management, the Bank devotes special attention to the following sources of risk:
• risk of time mismatch in repricing (repricing risk);
• yield curve risk to which the bank is exposed due to change in the yield curve;
• basis risk, to which it is exposed due to different reference interest rates in interest-sensitive positions with similar characteristics in terms of maturity or re-pricing;
• optionality risk to which it is exposed due to contractual provisions regarding interest-sensitive positions (loans with the possibility of early repayment, deposits with the possibility of early withdrawal)

Market risks are the possibility of negative effects on the financial result and the Bank's capital on the basis of changes in the value of the balance sheet and off-balance sheet positions of the banks arising from the movement of prices on the market. These risks include foreign exchange risk, price risk based on debt and equity securities and commodity risk.

Operational risk is the risk of negative effects on the financial result and equity of the Bank caused by human error, inadequate internal procedures and processes, inadequate management of the information system and other systems in the Bank, as well as by unpredictable external events.

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[1] Includes risk of default, concentration risk, FX induced credit risk, residual risk, government risk, and migration risk. Additional information on residual and migration risk is currently not anticipated for calculation of internal capital.
[2] It includes interest rate risk in trading portfolio, foreign exchange risk, credit spread risk and base risk. Also, as components of the VaR model that is the basis for calculating economic capital, the risk of volatility, the risk of migration of credit risk into the trading book and the risk of eliminating the open position are included. In particular, IDRC (incremental Default Risk Charge), an additional component of the capital calculated on the trading book positions, arising from the risk of the default status of the issuer of securities.
[3] Includes internal and external fraud, employee relations and workplace safety, customers, products and business processes, damage to material assets, interruptions in operations and errors in the Bank's systems, as well as execution of transactions and delivery and process management in the Bank.
[4] Includes interest gap, option risk, base risk.

4. FINANCIAL RISK MANAGEMENT (Continued)

Risk Management Framework

The most important role in the risk management as part of the internal control system is assigned to the Supervisory Board of the Bank, which is responsible for risk management system establishment and oversight. The Supervisory Board defines strategies and policies for managing key risk types that the Bank is exposed to in its operations. In addition, the Supervisory Board is in charge of prior approval of large exposures to a single entity or a group of related entities exceeding 10% of the Bank's own equity as well as of increase of such exposures to above 20% of the Bank's own equity. The Bank's Audit Committee assists the Supervisory Board in performance of its function by considering the Bank's most important internal acts before these are adopted by the Supervisory Board. The Management Board of the Bank is in charge of implementation of the approved risk management strategies and policies, and implementation of the procedures for risk identification, measurement and assessment. Important role in loan approval process is assigned to the Credit Committee, which is in charge of making decisions about credit applications within its competence level, or giving recommendation for higher credit approval competence level.

Internal organisation of the Bank ensures functional and organisational separation of risk management and other regular business activities. The Bank has a separate Risk Management Division in its organisational structure.

The Risk Management Division covers risk management through the activities of five departments: Strategic Risk Management and Control, Retail Credit Operations, Corporate Underwriting, Corporate Special Credit, and Financial and Operational Risk Department. All departments report directly to the member of the Management Board in charge of risk management, thereby ensuring avoidance of conflicts of interest and separation of the risk management and regular operating activities.

Internal Audit Department

The Internal Audit Department conducts its activities based on the annual operating plan and strategic five year internal audit plan approved by the Supervisory Board. Regularity of internal audit (frequency or length of an audit cycle) of a particular business area varies from one to five years and directly depends on the estimated risk level. The Internal Audit Department regularly monitors implementation of recommendations provided in its reports (action plans) and reports to the Management Board, Audit Committee and the Supervisory Board on all potential delays in the implementation of the measures.

(b) Credit Risk

Credit risk is the risk of the possibility of adverse effects on the financial result and capital due to non-performance of the debtor's obligations towards the Bank or potential decrease in the credit quality of the client.

Credit process in the Bank is based on strict segregation of the competences and responsibilities in credit operations between risk assuming activities for which business function is in charge, and risk managing activities. Business function is comprised of divisions in charge of the client acquisition and client relationship management, while the risk management function encompasses departments within the Risk Management Division, which are in charge of loan underwriting, monitoring, restructuring and collection. According to the "four eye" principle, a decision on a loan application is proposed by the business function (first vote) and the final decision or recommendation for loan approval decision is given by the risk management function (second vote). Exceptions can be made for certain standardized products in the retail segment – individuals and SMEs, when, due to a large number of relatively small loan amounts and simplification of the procedure, the approval process can be completely realized within the business function, with mandatory application of the "four-eye" principle in accordance with predefined criteria and parameters approved by the risk management function.

With the aim to ensure adequate and timely risk management in the area of crediting activity, the Bank applies the following internal acts: Risk Management Rulebook, Rules on Competences for Credit Business, documents which define rules for internal credit rating assignment, Rules of Procedure for the Credit Committee, Credit Risk Mitigation Policy, Real Estate Valuation Policy, Guidelines for the Management of Corporate Special Credit Clients, Rules on the IAS/IFRS Provisioning and other enactments. The Bank's goal is to protect itself against the risks and to optimize the level of the risks assumed by defining adequate procedures and individual responsibilities in the risk management process.

4. FINANCIAL RISK MANAGEMENT (Continued)

(b) Credit Risk (continued)

In order to define a consistent guidelines for the credit activity and a general framework for risk management, the Bank makes credit risk management strategies for Retail and Corporate segments for each financial year. The strategies include general guidelines for the basic parameters of risk management, principles of analysis of the creditworthiness of each customer segment, and definition of the direction of development of individual products, as well as detailed strategy direction of portfolio development per certain industries. In this manner, the Bank ensures that the approved business policies are implemented resulting in acceptable credit risk exposure at the level of individual loans, as well as adequate diversification and general quality of the loan portfolio.

The Bank also considers analysis of the money laundering and terrorist financing risk in making decision on the credit risk assumption.

Competences, responsibilities and authorities of persons involved in risk management system are defined by the Rules on Competences for Crediting Business. In credit process decision making, the “four eye” principle has to be followed in order to ensure that the two sides involved in the credit process check each other – the one proposing and the other approving a loan.

Credit Risk Reporting

The Bank manages credit risk, sets credit risk limits and controls it in all segments of its business and for all relevant types of corporate and retail loans. Timely identification, measuring, monitoring and managing of the credit risk on the Bank’s portfolio level is supported by the Risk Management Information System (“RMIS”). By reporting at the total portfolio level or at the individual client level, RMIS provides complete, accurate and timely information about the balance, quality and movements of the loan portfolio.

RMIS has to fulfil the four main functions:

1. Collect and process data and credit risk indicators,
2. Analyze movements and changes in the entire loan portfolio and its structural characteristics,
3. Continuously monitor credit risk and,
4. Provide a basis for the process of decision making on the credit risk management.

The scope of monitoring, management and reporting on credit risk on portfolio level includes monitoring of loan loss provisions (impairment allowances of balance sheet assets and provisions for probable losses per off-balance sheet items), as well as special reserves for estimated losses calculated in accordance with the NBS Decision on Classification and relevant internal acts of the Bank.

Credit Risk Parameters

Credit risk is quantified by measuring the expected loss. Main indicators that are used to monitor credit risk and to calculate expected loan losses are as follows:

- Exposure of the Bank at default (EaD);
- Probability of default (PD); and
- Loss given default (LGD).

The Bank uses an internal model for assessing credit risk. Rating models determine a specific rating for clients with a similar level of credit risk. Each grade rating is associated with the corresponding PD parameter based on the master rating scale. The Bank also internally estimates other credit risk parameters.

Internal credit risk assessment models, credit risk parameters and collaterals are used for loan loss provisions calculation in line with the International Financial reporting Standards (“IFRS”), as defined by the Bank’s separate acts.

In order to fulfil above mentioned functions, RMIS uses IT systems of the UniCredit Group and internally generated databases with information about the portfolio at the individual loan facility level. IT systems provide rating and past-due days data as important client’s credit risk parameters.

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4. FINANCIAL RISK MANAGEMENT (Continued)

(b) Credit Risk (continued)

Credit Risk Reporting (continued)

Limits

The Bank manages the concentration of credit risk in the portfolio by determining the appropriate limits. Limits are determined by internal acts and/or NBS regulations, and their compliance is regularly monitored and reported, and explained in more detail in the risk exposure section.

Reports

In monitoring of credit risk on portfolio level, the following reports are used:

Report	Organizational unit in charge	Dynamics	CRO Sector	Credit Committee	Management Board	Audit Committee	Supervisory Board
CRO Report / SB presentation	CFO/Strategic Risk Management Department	Quarterly (or more often)	+	-	+*	+*	+
Credit Risk Dashboard	Credit Risk Control Unit	Monthly***	+	-	-	-	-
Credit Portfolio Overview	Risk Management Division	Quarterly	+	+**	+	-	-

* the report is presented for consideration and analysis before final presentation to the Supervisory Board
** the report is submitted to the Credit Committees after its presentation to the Management Board
*** predefined report template is updated on a monthly basis according to the availability of the most recent accounting data and is submitted to the Head of the Risk Management Division and Heads of departments and units within CRO Function.

CRO Report to the Supervisory Board is prepared quarterly or more frequently if necessary depending on the schedule of the Supervisory Board's meetings. All organizational units within the Risk Management Division participate in preparation of the report while the Strategic Risk Management and Control Department is responsible for coordination and delivery of the report. The report is prepared in the form of a presentation and includes, among other things, the following:

- Status overview of the most relevant activities of the Risk Management Division;
- Information on the structure and movements of the loan portfolio;
- Information on the key indicators of the portfolio quality, balance and movements of non-performing loans (NPLs), provisions for credit losses, risk costs and coverage of NPLs with credit loss provisions;
- Basic information on the portfolio concentration and compliance with the set limits, including the list of 10 largest client groups and 10 largest non-performing clients within the overall exposure.

Credit Risk Dashboard Report is updated on a monthly basis by the Strategic Risk Management and Control Department and delivered to the Management Board member in charge of the Risk Management Division and Heads of all departments within this division. The information is presented at the sub-segment level (large corporate clients, middle-sized corporate clients, real estate financing, business clients and entrepreneurs and individuals) with comparative data for the previous month and previous year-end. The report includes the following information:

- Loan Structure (type and currency);
- Portfolio structure per internal credit rating categories;
- Portfolio structure per (non)-default client status;
- Data on the asset quality at the sub-segment level (exposure, NPL volume and ratio, amount of credit loss provisions, NPLs coverage with credit loss provisions);
- PD and LGD per segment;
- Credit loss provisioning costs per sub-segment (charge and release/reversal as compared to the beginning of year and previous month); and
- Cost of risk per sub-segment.

4. FINANCIAL RISK MANAGEMENT (Continued)

(b) Credit Risk (continued)

Credit Risk Reporting (continued)

Reports (continued)

Credit Portfolio Overview is prepared on a quarterly basis and is presented to the Bank's Management Board, and afterwards to Credit Committee. All organizational units dealing with the credit risk management within the Risk Management Division participate in preparation of the report. Among other things, the report includes the following information:

- detailed information on the structure and movements of the loan portfolio, overall and per segment;
- data on the key portfolio quality indicators, balance and movements of NPLs, provisions for credit losses, costs of risk, NPLs coverage with credit loss provisions, portfolio distribution per rating, etc.;
- the list of 10 largest client groups and 10 largest non-performing clients within the overall exposure;
- portfolio status and overview of the key activities and results according to the internal portfolio classification (Standard, WL, Restructuring, Workout);
- information on the portfolio concentration and compliance with the set limits.

In addition to the standardized reports, there are many activities undertaken in order to provide accurate parameters used in credit risk monitoring: ad hoc analysis and reporting and other activities that contribute to the accuracy of credit risk parameters.

Ad hoc analysis and reporting are applied in case of higher risk exposure, especially if the credit risk level is changing drastically and abruptly and when timely reaction is expected – for example: deterioration of internally defined rating grades, significant need for additional provisions, signs of mismatching in organization, implemented system or procedures, change of any of the credit risk parameters or in calculation of provisions.

Other activities conducted by the Bank include: quality verification of data used in monitoring, managing and reporting on the credit risk, improvement of the existing systems and procedures, annual process of budgeting and subsequent control and any adjustments of the budget parameters.

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4. FINANCIAL RISK MANAGEMENT (Continued)

(b) Credit Risk (Continued)

Credit Risk Reporting (Continued)

Credit Risk Exposure

The table below shows the Bank's maximum credit risk exposure per financial instrument type

	Cash and assets held with the central bank (Note 22)		Securities (Note 24)		Loans and receivables from banks and other financial organizations (Note 25)		Loans and receivables from clients (Note 26)		Other assets (Note 34)		Off-balance sheet items	
	2018	2017	2018	2017	2018	2017	2018	2017	2018	2017		2017
Individually impaired												
Corporate clients, rating 10	-	-	-	-	-	-	1,649,611	1,833,363	4,699	14,724	2,984	3,084
Corporate clients, rating 9	-	-	-	-	-	-	-	-	-	-	-	-
Corporate clients, restructured loans*	-	-	-	-	-	7	5,342,760	10,588,175	6,407	30,170	138,752	213,576
Retail clients, > 90 days past due	-	-	-	-	-	-	2,084,885	1,398,583	5,496	3,076	1,642	724
Gross loans	-	-	-	-	-	7	9,077,256	13,820,121	16,602	47,970	143,378	217,384
Impairment allowance	-	-	-	-		7	5,058,607	8,083,030	13,952	31,869	89,729	126,577
Carrying value	-	-	-	-	-	-	4,018,649	5,737,091	2,650	16,101	53,649	90,807
Group-level impaired												
Corporate clients, rating 1 - 6	23,788,821	38,226	100,424,606	2,190,401	20,981,215	11,834,160	165,420,012	147,265,403	111,073	72,120	148,856,844	134,431,232
Corporate clients, rating 7	-	-	-	-	10,911	-	1,894,008	5,158,399	622	2,438	829,633	3,675,251
Corporate clients, rating 8	-	-	9,140	9,355	172	-	2,040,926	458,097	386	499	465,448	41,710
Retail clients, < 90 days past due	-	-	-	-	-	-	84,127,598	75,224,008	1,653	388	1,580,678	1,575,544
Gross loans	23,788,821	38,226	100,433,746	2,199,756	20,992,298	11,834,160	253,482,544	228,105,907	113,734	75,445	151,732,604	139,723,737
Impairment allowance	211	196	5	1,648	17,362	8,510	1,858,373	1,290,680	794	543	152,438	198,264
Carrying value	23,788,610	38,030	100,433,741	2,198,108	20,974,936	11,825,650	251,624,171	226,815,227	112,940	74,902	151,580,165	139,525,473
Carrying value of rated assets	23,788,610	38,030	100,433,741	2,198,108	20,974,936	11,825,650	255,642,820	232,552,318	115,590	91,003	151,633,815	139,616,280
Carrying value of non-rated assets	29,616,699	29,622,987	1,493,552	82,147,259	-	-	-	789	867,341	886,724	-	-
Total carrying value	**53,405,309**	**29,661,017**	**101,927,293**	**84,345,367**	**20,974,936**	**11,825,650**	**255,642,820**	**232,553,107**	**982,931**	**977,727**	**151,633,815**	**139,616,280**

* Category "corporate clients – restructured loans" includes corporate customers with internal rating 8-, whose impairment allowance was made on a group-level and not individually.

4. FINANCIAL RISK MANAGEMENT (Continued)

(b) Credit Risk (Continued)

Implementation of Basel Standards

In the area of Basel standards implementation the focus of activities was placed mainly on the monitoring and confirming of predictive capabilities of the internally developed rating models and their parameters for corporate, retail, entrepreneur and small entity segments. In 2018 the Bank performed internal validation of all internally developed rating models and credit risk parameters, which confirmed their predictive capabilities and calibration against the identified risk level in the current banking operations. According to the resulting internal validation recommendations, the Bank improved calibration of PD model for the segment of entrepreneurs and small businesses. Following the implementation of IFRS 9 and Basel III standards, in 2018, further improvement and continuous analysis of implemented calculations continued with a focus on the analysis of the impact of applied methodological solutions and individual variables in the calculation process, as well as analysis of data transfer with the improvement of data quality.

Internal Rating System (Rating Scale)

The ranking rules for customers are established at the level of the UniCredit Group and as such are uniform for each member of the Group. The Bank's rating system was developed and has been in use since 2004 at the group level for clients classified in the corporate clients group. For retail clients and entrepreneurs, the rating system was internally developed and has been in use since 2010. The Bank uses the Group's rating models for multinational companies, banks, insurance companies and exposures to states/governments. The Master Scale is used as a unique rating assignment method which ensures that customers with the same rating have the same credit characteristics and the same probability that they will not settle their obligations, in part or in full, within the period of 1 year.

The Master Scale is divided into 10 rating classes that are further broken down into a total of 26 rating subgroups.

The internal master scale is compliant with Basel standards, meaning that each rating subgroup has a PD parameter associated with it, with probability that a customer with particular characteristics will be unable to settle liabilities toward the Bank and will be in default. For the first 24 subgroups the probability of default ranges between 0.02% and 20.00%, where those clients are rated between 1+ and 8. Their probability of default is based on statistical analysis based on the historical data.

Ratings from 1+ to 6-: These rating notches are reserved for customers determined in an internal credit assessment to have a credit standing of very good to just acceptable. For customers with this rating periodic review of credit rating is performed annually.

Ratings 7+ to 7-: Cover three subgroups for transactions with low credit rating. Customers assigned these rating notches have substantially greater risk factors and must be constantly monitored.

Ratings 8+ and 8- cover those companies without individual provisioning which are subject to special workout or credit-reduction measures.

Rating 8- relates to customers in default according to the Basel Standards criteria.

Rating 9 comprises customers with loan loss provision calculated on an individual basis or those where a portion of the receivable has been written off.

Rating 10 is assigned to the clients in the process of liquidation or bankruptcy.

Ratings 8-, 9 and 10 are by definition assigned to customers in default in accordance with Basel Standards criteria, with specific credit loss provisioning calculation.

4. FINANCIAL RISK MANAGEMENT (Continued)

(b) Credit Risk (Continued)

Impairment Allowance and Provisioning Methodology

In accordance with the current Rule on IFRS Loan Loss Provisioning, the Bank calculates a 12-month expected credit loss (hereinafter: ECL) or ECL for the entire life of a financial instrument, depending on the significance of a change in the credit risk of a financial instrument from its initial recognition. For these purposes, the Bank applies the following three levels of impairment:

• Stage 1 - covers all new financial assets at the time of initial recognition and instruments that do not have a significant deterioration in credit quality in relation to initial recognition or are those instruments in the category of low credit risk;
• Stage 2 - covers financial instruments that have significant deterioration in credit quality since the moment of initial recognition, but where there is no objective evidence of impairment losses;
• Stage 3 - includes financial assets that have objective evidence of impairment at the reporting date.

In the end Stages 1 and 2 involve only non-problematic financial assets, while Stage 3 includes problematic financial assets. Calculation of the expected losses for financial instruments in stage 1 applies a twelve-month calculation of the expected loss, while for financial instruments in Stage 2, a life-time calculation is applied.

Transfer of financial assets from Stage 1 to Stage 2 is carried out when the credit risk of financial assets has increased significantly since the moment of initial recognition. Transfer logic is based on quantitative and qualitative criteria and must be applied to all financial instruments. The probability of default probability (PD) is the main element on which the quantitative logic transfer criterion is based.

The four additional qualitative criteria that come after applying the quantitative criterion are:
• Classification in the status of restructured performing exposures (i.e. Forbearance classification) results in an automatic classification in Stage 2 for the next 9 months (beginning from the date of classification into that status). After that period, if there are no other significant signs of credit risk deterioration, the transaction may be returned to Stage 1;
• 30 days past due - when the transaction reaches 30 days of delay, it should be recognized at Stage 2;
• All performing exposures that are classified on watch list 2 are classified into Stage 2;
• All performing exposures assigned under the responsibility of the restructuring department are automatically classified into Stage 2.

Rules and principles for calculating the expected credit loss for troubled financial instruments (Stage 3)

Pursuant to Rule on IFRS Loan Loss Provisioning, if there is objective evidence of impairment (hereinafter referred to as default status) on the date of compilation of financial statements, all financial assets are classified into Stage 3 impairment. For financial instruments classified into Stage 3, the rule is that impairment is based on the calculation of expected loan losses for the entire life of placements. In this process, the Bank specifically treats clients in a default status whose exposure is considered significant and such loans or clients are individually assessed by the Bank on a case by case basis, whereas for placements that are not individually significant, this assessment is carried out on a collective basis.

A financial asset is impaired and impairment has arisen if there is objective evidence of impairment that arises from one or more events that occurred after the date of initial recognition of the asset and which have an impact on the estimated future cash flows of that financial asset. If any such evidence exists, the Bank is required to calculate the amount of that impairment in order to determine whether the impairment loss should be recognized. In other words, if there is any evidence of impairment, the Bank should estimate the amount that can be recovered for that asset or group of assets and recognize impairment losses.

When determining the adequate amount of the provision, the difference between the need to calculate the specific provision on an individual basis and the specific provision on a group basis for clients are grouped into categories with similar risk characteristics, based on the segment to which the client belongs and the total amount of exposure at the client level. The total exposure of the client is comprised of the balance sheet and off-balance sheet receivables, including non-deductible placements.

4. FINANCIAL RISK MANAGEMENT (Continued)

(b) Credit Risk (Continued)

Impairment Allowance and Provisioning Methodology (continued)

Rules and principles for calculating the expected credit loss for troubled financial instruments (Stage 3) (Continued)

The process of determining a specific provision on an individual basis is intended to measure the loss on the basis of impairment at the client level. An individual provision is estimated as the difference between the carrying amount of the receivable and the present value of the expected future cash flows (excluding future impairment losses that are not identified as incurred) discounted at the effective interest rate of the financial asset (for example, the effective interest rate specified when concluding the contract). In other words, the provision will be determined in the amount of individual receivables that are not expected to be charged. In the event that an effective interest rate is not available, an alternative interest rate that is defined in accordance with the Bank's internal acts will be used to calculate the provision. When determining the present value of the receivables, the discounted cash flow from the repayment of principal, interest or any other cash flow from the placements is calculated first. After that, the discounted cash flow from the net realizable value of collateral for the given placement is calculated. The final net present value of future cash flows of placements is compared to the carrying amount of the same and the amount of provisions for impairment losses for the given placements recognized in the income statement is determined.

The calculation of provisions for exposures with impairment that are not classified as individually significant is carried out on a group basis by grouping clients in default status into homogeneous categories with similar risk characteristics. When defining homogeneous categories, the Bank applies the criteria used for segmentation when developing a model for calculating the loss rate due to default status (LGD model).

The calculation of group-based bookings in Stage 3 is done for clients in the default status, and in doing so, clients do not meet the requirements for an individual assessment of the provision. Calculation of the provision on a group basis is done according to the calculation: ECL = unsecEAD x LGDs3 (time in default)

Wherein:
• unsecEAD - Exposure in defaults reduced to the value of the collateral
• LGDs3 (time in default) - loss at the moment of default

If the claim is fully collateralized and for this reason unsecEAD is equal to 0, the calculation is applied:
ECL = EAD x Reserve weighting for Stage 1
The provisioning ratio for Stage 1 is set at a six-month level, by translating this value based on the average level of provision by segment of the portfolio.

The LGDs3 (time in default) values depend on the client segment, the amount of EAD, the year of repayment, and the period in which the client spent in default.

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4. FINANCIAL RISK MANAGEMENT (Continued)

(b) Credit Risk (Continued)

Impairment Allowance and Provisioning Methodology (Continued)

Rules and principles for calculating the expected credit loss for troubled financial instruments (Stage 3) *(Continued)*

The table below shows a breakdown of gross and net non-performing loans due from banks and customers. Non-performing loans are loans which have at least one repayment instalment over 90 days past due. Such loans are impaired and provided for in full, after considering collection from operating cash flows and/ collateral foreclosure.

	Securities (Note 24)		Loans and receivables from banks and other financial organizations (Note 25)		Loans and receivables from clients (Note 26)		Other assets (Note 34)		Off-balance sheet items	
	Gross	Net	Gross	Net	Gross	Net	Gross	Net	Gross	Net
December 31, 2018										
Corporate clients, rating 10	-	-	-	-	1,649,611	315,518	4,699	568	2,984	-
Corporate clients, rating 9	-	-	-	-	-	-	-	-	-	-
Corporate clients, restructured loans	-	-	-	-	5,342,760	2,539,173	6,407	1,515	138,752	52,540
Retail clients, > 90 days past due	-	-	-	-	2,084,885	1,163,958	5,496	567	1,642	1,109
Total	**-**	**-**	**-**	**-**	**9,077,256**	**4,018,649**	**16,602**	**2,650**	**143,378**	**53,649**
December 31, 2017										
Corporate clients, rating 10	-	-	-	-	1,833,363	571,006	14,724	3,262	3,084	85
Corporate clients, rating 9	-	-	-	-	-	-	-	-	-	-
Corporate clients, restructured loans	-	-	7	-	10,588,175	4,205,748	30,170	12,700	213,576	90,139
Retail clients, > 90 days past due	-	-	-	-	1,398,583	960,337	3,076	139	724	583
Total	**-**	**-**	**7**	**-**	**13,820,121**	**5,737,091**	**47,970**	**16,101**	**217,384**	**90,807**

The aging structure of matured and unimpaired loans as of December 31, 2018 is provided in the table below:

	Up to 30 days past due	31 to 60 days past due	61 to 90 days past due	Over 90 days past due	Total
Loans and receivables from clients					
Gross	11,985,167	524,328	251,400	-	12,760,895
Impairment allowance	(176,839)	(70,384)	(38,546)	-	(285,769)
Net carrying value	11,808,328	453,944	212,854	-	12,475,126

4. FINANCIAL RISK MANAGEMENT (Continued)

(b) Credit Risk (Continued)

Security Instruments - Collaterals

Credit risk is mitigated through adequate collateral management process. The purpose of acquiring all available collaterals, proper booking, assessment and monitoring is to minimize risk as much as possible. Therefore the Bank is especially dedicated to the management of collaterals, maintaining the acceptable relationship between the undertaken risk and real rate of the collateral recovery, control and mitigation of risks related to quality, concentration, or insurance of the receivables, maturity, currency, etc. Aiming at further enhancement of processes and systems with regards to credit risk mitigation, the Bank set up a special unit, whose activities included collateral appraisal, process of collateral monitoring, accurate reporting, management of the relationships with external associates, preparations of expert opinions, improvement of data quality and statistical monitoring of collaterals.

The Bank uses relevant policies and procedures for collateral management. The most significant collaterals accepted and used by the Bank for minimizing credit risk comprise:

- financial collaterals (cash deposits), allowed to be recognized in full amounts;
- payment guarantees issued by first-class banks and governments, allowed to be recognized in full amounts;
- mortgages on residential or commercial property, recognized up to 70% or 60%, respectively of the appraised value of property; and
- securities issued by governments, central banks or institutions with adequate credit rating.

In the event that the currency of a security instrument differs from the currency of the loan for which it provides security, the value of the security instrument must be further reduced using a factor defined for every currency combination, as specified by the Bank’s relevant internal regulations defining the process of credit risk mitigation.

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4. FINANCIAL RISK MANAGEMENT (Continued)

(b) Credit Risk (Continued)

Security Instruments – Collaterals (Continued)

Appraised fair values of collaterals securing the Bank's loans up to the credit risk exposure level as of December 31 are presented in the table below:

	Loans and receivables from banks and other financial organizations		Loans and receivables from clients		Off-balance sheet assets	
	2018	2017	2018	2017	2018	2017
Corporate clients, rating 10	**-**	**-**	**470,620**	**627,258**	**-**	**-**
Real estate	-	-	470,620	627,258	-	-
Other	-	-	-	-	-	-
Corporate clients, rating 9	**-**	**-**	**-**	**-**	**-**	**-**
Real estate	-	-	-	-	-	-
Other	-	-	-	-	-	-
Corporate clients, restructured loans	**-**	**-**	**773,446**	**3,217,452**	**24,631**	**75,832**
Real estate	-	-	743,205	2,313,590	5,184	70,805
Other	-	-	30,241	903,862	19,447	5,027
Retail clients, > 90 days past due	**-**	**-**	**228,427**	**376,898**	**-**	**-**
Real estate	-	-	228,427	376,898	-	-
Other	-	-	-	-	-	-
Group-level impairment allowance based on collateral appraisal	**592,478**	**1,304,963**	**45,596,671**	**59,485,755**	**7,978,701**	**10,298,486**
Real estate	878	2,000	40,808,961	50,342,776	4,013,898	5,555,007
Other	591,600	1,302,963	4,787,710	9,142,979	3,964,803	4,743,479
Total	**592,478**	**1,304,963**	**47,069,164**	**63,707,363**	**8,003,332**	**10,374,318**

All amounts expressed in thousands of RSD, unless otherwise stated.

4. FINANCIAL RISK MANAGEMENT (Continued)

(c) *Market Risks*

Market risks represent the possibility of adverse effects on the financial result and the Bank's capital on the basis of changes in the value of balance sheet and off-balance sheet positions that arise from the movement of prices on the market.

The established system of limits for the Bank's exposure to market risks establishes the limit of total absorption of economic capital as well as the acceptable level of economic loss both for the activities carried out through the trading book and for the overall business activity of the Bank and in accordance with the risk-taking capacities.

Some of the basic indicators for monitoring the Bank's exposure to market risk are:
• VaR - potential loss of portfolio value over one day with 99% confidence interval; VaR is calculated on the basis of a historical simulation approach and is monitored daily. The main risk factors that are covered by this calculation are: interest rate risk, credit spread, foreign exchange risk, volatility and inflation,
• Stressed VaR - historical approach is further stressed by parameters that were characteristic for periods of major economic crises.

In addition to these basic indicators, when monitoring and managing exposure to market risk, the Bank also uses some additional granular limits - aimed at preventing increased exposure in individual risk factors, as well as in risk factors that are not sufficiently taken into account in VaR analysis.
The most important of these indicators are sensitivity analysis - BPV and CPV.

During 2018, the bank's exposure to market risks was within defined limits and in accordance with the risk-taking capacities.

Overview of the VaR position of the Group's trading portfolio includes only the trading book positions of the Bank:

In RSD 000	As at December 31st	Average	Maximum	Minimum
2018.				
Foreign exchange risk	5,542	4,459	9,095	200
Risk of interest rate change	914	1,963	4,707	681
Risk of credit spread	3,086	4,301	7,395	1,648
Covariance	(3,220)	-	-	-
In total	6,322	6,592	10,577	1,683
2017.				
Foreign exchange risk	316	4,053	20,870	121
Risk of interest rate change	2,930	2,777	7,116	89
Risk of credit spread	3,691	3,441	8,170	1,116
Covariance	(2,220)	-	-	-
In total	4,718	6,059	19,790	1,571

An analysis of interest rate sensitivity to interest rate increase/decrease, assuming a parallel change in yield curve and static banking book is shown in the table below:

	December 31st 2018	December 31st 2017
	The effect of a parallel change in the interest rate by 1 bp	The effect of a parallel change in the interest rate by 1 bp
RSD	(17,292)	(11,739)
EUR	5,878	2,901
USD	(287)	(200)
GBP	-	-
CHF	(457)	(441)
Other currencies	-	-
Total effect*	23,914	15,281

* The total effect is equal to the sum of the absolute values by currencies.

All amounts expressed in thousands of RSD, unless otherwise stated.

4. FINANCIAL RISK MANAGEMENT (Continued)

(c) Market Risks (continued)

(i) Currency Risk

Foreign currency risk is the risk of potential negative effects on the Bank's financial result and equity due to fluctuations in the foreign currency exchange rates.

The foreign currency risk ratio is the total open foreign currency position relative to the Bank's capital, calculated in accordance with NBS Decision on Capital Adequacy of Banks. The Bank is under obligation to maintain the ratio between assets and liabilities in such a way that its foreign currency position at the end of a working day must not exceed 20% of its capital. The Financial and Operational Risk Department prepares a report on daily liquidity for NBS on daily and monthly bases.

The Bank is exposed to the effects of exchange rate fluctuations of the most important foreign currencies on its financial position and cash flows. Bank management sets limits for risk of exposure to particular foreign currencies and constantly monitors whether balances of various foreign currencies are within prescribed limits. Limits are effective for all relevant foreign currency products within the Markets Department. They comprise trade balances as well as selected strategic foreign currency ALM balances. All sensitivities that result from foreign currency balances are limited by the general VaR limit set for both, the Bank, in the aggregate, and for the Markets and ALM departments individually.

In order to protect against the risk of changing foreign exchange rates, the Bank concludes derivative contracts and contracts loans and placements with a currency clause.

The Bank's foreign exchange risk management at the operational level is the responsibility of the Directorate for Operations in the Financial Markets.

	2018	2017
Foreign exchange risk ratio:		
- as at December 31	1.05	0.93
- maximum for the period – December	4.48	3.59
- minimum for the period – December	0.33	0.06

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4. FINANCIAL RISK MANAGEMENT (Continued)

(c) Market Risks (continued)

(i) Currency Risk (continued)

The Bank's net currency position as at December 31, 2018:

	USD	EUR	CHF	Other currencies	RSD	Total
Cash and assets held with the central bank	145,772	14,924,268	173,224	68,397	38,093,648	53,405,309
Receivables under derivatives	-	624,660	-	-	58,163	682,823
Securities	2,112,792	20,564,386	-	-	79,250,115	101,927,293
Loans and receivables from banks and other financial organisations	322,053	15,419,289	15,669	213,736	5,004,189	20,974,936
Loans and receivables from clients	444,835	190,718,451	4,414,382	-	60,065,152	255,642,820
Change in fair value of hedged items	-	1	222,772	-	-	222,773
Receivables under hedging derivatives	-	2	-	-	-	2
Investments in subsidiaries	-	-	-	-	112,644	112,644
Intangible assets	-	-	-	-	1,617,855	1,617,855
Property, plant and equipment	-	-	-	-	1,589,673	1,589,673
Investment property	-	-	-	-	1,331	1,331
Deferred tax assets	-	-	-	-	239,899	239,899
Other assets	1,597	44,932	105	3	936,294	982,931
Total assets	**3,027,049**	**242,295,989**	**4,826,152**	**282,136**	**186,968,963**	**437,400,289**
Liabilities under derivatives	-	651,294	-	-	72,338	723,632
Deposits and other liabilities to banks, other financial organisations and central bank	450,417	120,506,759	479,611	1,993	11,639,355	133,078,135
Deposits and other financial liabilities to clients	15,558,121	101,127,525	1,780,158	1,725,130	100,740,102	220,931,036
Liabilities under hedging derivatives	-	170,554	318,026	-	-	488,580
Provisions	-	-	-	-	1,131,110	1,131,110
Current tax liabilities	-	-	-	-	461,958	461,958
Deferred tax liabilities	-	-	-	-	381	381
Other liabilities	108,529	1,113,117	911	9,658	1,524,744	2,756,959
Equity	-	-	-	-	77,828,498	77,828,498
Total liabilities and equity	**16,117,067**	**223,569,249**	**2,578,706**	**1,736,781**	**193,398,486**	**437,400,289**
Off-balance sheet financial instruments	13,096,064	(17,574,823)	(2,246,527)	1,520,309	5,124,285	(80,692)
Net currency position as of December 31, 2018	**6,046**	**1,151,917**	**919**	**65,664**	**(1,305,238)**	**(80,692)**

** Note: assets and liabilities with a currency clause are recorded within the currency positions for which they are indexed.*

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4. FINANCIAL RISK MANAGEMENT (Continued)

(c) Market Risks (continued)

(i) Currency Risk (continued)

The Bank's net currency position as at December 31, 2017:

	USD	EUR	CHF	Other currencies	RSD	Total
Cash and assets held with the central bank	190,858	10,011,837	97,931	126,245	19,234,146	29,661,017
Receivables under derivatives	-	157,024	-	-	28,180	185,204
Securities	1,946,572	20,653,196	-	-	61,745,599	84,345,367
Loans and receivables from banks and other financial organisations	1,764,534	9,804,623	20,209	233,452	2,832	11,825,650
Loans and receivables from clients	4,303,490	161,563,932	4,855,601	-	61,830,084	232,553,107
Change in fair value of hedged items	-	141	192,110	-	-	192,251
Receivables under hedging derivatives	-	9,195	-	-	-	9,195
Investments in subsidiaries	-	-	-	-	112,644	112,644
Intangible assets	-	-	-	-	1,162,458	1,162,458
Property, plant and equipment	-	-	-	-	1,551,389	1,551,389
Investment property	-	-	-	-	1,364	1,364
Deferred tax assets	-	-	-	-	171,179	171,179
Other assets	601	47,038	4	330	929,754	977,727
Total assets	**8,206,055**	**202,246,986**	**5,165,855**	**360,027**	**146,769,629**	**362,748,552**
Liabilities under derivatives	-	152,548	-	-	54,455	207,003
Deposits and other liabilities to banks, other financial organisations and central bank	3,397,484	86,359,808	771,632	457	9,004,192	99,533,573
Deposits and other financial liabilities to clients	15,120,973	96,095,671	1,443,969	1,160,204	72,838,016	186,658,833
Liabilities under hedging derivatives	-	171,484	277,310	-	-	448,794
Provisions	-	-	2,718,490	-	-	2,718,490
Current tax liabilities	-	-	-	-	1,072,531	1,072,531
Deferred tax liabilities	-	-	-	-	178,821	178,821
Other liabilities	194,790	1,099,908	1,852	4,235	1,289,227	2,590,012
Equity	-	-	-	-	69,340,495	69,340,495
Total liabilities and equity	**18,713,247**	**183,879,419**	**5,213,253**	**1,164,896**	**153,777,737**	**362,748,552**
Off-balance sheet financial instruments	10,503,270	(18,275,802)	60,771	836,823	6,841,896	(33,042)
Net currency position as of December 31, 2017	**(3,922)**	**91,765**	**13,373**	**31,954**	**(166,212)**	**(33,042)**

** Note: assets and liabilities with a currency clause are recorded within the currency positions for which they are indexed.*

4. FINANCIAL RISK MANAGEMENT (Continued)

(d) Operational Risks

Operational risk is the risk of loss resulting from error, breach, interruption, damage caused by internal processes, employees or systems or external events. Operational risk is defined as an event occurring as the result of inappropriate or unsuccessful internal processes, actions of employees and systems or systemic and other external events: internal or external malversation, employment practice and safety at work, receivables from clients, distribution of products, fines and penalties for injury, damage to property, disruption in operation and system errors, process management. Strategic risks, business risks and reputation risks differ from operational risks, while legal risks and compliance risk are included in the definition of operational risk.

The Financial and Operational Risk Department is responsible for recording, monitoring and managing the Bank's operational risks and directly answers to the Chief Risk Officer (CRO).This Department's basic task is to coordinate and cooperate with operating risk managers and to communicate with colleagues at the Operational Risk Department in Milan, with the purpose of securing information for the efficient monitoring of operational risk at all levels. On a daily basis the Department monitors changes in specially defined accounts and on a weekly basis it reports to members of the Management Board regarding all changes in operational risks. For the purpose of efficient monitoring of significant changes in connection with operational risks within the Bank, Operational Risk Managers and Deputy Managers have been appointed from various organizational units that are responsible for the accuracy and timeliness of recording data on all harmful events in their organizational unit into a database. All events that have occurred are recorded in the Group's ARGO application.

The Operational Risk Committee meets quarterly for more efficient internal control and process improvement to minimize risks arising from operational risk. The Bank's Management Board is responsible for decision making on operational risk. It is responsibility of the Department to calculate the capital requirements for operational risks, which is computed using the standardized approach and to prepare reports for local management and the Group.

(e) Liquidity Risks

The main objective of the overall liquidity management of the Bank is to maintain adequate liquidity and financing position in order to enable the bank to fulfil its payment obligations not only in regular business, but also in stressful circumstances.

The liquidity risk that the Bank meets in everyday business may have different forms:
• Intraday liquidity - the liquidity risk during the day occurs when the Bank is unable to timely meet its payment obligations, under normal and stressful conditions.
• The short-term liquidity risk refers to the risk of mismatch between the amount and / or the maturity of cash inflows and outflows of cash over a short period of time (up to one year).
• Market liquidity - the risk that the Bank may face a significant loss of its liquid assets whenever necessary to liquidate them through sales or repo operations.
• The structural liquidity risk is defined as the inability to collect the necessary funds to maintain an adequate relationship between medium and long-term (over one year) assets and liabilities at reasonable price levels, in a stable and sustainable manner, without affecting the daily operations or the financial position of the Bank.
• The risk of unforeseen or stressful circumstances is related to future and unexpected obligations that could require a higher amount of liquidity from the bank in relation to what is considered as the amount for conducting a regular business.
• The risk of concentration of financing occurs when the Bank uses a limited number of sources of financing, so that they become such that the withdrawal of one or more of them could cause liquidity problems.
• Foreign currency liquidity risk (FX risk) arising from current and projected liquidity mismatch between the cash inflows and outflows in foreign currencies, or the different allocation of assets and liabilities in foreign currencies in a time horizon.

Within the framework of liquidity risk management, the Bank addresses each of the above mentioned sources of liquidity risk through the appropriate system of limits.

All amounts expressed in thousands of RSD, unless otherwise stated.

4. FINANCIAL RISK MANAGEMENT (Continued)

(e) Liquidity Risks (continued)

The limit system used in daily liquidity risk management ensures that the Bank maintains a liquidity and funding position that is strong enough to bear the potential effects of unfavourable scenarios in which the above risks can be materialized. The Limit System for the Group is defined in the Risk Appetite Framework (RAF) as well as other granular limits. RAF defines the level of risk that the Bank is willing to take in achieving its strategic goals and business plan, taking into account the interest of its shareholders, as well as capital and other regulatory and legal requirements. As such, RAF is approved by the Board of Directors, while the granular limits (or other form of limitation) derive from RAF: their approval process and escalation, however, includes other commissions or functions that are set at a lower hierarchical level in the Bank's organisation.

Some of the main liquidity indicators included in the RAF for 2018 were:
• The Bank's liquidity ratio
• The Bank's narrow liquidity ratio
• Liquidity Coverage Ratio (LCR)
• Net Stable Funding Ratio (NSFR)

During 2018, the Bank's liquidity was at an adequate level and there was no breach of any of the defined limits.

The Bank's liquidity ratio and the rigid/cash liquidity ratio

The Bank is under obligation to maintain the ratio between the sum of liquid receivables of first order and liquid receivables of second order, on the one hand, and the sum of the Bank's demand deposit and deposits without contractual maturity and deposits with contracted maturity, as follows:

- at least 1.0 – when calculated as an average of all working days in a month;
- not below 0.9 for over three consecutive days; and
- at least 0.8 – when calculated for one working day.

In addition, the Bank is obligated to maintain the liquidity levels so that the rigid/cash liquidity ratios are as follows:

- at least 0.7 – when calculated as an average of all working days in a month;
- not below 0.6 for over three consecutive days,
- at least 0.5 – when calculated for one working day.

The Bank is under obligation to report to the National Bank of Serbia if the liquidity ratio is not within prescribed parameters for two consecutive working days, and must do so on the next working day. If the Bank determines a critically low liquidity ratio, it must report this to the National Bank of Serbia at the latest by the next working day. Such report should contain information on the amount of liquid assets that are not available, on the reasons for the lack of liquidity and on planned activities for resolving the cause of illiquidity. The Financial and Operational Risk Department prepares a report on daily liquidity for the National Bank of Serbia on a daily basis.

The realized values of the liquidity and liquidity ratios indicate a high level of liquidity during 2018:

	2018	2017
Liquidity ratio (I grade)		
- as at 31 December	1.53	1.39
- average for the period – December	1.57	1.32
- maximum for the period – December	2.02	1.40
- minimum for the period – December	1.37	1.25

	2018	2017
Rigid/cash liquidity ratio:		
- as of December 31	1.19	1.05
- average for the period – December	1.29	1.07
- maximum for the period – December	1.44	1.18
- minimum for the period – December	1.12	0.99

All amounts expressed in thousands of RSD, unless otherwise stated.

4. FINANCIAL RISK MANAGEMENT (Continued)

(e) Liquidity Risks (continued)

Liquidity Coverage Ratio (LCR)

This indicator represents the ratio of the Bank's high quality liquid assets to the net outflow of its liquid assets that would occur during the next 30 days from the date of calculating this indicator under the assumed stress conditions. This indicator is calculated on a monthly basis for the Bank and consolidated at the Group level 2 times a year. The bank is obliged to keep the liquidity coverage ratio observing total in all currencies at a level not lower than 100%.

The realized LCR values indicate a high level of liquidity during 2018:

As at December 31st	**2018**	**2017**
Protective layer of liquidity	125,544,812	86,227,529
Net outflows of liquid assets	85,018,851	46,919,089
Liquid assets coverage indicator	148%	184%

The liquidity risk management system also defines the specific limits that ensure that the liquidity reserves are large enough to cover periods of intense stress.
The stress test of liquidity risk is carried out on a weekly basis and is based on the analysis of the scenario. The scenario analysis aims at testing the Bank's ability to continue business activities while facing a stressful event. Three basic scenarios are analyzed:
• Market scenario (stressful circumstances caused by market events)
• The name crisis (stressful circumstances caused by unfavourable news in the media or events related to the bank)
• Combined scenario (combination of the previous two scenarios)

In order to ensure timely and adequate handling in cases of increased liquidity risk the Bank has adopted the Contingency Liquidity Plan which are precisely defined:
• Procedures for early detection of Bank's liquidity problems that include a list of early warning indicators;
• Clearly defined activities, obligations and responsibilities in managing the liquidity crisis;
• A way of accessing available or potential sources of liquidity, as well as procedures for securing access to supplementary sources of financing, or sources that are not used in regular business.

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4. FINANCIAL RISK MANAGEMENT (Continued)

(e) Liquidity Risk (Continued)

The following table provides breakdown of relevant maturity groups of the Bank’s financial assets and liabilities as of December 31, 2018:

	Up to 1 month	From 1 to 3 months	From 3 months to 1 year	From 1 to 5 years	Over 5 years	Total
Assets						
Cash and assets held with the central bank	53,405,309	-	-	-	-	53,405,309
Claims based on derivatives	42,646	2,442	7,202	153,228	477,305	682,823
Securities	2,288,192	10,392,019	6,453,726	79,354,801	3,438,555	101,927,293
Loans and receivables from banks and other financial organizations	20,170,018	-	591,567	213,351	-	20,974,936
Loans and receivables from clients	3,612,637	4,606,855	41,869,545	95,221,440	110,332,343	255,642,820
Receivables under hedging derivatives	-	-	-	2	-	2
Other assets	982,931	-	-	-	-	982,931
Total assets	**80,501,733**	**15,001,316**	**48,922,040**	**174,942,822**	**114,248,203**	**433,616,114**
Liabilities						
Liabilities under derivatives	19,764	7,914	36,314	155,702	503,938	723,632
Deposits and other liabilities to banks, other financial organisations and central bank	41,610,519	7,765,703	19,793,638	51,231,904	12,676,371	133,078,135
Deposits and other financial liabilities to clients	183,014,573	12,972,449	13,909,807	9,771,850	1,262,357	220,931,036
Liabilities under hedging derivatives	-	-	-	170,553	318,027	488,580
Current tax liabilities	461,958	-	-	-	-	461,958
Other liabilities	2,756,959	-	-	-	-	2,756,959
Total liabilities	**227,863,773**	**20,746,066**	**33,739,759**	**61,330,009**	**14,760,693**	**358,440,300**
Net liquidity gap as at December 31, 2018	**(147,362,040)**	**(5,744,750)**	**15,182,281**	**113,612,813**	**99,487,510**	**75,175,814**

The structure of asset and liability maturities as at December 31, 2018 is indicative of maturity mismatch between the outstanding maturities of assets and those of liabilities in the time buckets of up to a month and from one to three months, primarily due to maturity structure of deposits, i.e., a significant share of demand deposits in the total deposits due to banks and customers. Such customer behaviour, i.e., focus on shorter maturities is a logical consequence of the current decline in the market interest rates. However, based on historical data and experience, a significant portion of demand deposits may be considered a long-term source of financing given their stability, growth rate and withdrawal rate. At the same time, the Bank is in possession of liquid instruments, securities that can be pledged with the National Bank of Serbia at any time, or sold on a secondary market and has at its disposal funds from the parent bank and international financial institutions in accordance with the adopted financing plan for the current year.

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4. FINANCIAL RISK MANAGEMENT (Continued)

(c) Liquidity Risk (Continued)

The following table provides breakdown of relevant maturity groups of the Bank's financial assets and liabilities as of December 31, 2017:

	Up to 1 month	From 1 to 3 months	From 3 months to 1 year	From 1 to 5 years	Over 5 years	Total
Assets						
Cash and assets held with the central bank	29,661,017	-	-	-	-	29,661,017
Claims based on derivatives	11	22,771	5,398	98,691	58,333	185,204
Securities	48,681	9,034,738	3,596,100	63,530,380	8,135,468	84,345,367
Loans and receivables from banks and other financial organizations	10,047,969	-	1,773,127	4,554	-	11,825,650
Loans and receivables from clients	9,237,530	4,399,647	33,900,614	83,022,614	101,992,702	232,553,107
Receivables under hedging derivatives	-	-	-	9,195	-	9,195
Other assets	977,727	-	-	-	-	977,727
Total assets	**49,972,935**	**13,457,156**	**39,275,239**	**146,665,434**	**110,186,503**	**359,557,267**
Liabilities						
Liabilities under derivatives	54,456	-	-	98,690	53,857	207,003
Deposits and other liabilities to banks, other financial organisations and central bank	27,747,586	3,121,932	21,728,958	35,188,026	11,747,071	99,533,573
Deposits and other financial liabilities to clients	146,517,472	14,033,430	14,298,078	10,489,356	1,320,497	186,658,833
Liabilities under hedging derivatives	-	-	-	17,524	431,270	448,794
Subordinated liabilities	1,022	-	2,717,468	-	-	2,718,490
Current tax liabilities	178,821	-	-	-	-	178,821
Other liabilities	2,590,012	-	-	-	-	2,590,012
Total liabilities	**177,089,369**	**17,155,362**	**38,744,504**	**45,793,596**	**13,552,695**	**292,335,526**
Net liquidity gap as at December 31, 2017	**(127,116,434)**	**(3,698,206)**	**530,735**	**100,871,838**	**96,633,808**	**67,221,741**

4. FINANCIAL RISK MANAGEMENT (Continued)

(f) Compliance Risks

Compliance risk represents possibility of adverse effect on the Bank's financial performance and capital due to the failure of the Bank to align its operations with the effective laws and regulations, professional standards, procedures for prevention of money laundering and terrorist financing and other procedures and other bylaws aimed at improving banking operations. It particularly relates to the risk of regulatory sanctions, risk of financial loss and reputation risks. The Bank has organized a special organizational unit whose competence covers compliance review.

The primary task of the Compliance Department is to identify and asses the Bank's compliance risk and report to the Management Board and Audit Committee and, as appropriate, the Supervisory Board and to propose plans on main compliance risks. The Compliance Department assess risks in accordance with the adopted Methodology and Annual Activity Plan.

Moreover, the Bank's compliance function supports other organizational units of the Bank in defining procedures, introducing new products or modifying the existing ones, in implementation of the laws and bylaws, rules, standards and the Bank's internal acts specifically governing the following areas: prevention of money laundering and terrorist financing, financial sanctions, banking secrets, protection of personal data, insider information and market abuse, professional market conduct standards, conflict of interests, corruption, loansharking, professional conduct with clients and provision of adequate advice, application of standards on consumer protection and transparency, protection of competition and other regulatory areas in accordance with the rules of UniCredit Group and adopted program for the Bank's compliance function.

Within the Compliance Directorate a separate organizational unit has been formed – Unit for Prevention of Money Laundering and Terrorist Financing, where the number of staff members who perform the tasks of identification, measurement and monitoring and managing the risk of money laundering and terrorist financing is proportionate to the volume, type and complexity of the Bank's organizational structure and its exposure to this risk.

(g) Risk Money Laundering and Terrorist Financing

Risk of money laundering and terrorist financing is a risk of possible adverse effects on the Bank's financial performance, capital or reputation due to the use of the Bank for money laundering and/or terrorist financing.

Risk of money laundering and terrorist financing arises particularly as a result of the failure of banks to align their business operations with the effective legislation, regulations and internal acts governing prevention of money laundering and terrorist financing, or as a result of mutual nonalignment of the Bank's internal acts governing this matter.

The Bank has in place adequate policies and procedures for identification, measurement, assessment and management of this risk.

Within the Compliance Department a separate organizational unit has been formed – Anti Money Laundering and Terrorist Financing prevention unit – to take care of the improvement and continuous implementation of the policies and procedures for managing the risk of money laundering and terrorist financing. The Bank has provided the staff of the Unit with appropriate HR, material, IT and other resources for work as well as with ongoing professional education and trainings.

(h) Strategic Risks

Strategic risk is a risk of adverse effects on the Bank's financial performance and capital due to inadequate strategies and policies in place and their inadequate implementation as well as due to changes in the environment the Bank operates in or the Bank's failure to respond property to such changes.

Each and every employee within the Bank's risk management system is responsible for strategic risk management, with the Supervisory Board having the key role in this system establishment, while the Management Board is in charge of its implementation, as well as for the risk identification, measurement and assessment. Among other things, the Bank's governing bodies monitor the strategic risk through creation and monitoring of the budget, which is prepared annually, as well as through preparation of the multiannual strategic plan, which allows them, at least quarterly, to get to know and be able to respond to all the changes in the environment the Bank operates in. The system of reporting to the Bank's management, which is in place in all the operating segments, ensures an adequate and timely set of information required for the decision making process on the part of the Bank's management in order to enable prompt responses to the changes in the business environment.

4. FINANCIAL RISK MANAGEMENT (Continued)

(h) Strategic Risks (continued)

The Bank's organizational structure, set up by the above said governing bodies is defined and adjusted in such a manner that resources dedicated to the preparation and application of crediting policies and strategies, development and implementation of the respective methodologies, rulebooks and other bylaws. The Bank continuously monitors, assesses and adjusts all the relevant bylaws and enactments and crediting processes and proposes improvements or actions to be taken in response to the changes in the environment in order to adequately decrease their impact on the Bank's financial performance.

The critical element of the strategic risk management is the Bank's internal control system, which enables continuous monitoring of all the risks the Bank is or may be exposed to in its operations. The said system provides implementation of adequate strategies and policies in the Bank's practice and elimination of weaknesses or inconsistences, if any, which represents additional strategic risk monitoring and management.

(i) Business Risk

Business risk is defined as a measure of the difference between unexpected and expected unwanted changes in future revenue of the Bank.

Business risk may result from extremely unfavourable developments in the market environment, changes in competition or behaviour of clients, as well as changes in the legal framework. Sources of this data represent a series of financial statements that include items whose variability is assessed within other types of risk (credit, market, operational). Therefore, in order to avoid overlapping with the assessment of other types of risk (e.g. credit, market, operational), the focus is on specific types of income and expenses of the Bank, which, after evaluation, are identified and aggregated with other types of risks in order to obtain the total assessment of the risk profile through the economic capital of the bank.

(j) Reputational Risk

Reputational risk is the current or future risk of falling profits as a result of the negative perception of the image of the Bank by clients, contracting parties, shareholders of the Bank, investor or regulator.

In order to adequately organise the risk management process and clearly distinguish the responsibilities of the employees within the Risk Management Division, as well as define and implement risk mitigation measures in this area, the Bank has adopted and implemented policies and other internal acts of the lower rank.

(k) Interest Rate Risk in the Banking Book

Interest rate risk is defined as the possibility of adverse effects on the financial result and the Bank's equity based on positions in the banking book due to changes in interest rates.

The Bank's exposure to interest rate risk is considered from two perspectives:
• Impact on economic value - when changes in interest rates affect the basic value of assets. liabilities and off-balance sheet instruments, because the economic value of future cash flows changes (and in some cases. cash flows themselves)
• Impact on the financial result - when changes in interest rates affect earnings by changing net interest income.

The system of limits for measuring exposure to interest rate risk is followed by potential changes in economic value (EV) and changes in expected net interest income (NII) or profit. addressing all material sources of risk, in particular:
• Repricing risk - arises from the forward structure of the banking book and relates to time mismatch of maturity and repricing period,
• Yield curve risk - arising from changes in the yield curve shape,
• Basis risk to which the bank is exposed due to different reference interest rates in interest sensitive positions with similar characteristics in terms of maturity or re-pricing
• Optionality risk to which it is exposed due to embedded options in relation to interest-sensitive positions (loans with the possibility of early repayment, deposits with the possibility of early withdrawal).

All amounts expressed in thousands of RSD, unless otherwise stated.

4. FINANCIAL RISK MANAGEMENT (Continued)

(k) Interest Rate Risk in the Banking Book (continued)

The Bank has implemented the framework of interest rate risk scenarios that address all mentioned sources of interest rate risk and, depending on the strength of the assumptions, can be divided into two basic groups:
• a regular business scenario
• a stress test scenario.

Scenarios vary depending on the specific risk generator, whose parameters are changed or stressed:

• assumptions of stress on interest rates (parallel, non-parallel changes in interest rates)
• assumptions of stress on the balance sheet (dynamic balance sheet, constant balance sheet)
• single-factor analysis
• multifactor analysis.

The effects of all scenarios are analyzed from the point of view of the change in economic value and net interest income.

Interest rate risk scenarios included in RAF 2018:
• Economic value sensitivity (EV)
• Sensitivity of net interest income (NII).

One of the tasks of the Finance Department/Assets and Liabilities Management Unit of the Bank is to establish procedures for the Bank to be within defined limits for interest rate risk. This is accomplished through activities in the financial markets (through interbank transactions. securities transactions) conducted in cooperation with the Markets Department as well as other activities on the side of assets and liabilities managed by interest gap in order to interest rate risk protection, in line with the preferred risk profile. At the same time, the Department deals with the management of the investment portfolio of the Bank, which, together with the approved instruments, enables the achievement of a strategic position that enables the stability of interest income from the banking book. In order to protect against interest rate risk, the Department performs hedging transactions of specific portfolios or transactions.

An analysis of the Bank's sensitivity to increase or decrease interest rates on the market to positions in the banking book (EV), assuming no asymmetric trends in yield curves, is presented as follows:

In RSD 000	Parallel increase of 200 bp	Parallel decrease of 200 bp
2018		
As at 31 December	(2,258,022)	2,551,880
Average for the year	(2,235,410)	2,683,621
Maximum for the year	(1,953,384)	3,174,515
Minimum for the year	(2,352,775)	1,943,336
2017		
As at 31 December	(1,670,590)	2,178,791
Average for the year	(2,109,802)	2,131,679
Maximum for the year	(3,003,411)	3,104,805
Minimum for the year	(1,407,624)	1,237,088

All amounts expressed in thousands of RSD, unless otherwise stated.

4. FINANCIAL RISK MANAGEMENT (Continued)

(k) Interest rate risk in the banking book (continued)

Exposure to interest rate changes as at December 31, 2018 is presented to the entire interest bearing part of the balance sheet:

	Carrying amount	Up to 1 month	From 1 to 3 months	From 3 months to 1 year	From 1 to 5 years	Over 5 years	Non-interest bearing
Cash and assets held with the central bank	53,405,309	18,945,448	-	-	-	-	34,459,861
Claims based on derivatives	682,823	-	-	-	-	-	682,823
Securities	101,927,293	3,781,744	10,392,019	87,753,530	-	-	-
Loans and receivables from banks and other financial organizations	20,974,936	20,164,960	-	804,874	-	-	5,102
Loans and receivables from clients	255,642,820	3,759,029	5,948,073	235,441,345	3,984,342	5,756,802	753,229
Receivables under hedging derivatives	2	-	-	-	-	-	2
Other assets	982,931	-	-	-	-	-	982,931
Total assets	**433,616,114**	**46,651,181**	**16,340,092**	**323,999,749**	**3,984,342**	**5,756,802**	**36,883,948**
Liabilities under derivatives	723,632	-	-	-	-	-	723,632
Deposits and other liabilities to banks, other financial organisations and central bank	133,078,135	40,951,782	23,801,512	19,342,253	47,259,926	1,447,884	274,778
Deposits and other financial liabilities to clients	220,931,036	60,223,289	20,587,164	15,385,259	7,556,718	23,200	117,155,406
Liabilities under hedging derivatives	488,580	-	-	-	-	-	488,580
Current tax liabilities	461,958	-	-	-	-	-	461,958
Other liabilities	2,756,959	-	-	-	-	-	2,756,959
Total liabilities	**358,440,300**	**101,175,071**	**44,388,676**	**34,727,512**	**54,816,644**	**1,471,084**	**121,861,313**
Net interest rate risk sensitivity exposure at December 31, 2018	**75,175,814**	**(54,523,890)**	**(28,048,584)**	**289,272,237**	**(50,832,302)**	**4,285,718**	**(84,977,365)**

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4. FINANCIAL RISK MANAGEMENT (Continued)

(k) Interest rate risk in the banking book (continued)

Exposure to interest rate changes as at December 31, 2017 is presented to the entire interest bearing part of the balance sheet:

	Carrying amount	Up to 1 month	From 1 to 3 months	From 3 months to 1 year	From 1 to 5 years	Over 5 years	Non-interest bearing
Cash and assets held with the central bank	29,661,017	15,965,402	-	-	-	-	13,695,615
Claims based on derivatives	185,204						185,204
Securities	84,345,367	2,144,526	8,827,206	3,567,870	61,670,297	8,135,468	-
Loans and receivables from banks and other financial organizations	11,825,650	10,046,067	-	1,773,129	4,554	-	1,900
Loans and receivables from clients	232,553,107	8,384,437	4,398,789	197,850,446	16,578,446	4,487,915	853,074
Receivables under hedging derivatives	9,195	-	-	-	-	-	9,195
Other assets	977,727	-	-	-	-	-	977,727
Total assets	**359,557,267**	**36,540,432**	**13,225,995**	**203,191,445**	**78,253,297**	**12,623,383**	**15,722,715**
Liabilities under derivatives	207,003	-	-	-	-	-	207,003
Deposits and other liabilities to banks, other financial organisations and central bank	99,533,573	26,276,233	4,078,331	68,404,055	260,000	-	514,954
Deposits and other financial liabilities to clients	186,658,833	75,244,759	72,897,649	20,078,300	4,350,796	-	14,087,329
Liabilities under hedging derivatives	448,794	-	-	-	-	-	448,794
Subordinated liabilities	2,718,490	-	2,718,490	-	-	-	-
Current tax liabilities	178,821	-	-	-	-	-	178,821
Other liabilities	2,590,012	-	-	-	-	-	2,590,012
Total liabilities	**292,335,526**	**101,520,992**	**79,694,470**	**88,482,355**	**4,610,796**	**-**	**18,026,913**
Net interest rate risk sensitivity exposure at December 31, 2017	**67,221,741**	**(64,980,560)**	**(66,468,475)**	**114,709,090**	**73,642,501**	**12,623,383**	**(2,304,198)**

4. FINANCIAL RISK MANAGEMENT (Continued)

(l) Information System Risk

The risk of the information system is the possibility of creating negative effects on the financial result and capital, achieving business goals, doing business in accordance with the regulations and the reputation of the Bank due to inadequate management of the information system or other weaknesses in that system which negatively affects its functionality or security or endangers the continuity of operations Banks.

In order to control, i.e. mitigate this type of risk, as well as to improve the management of such risk, the Bank has adopted and applied the strategy of development of the information system.

In order to adequately organise the process of managing this risk and clearly delineate the responsibilities of employees, as well as the definition and application of risk mitigation measures in this area, the Bank applies the business rules, procedures and other lower rank internal regulations.

(m) Capital Management

As the Bank's regulator, the National Bank of Serbia ("NBS") defines the method of calculating capital and capital adequacy based on Basel III Regulatory Framework, Regulatory capital, capital adequacy ratios and calculation of risk-weighted assets are defined by the Decision on Capital Adequacy of Banks effective as from June 30. 2017 (the "Decision"). The Bank monitors its capital adequacy ratio on a quarterly basis using the standardized approach.

The Bank is required to calculate the following capital adequacy ratios:

1. the Common Equity Tier 1 capital ratio (CET 1 ratio) represents the Bank's common equity tier 1 capital relative to the risk-weighted assets, expressed as percentage. The minimum CET 1 ratio defined by the Decision is 4.5%;
2. the Tier 1 capital ratio (T1 ratio) is the Bank's core capital adequacy ratio, representing the core capital relative to the risk-weighted assets, expressed as percentage. The minimum T1 ratio defined by the Decision is 6%;
3. the total capital adequacy ratio (CAR) represents the Bank's capital relative to the risk-weighted assets, expressed as percentage. The minimum CAR defined by the Decision is 8%.

The Bank is required to maintain its core capital in RSD equivalent amount of EUR 10.000.000 at all times, using the official middle exchange rate of NBS effective as at the calculation date. In addition, the Bank is required to maintain at all times its capital in the amount necessary for coverage of all risks the Bank is or may be exposed to in its operations, yet no less than the amount required to maintain the minimum capital adequacy ratios or increased capital adequacy ratios – in case NBS orders the Bank to achieve and maintain capital adequacy ratios higher than the prescribed ones. In 2018 NBS did not impose on the Bank capital adequacy ratios higher than the prescribed ones.

The Bank's capital is the sum of the core capital (Tier 1) and supplementary capital (Tier 2). The core capital is the sum of the Common Equity Tier 1 capital and Additional Tier 1 capital.

The Bank's Common Equity Tier 1 capital is the sum of the following items adjusted for the regulatory adjustments less deductible items:

- shares and other equity instruments;
- relevant share premium with the Common Equity Tier 1 instruments;
- the Bank's profit;
- revaluation reserves and other unrealized gains;
- reserves from profit and other reserves of the Bank;
- reserve funds for general banking risks.

Regulatory adjustments – When calculating the value of its capital components, the Bank is bound to exclude from any capital component any increase in equity determined under IFRS/IAS resulting from securitization of exposures. Since the Republic of Serbia has no regulations enacted to govern this area, the said regulatory adjustment is not applicable.

4. FINANCIAL RISK MANAGEMENT (Continued)

(m) Capital Management (continued)

The Bank does not include in its capital the following:

- fair value reserves relating to gains or losses in cash flow hedging instruments for financial instruments measured at other than fair value, including the projected cash flows;
- gains or losses on the Bank's liabilities measured at fair value, resulting from the changes in the Bank's credit quality;
- gains or losses arising from the credit risk for liabilities per derivatives measured at fair value, where the Bank may not offset such gains or losses against those arising from its counterparty credit risk.

Unrealized gains or losses on assets or liabilities measured at fair value, except for the above listed gains or losses, are included in the calculation of capital.

Deductible from the Common Equity Tier 1 capital are:

- current and prior year's losses and unrealized losses;
- intangible assets, including goodwill, decreased for the amount of deferred tax liabilities that would be derecognized in case of impairment or derecognition of intangible assets under IFRS/IAS;
- deferred tax assets dependable on the Bank's future profitability in line with the effective regulations;
- defined benefit pension fund assets on the Bank's balance sheet;
- the Bank's direct, indirect and synthetic holdings of its own Common Equity Tier 1 instruments, including those that the Bank is under an actual or contingent obligation to repurchase by virtue of a constructive obligation;
- the Bank's direct, indirect and synthetic holdings of Common Equity Tier 1 instruments of financial sector institutions (hereinafter: FSI) entities where those entities have reciprocal holdings in the Bank, designed to artificially inflate the bank's capital;
- the Bank's applicable direct, indirect and synthetic holdings of Common Equity Tier 1 instruments of FSI entities where the Bank holds no significant investments in accordance with Articles 19 and 20 of the Decision;
- the Bank's applicable direct, indirect and synthetic holdings of Common Equity Tier 1 instruments of FSI entities where the Bank holds significant investments in accordance with Sections 19 of the Decision;
- the amount for which the Bank's Additional Tier 1 capital deductible items exceed the Bank's Additional Tier 1 capital;
- the amount of exposures qualifying for application of a risk weight of 1.25%, where the Bank decides to deduct the exposure from the Common Equity Tier 1 rather than apply the said risk weight, such as:
  - holdings in non-FSI entities exceeding 10% of their capital and/or holdings enabling effective execution of significant influence on the management of such entities or their business policies;
  - securitized items in accordance with Section 201, paragraph 1, item 2), Section 202, paragraph 1, item 2), and Section 234 of the Decision;
  - free deliveries, if the counterparty has failed to settle its liability within four working days from the agreed delivery/payment date, in accordance with Section 299 of the Decision;
- any tax charge relating to the Common Equity Tier 1 items foreseeable at the moment of its calculation, except where the Bank has previously suitably adjusted the amount of Common Equity Tier 1 items in the amount such tax charges reduce the amount up to which those items may be used to absorb risks or losses;
- amount of the required reserve for estimated losses on the Bank's balance sheet assets and off-balance sheet items.

4. FINANCIAL RISK MANAGEMENT (Continued)

(m) Capital Management (continued)

Upon determining deductible deferred tax assets items and the Bank's applicable direct, indirect and synthetic holdings of Common Equity Tier 1 instruments of FSI entities where the Bank holds significant investments, the Bank is not required to deduct from the Common Equity Tier 1 capital the amounts of items that in the aggregate are equal to or lower than the limit which is arrived at by multiplying the Common Equity Tier 1 items remaining after the regulatory adjustments and decrease for deductible items by 17.65%:

- deferred tax assets dependable on the Bank's future profitability, arising from the temporary differences in the amount lower than or equal to 10% of the Bank's Common Equity Tier 1 capital calculated in accordance with Section 21. paragraph 2 of the Decision;
- the Bank's direct, indirect and synthetic holdings of Common Equity Tier 1 instruments of FSI entities where the Bank holds significant investments in the amount lower than or equal to 10% of the Bank's Common Equity Tier 1 capital calculated in accordance with Section 21. paragraph 2 of the Decision.

As of December 31, 2018 the Bank did not reduce its Common Equity Tier 1 capital for the amount of direct holdings of Common Equity Tier 1 instruments or for deferred tax assets dependable on the Bank's future profitability, arising from the temporary differences since their aggregate amount was below the defined limit.

The Bank's Additional Tier 1 capital consists of the sum of the following items less respective deductibles:

- shares and other equity instruments that meet the requirements referred to in Section 23 of the Decision;
- relevant share premium.

As of December 31, 2018 the Bank had no additional Tier 1 capital.

The Bank's supplementary (Tier 2) capital consists of the sum of the following items less respective deductibles:

- shares and other Tier 2 instruments and liabilities under subordinated loans;
- the relevant share premium, i.e., amounts paid in above the par value of such instruments;
- general credit risk adjustments gross of tax effects, of up to 1.25% of the risk-weighted credit risk exposures for banks calculating the risk-weighted exposures amounts by applying the standardized approach.

The amount in which the supplementary Tier 2 capital instruments, i.e., subordinated liabilities are included in the calculation of the supplementary Tier 2 capital during the final five years before they mature, is calculated as follows: the ratio of their nominal value and/or the principal amount on the first day of the final five-year period before their mature and the number of calendar days in that period is multiplied by the number of the calendar days remaining to maturity of the instruments or subordinated liabilities at the calculation date.

As of December 31, 2018 the Bank had no additional Tier 2 capital.

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4. FINANCIAL RISK MANAGEMENT (Continued)

(m) Capital Management (continued)

The following table presents the Bank's balance of capital as of December 31, 2018 and as of December 31, 2017:

	2018	2017
Common equity Tier 1 capital - CET1		
Paid in Common Equity Tier 1 instruments	23,607,620	23,607,620
Share premium with the Common Equity Tier 1 Capital instruments	562,156	562,156
Previous year's profit eligible for inclusion in CET 1 Capital	-	-
Revaluation reserves and other unrealized gains	2,517,701	1,545,736
(-) Unrealized losses	(620)	(5,416)
Other reserves	41,919,994	36,997,080
(-) Intangible assets, including goodwill, decreased for the amount of deferred tax liabilities)	(1,617,855)	(1,162,458)
(-) Amount of taxes associated with CET1 Capital items which can be predicted at the time of capital calculation, unless the bank previously adjusted the amount of CET1 Capital items in the amount in which CET1 Capital items can be used to cover risks of losses	(377,655)	(231,860)
(-) Amount of required reserve for estimated losses on the Bank's balance sheet assets and off-balance sheet items	(9,958,131)	(13,237,594)
Total Common Equity Tier 1 capital - CET1	**56,653,210**	**48,075,264**
Additional Tier 1 capital - AT1	-	-
Total core Tier 1 capital - T1 (CET1 + AT1)	**56,653,210**	**48,075,264**
Supplementary capital - T2		
Paid amount of subordinated liabilities	-	538,731
Total supplementary capital - T2	-	538,731
Total Regulatory Capital (T1 + T2)	**56,653,210**	**48,613,995**

In both 2018 and 2017 the Bank achieved capital adequacy ratios within the limits prescribed by NBS Decision on Capital Adequacy of Banks and Decision on Risk Management.

5. USE OF ESTIMATES AND JUDGMENTS

The preparation of the financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under given circumstances. Revision to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

These disclosures supplement the comments on financial risk management (Note 4).

(a) Key Sources of Estimation Uncertainty

(i) Provisions for Credit Losses

Financial assets are assessed for impairment on a basis described in accounting policy 3(k)(viii).

The measurement of impairment losses in accordance with IFRS 9 and IAS 39 for all categories of financial assets requires estimates, in particular estimates relating to the determination of the amount and expected time on the basis of the inflow of future cash flows, as well as the cash flows arising from the realisation of the estimated value collateral in determining impairment losses and assessing a significant increase in credit risk. These estimates are guided by a number of factors, whose combination and interaction can lead to different levels of loan loss provisions, in different scenarios.

The Bank's ECL calculations are the results of complex models with a number of assumptions concerning the choice of input variables as well as their interdependence. Elements of an ECL model that are considered part of the accounting judgments and estimates include:
• Internal credit rating model of the Bank, which assigns PD to individual rating categories;
• The Bank's criteria for assessing whether there has been a significant increase in credit risk and consequently lead to an ECL calculation based on the entire life of the instrument (the so-called LT ECL - life time ECL), using quantitative criteria (changes in PD in relative to the date of the initial recognition of the financial asset), as well as qualitative estimates (forbearance, restructuring classification, 30 days of arrears, watch list 2 categorization);
• Segregation of financial assets when their ECL is assessed on a collective basis;
• Development of an ECL model including various formulas and selection of inputs;
• Determining the correlation between macroeconomic scenarios and economic inputs, such as GDP trends, unemployment levels and wages as well as interest rates, and modelling their linkages and impacts on PD and LGD used;
• In cooperation with UniCredit Group, a selection of forward looking scenarios of macroeconomic scenarios and their weighting probabilities, in order to derive the connection between the ECL model and possible economic trends.

In line with internal policies, the Bank will regularly review and maintain its models in the context of a real experience of credit losses when required.

Impairment of financial assets and probable loss on the basis of off-balance sheet items for individually significant receivables is assessed by the Bank on an individual basis. The assessment of the impairment of financial assets on an individual basis includes the determination of the existence of objective evidence of this impairment, i.e. the existence of a default status. The amount of impairment of financial assets is determined as the difference between the carrying amount of the receivable and the present value of the expected future cash flows on that claim, while the estimate of the probable loss on the basis of off-balance sheet items includes an estimate of the recoverability of future cash outflows for each assumed off-balance sheet liability.

The Bank assesses the impairment of financial assets and the probable loss on off-balance sheet items on a group basis for all receivables in which this impairment or these losses cannot be directly linked to those claims, but for which experience can be estimated to exist in the loan portfolio. In this assessment, the Bank grouped receivables based on similar credit risk characteristics that reflect the ability of the borrower to settle its obligations in accordance with the contractual terms (portfolio segments, rating of the category, etc.). An impairment assessment on a group basis is a common estimate of the future cash flows of an individual group of receivables based on data on losses from previous periods for receivables with credit risk characteristics similar to those in that group, in accordance with the methodology.

5. USE OF ESTIMATES AND JUDGMENTS (Continued)

(a) Key Sources of Estimation Uncertainty (continued)

(ii) Fair value estimates

Determination of fair value for financial assets and liabilities for which there is no observable market price requires the use of valuation techniques as described in accounting policy 3(k)(vii). For financial instruments that trade infrequently and have little price transparency, fair value is less objective, and requires varying degrees of judgment depending on liquidity, concentration, uncertainty of market factors, pricing assumptions and other risks affecting the specific instrument.

(b) Critical Accounting Judgments in Applying the Bank's Accounting Policies

Critical accounting judgments made in applying the Bank's accounting policies include the following:

(i) Measurement of Financial Instruments

The Bank's accounting policy on fair value measurement is disclosed in accounting policy 3(k)(vii).

The Bank measures fair values using the following fair value hierarchy that reflects the significance of the inputs used in making the measurements:

- Level 1: Quoted market price (unadjusted) in an active market for an identical instrument;
- Level 2: Valuation techniques based on observable inputs other than quoted prices, either directly (i.e. as prices) or indirectly (i.e. derived from prices). This category includes instruments valued using: quoted market prices in active markets for similar instruments; quoted prices for identical or similar instruments in markets that are considered less than active; or other valuation techniques where all significant inputs are directly or indirectly observable from market data.
- Level 3: Valuation techniques using significant unobservable inputs. This category includes all instruments where the valuation technique includes inputs not based on observable data and the unobservable inputs have a significant effect on the instrument's valuation. This category includes instruments that are valued based on quoted prices for similar instruments where significant unobservable adjustments or assumptions are required to reflect differences between the instruments.

Fair values of financial assets and financial liabilities that are traded in active markets are based on quoted market prices. For all other financial instruments the Bank determines fair values using valuation techniques.

Valuation techniques include net present value and discounted cash flow models, comparison to similar instruments for which market observable price exist and other valuation models. Assumptions and inputs used in valuation techniques include risk-free and benchmark interest rates, credit spreads and other factors used in estimating discount rates, bond and equity prices, foreign exchange rates, equity and equity index prices and expected price volatilities and correlations. The objective of valuation techniques is to arrive at a fair value determination that reflects the price of the financial instrument at the reporting date, which would have been determined by market participants acting at arm's length.

The Bank uses widely recognized valuation models for determining the fair value of common and more simple financial instruments, such as interest rate and currency swaps that use only observable market data and require little management judgment and estimation. Observable prices and model inputs are usually available in the market for listed debt and equity securities, exchange traded derivatives and simple over the counter derivatives like interest rate swaps. Availability of observable market prices and model inputs reduces the need for management judgment and estimation and also reduces the uncertainty associated with determination of fair values. Availability of observable market prices and inputs varies depending on the products and markets and is prone to changes based on specific events and general conditions in the future markets.

5. USE OF ESTIMATES AND JUDGMENTS (Continued)

(b) Critical Accounting Judgments in Applying the Bank's Accounting Policies (continued)

(ii) Business model evaluation and SPPI test

Classification and measurement of debt financial instruments in accordance with IFRS 9 depends on the business model and results of the SPPI test as described in accounting policy 3(k)(ii).

The business model reflects the way in which the Bank manages its financial assets for the purpose of collecting cash flows. Management assesses a business model at the level of a group of financial assets such as portfolio or sub portfolio of financial assets. When assessing, relevant information such as past sales, management's intentions regarding future sales, performance evaluation and management reporting are taken into account. A process of continuous monitoring of financial assets at amortized cost or fair value has been established through other results that have ceased to be recognized before maturity in order to determine the reasons for alienation and whether the reasons are in line with the objective of the business model within which the financial asset is held. If a business model is hold to collect or hold to collect and sale, an estimate is made either at the level of the individual contract or group of contracts whether the contracted cash flows of the financial asset represent only the payment of principal and interest ("SPPI test"). If the contractual terms of a financial asset include exposure to risks that are not in accordance with the underlying loan arrangement, a financial asset is classified and measured at fair value through profit or loss.

(iii) Estimated Useful Lives of Intangible Assets, Property, Plant and Equipment and Amortization/Depreciation Rates Used

The calculation of amortization/depreciation charge and amortization/depreciation rates applied are based on the estimated useful lives of intangible assets, property, plant and equipment, which are subject to an ongoing review. The estimated useful lives are reviewed for adequacy at least annually, or more frequently if there is any indication that significant changes have occurred to the factors determining the previously defined estimated useful lives or other events affecting the estimated useful lives. Useful life estimates require the management to make significant estimates and judgments based on the historical experience with similar assets, as well as anticipated technical advancement and changes in economic and industrial factors.

(iv) Impairment of Non-Financial Assets

At each reporting date, the Bank's management reviews the carrying amounts of its non-financial assets other than investment property and deferred tax assets in order to determine the indications of impairment losses. If there is any indication that such assets have been impaired, the recoverable amount of the asset is estimated in order to determine the extent of impairment loss. If the estimated recoverable amount of an asset is below its carrying value, the carrying amount of the asset is reduced to its recoverable amount. An impairment loss is immediately recognized as an expense of the current period. Assessment of indicators and objective evidence of impairment requires the management to make significant estimates regarding the expected cash flows, discount rates and usage capacity of the assets subject to review.

(v) Deferred Tax Assets

Deferred tax assets are recognized to the extent that it is probable that taxable profit will be available against which such deferred tax assets may utilized. The Bank's management needs to make prudent assessments of deferred tax assets which may be recognized, based on their period of inception and amounts, as well as on the amount of future taxable income and tax policy planning strategy.

(vi) Provisions for Litigations

The Bank is involved in a number of lawsuits and labour disputes. Provisions are recognized when the Bank has a present obligation (legal or constructive) as a result of past events, it is probable that the Bank will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation. Estimates of the provisions for legal suits requires the Bank's management and Legal Unit to make significant estimates and judgments, including the estimate of the probability of negative suit outcomes and probable and reasonable estimates of loss amounts. The required provision amounts represent the best estimates made by the management based on the information available as at the reporting date. However, they may be subject to future changes due to new events taking place or obtaining new information.

All amounts expressed in thousands of RSD, unless otherwise stated.

5. USE OF ESTIMATES AND JUDGMENTS (Continued)

(b) Critical Accounting Judgments in Applying the Bank's Accounting Policies (continued)

(vii) Provisions for Employee Benefits

The costs of provisions for employee retirement benefits are determined by actuarial calculation. The actuarial calculation includes an assessment of the discount rate, future salary growth rate, future employee turnover rate and mortality rates. Actual outcome may vary significantly from the said estimates, particularly given the long term they relate to.

6. FINANCIAL ASSETS AND LIABILITIES - ACCOUNTING CLASSIFICATION AND FAIR VALUES

The following table show the breakdown of financial instruments measured at fair value at the end of the reporting period, grouped in fair value hierarchy levels:

	Note	Level 1	Level 2	Level 3	Total
2018					
Receivables under derivatives	23	-	682,823	-	682,823
Securities					
-securities measured at fair value through profit or loss	24	-	1,493,552	-	1,493,552
-securities measured at fair value through other comprehensive income	24	2,112,792*	98,284,026	-	100,396,818
Change in fair value of hedged items	27	-	-	222,773	222,773
Receivables under hedging derivatives	28	-	2	-	2
		2,112,792	**100,460,403**	**222,773**	**102,795,968**
Liabilities under derivatives	35	-	723,632	-	723,632
Liabilities under hedging derivatives	38	-	488,580	-	488,580
		-	**1,212,212**	**-**	**1,212,212**

* Securities valued at fair value through other comprehensive income - Level 1, include Treasury bills of the Republic of Serbia denominated in USD, listed in EU Stock Exchanges as highly liquid assets.

	Note	Level 1	Level 2	Level 3	Total
2017					
Receivables under derivatives	23	-	185,204	-	185,204
Securities					
-securities measured at fair value through profit or loss held for trading**	24	-	2,095,845	-	2,095,845
-securities available for sale**	24	1,946,572*	80,225,064		82,171,636
Change in fair value of hedged items	27	-	17,956	174,295	192,251
Receivables under hedging derivatives	28	-	9,195	-	9,195
		1,946,572	**82,533,264**	**174,295**	**84,654,131**
Liabilities under derivatives	35	-	207,003	-	207,003
Liabilities under hedging derivatives	38	-	448,794	-	448,794
		-	**655,797**	**-**	**655,797**

* Securities valued at fair value through other comprehensive income - Level 1 include Treasury bills of the Republic of Serbia denominated in USD, listed in EU Stock Exchanges as highly liquid assets.

** Classification of securities in accordance with IAS 39.

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6. FINANCIAL ASSETS AND LIABILITIES - ACCOUNTING CLASSIFICATION AND FAIR VALUES (Continued)

(i) Fair Value Hierarchy for Assets and Liabilities Other than Measured at Fair Value

The estimated fair values of financial assets and liabilities that are not measured at fair value are shown in the table following the fair value hierarchy levels in accordance with IFRS 13:

2018	Note	Level 1	Level 2	Level 3	Total Fair Value	Carrying Value
Cash and assets held with the central bank	22	-	-	53,405,309	53,405,309	53,405,309
Securities						
- securities measured at amortized cost	24	-	-	36,923	36,923	36,923
Loans and receivables from banks and other financial organizations	25	-	805,007	20,163,268	20,968,275	20,974,936
Loans and receivables from clients	26	-	95,601,414	164,653,511	260,254,926	255,642,820
Other assets	34	-	-	982,931	982,931	982,931
		-	**96,406,421**	**239,241,942**	**335,648,364**	**331,042,919**
Deposits and other liabilities to banks, other financial institutions and the central bank	36	-	100,523,415	32,208,409	132,731,824	133,078,135
Deposits and other financial liabilities to clients	37	-	52,824,689	168,812,410	221,637,099	220,931,036
Current tax liabilities	21.4	-	-	461,958	461,958	461,958
Deferred tax liabilities	33	-	-	381	381	381
Other liabilities	41	-	-	2,756,959	2,756,959	2,756,959
		-	**153.348.104**	**204.240.117**	**357.588.221**	**357.228.469**

2017	Note	Level 1	Level 2	Level 3	Total Fair Value	Carrying Value
Cash and assets held with the central bank	22	-	-	29,661,017	29,661,017	29,661,017
Securities						
- securities held to maturity*	24	-	-	81,780	81,780	77,886
Loans and receivables from banks and other financial organizations	25	-	9,248,386	2,577,264	11,825,650	11,825,650
Loans and receivables from clients	26	-	80,231,248	169,267,555	249,498,803	232,553,107
Other assets	34	-	977,727	-	977,727	977,727
		-	**90,457,361**	**201,587,616**	**292,044,977**	**275,095,387**
Deposits and other liabilities to banks, other financial institutions and the central bank	36	-	85,780,106	15,199,254	100,979,360	99,533,573
Deposits and other financial liabilities to clients	37	-	34,783,435	152,525,877	187,309,312	186,658,833
Subordinated liabilities	39	-	2,718,490	-	2,718,490	2,718,490
Current tax liabilities	21.4	-	178,821	-	178,821	178,821
Other liabilities	41	-	2,590,012	-	2,590,012	2,590,012
		-	**126,050,864**	**167,725,131**	**293,775,995**	**291,679,729**

* Classification of securities in accordance with IAS 39.

6. FINANCIAL ASSETS AND LIABILITIES - ACCOUNTING CLASSIFICATION AND FAIR VALUES (Continued)

(i) Fair Value Hierarchy for Assets and Liabilities Other than Measured at Fair Value (continued)

Valuation techniques and models the Bank uses for fair value calculations are disclosed in Note 5b(i).

(ii) Assets with Fair Values Approximate to Carrying Values

For financial assets and financial liabilities that are highly liquid or having a short term original maturity (less than one year) it is assumed that the carrying amounts approximate their fair values. The basic assumption used here is that in the near term, for highly liquid assets, no significant market changes will occur that can affect the fair value. This assumption is also applied to demand deposits, savings accounts without specified maturity and all variable interest rate financial instruments.

(iii) Financial Instruments with Fixed Interest Rates

The fair values of fixed rate financial assets and liabilities carried at amortized cost are estimated by comparing market interest rates when they were first recognized with current market rates offered for similar financial instruments. The estimated fair values of fixed interest bearing financial instruments are based on discounted cash flows using prevailing money-market interest rates for financial instruments with similar credit risk characteristics and maturities.

Financial assets held to maturity and loans and deposits include a portion of the loan portfolio at fixed interest rates, which causes differences between the carrying amounts and fair values of such instruments.

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7. NET INTEREST INCOME

Net interest income includes:

	2018	2017
Interest income		
Cash and assets held with the central bank	276,749	288,892
Receivables under derivatives	195,295	118,842
Securities measured at fair value through profit or loss	175,682	-
Securities at fair value through profit or loss held for trading*	-	100,859
Securities measured at fair value through other comprehensive income	3,764,954	-
Securities available for sale*	-	3,613,540
Securities measured at amortized cost	3,294	-
Securities held to maturity*	-	6,951
Loans and receivables from banks and other financial organizations	125,448	143,880
Loans and receivables from clients	11,385,237	10,262,550
Derivatives and assets held for risk hedging purposes	284,378	313,677
Total interest income	16,211,037	14,849,191
Interest expenses		
Liabilities under derivatives	188,959	114,804
Liabilities under hedging derivatives	75,676	80,105
Deposits and other liabilities to banks, other financial organizations and the central bank	985,309	1,085,444
Deposits and other financial liabilities to clients	1,114,553	1,284,698
Subordinated liabilities	167,191	135,462
Total interest expenses	2,531,688	2,700,513
Net interest income	**13,679,349**	**12,148,678**

*Classification of securities in accordance with IAS 39

In accordance with the Bank's accounting policy 3(d), interest income from non-performing impaired loans amounted to RSD 970,534 thousand in 2018 (2017: RSD 671,414 thousand).

8. NET FEE AND COMMISSION INCOME

Net fee and commission income includes:

	2018	2017
Fee and commission income		
Payment transfer activities	1,263,559	1,166,651
Fees on issued guarantees and other contingent liabilities	656,019	586,770
Brokerage fees	31,471	19,725
Custody fees	391,242	363,251
Fees arising from card operations	1,284,121	1,186,707
Fees per deposits	408,551	369,753
Loan origination and processing fees	454,875	360,645
Other fees and commissions	292,413	244,526
Total fee and commission income	4,782,251	4,298,028
Fee and commission expenses		
Payment transfer activities	179,098	163,816
Fees arising on guarantees. sureties and letters of credit	8,467	11,688
Fees arising from card operations	973,219	1,026,715
Other fees and commissions	128,653	146,305
Total fee and commission expenses	1,289,437	1,348,524
Net fee and commission income	**3,492,814**	**2,949,504**

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9. NET GAINS FROM CHANGE IN FAIR VALUE OF FINANCIAL INSTRUMENTS

Net gains from change in fair value of financial instruments include:

	2018	2017
Net income from changes in the value of derivatives at fair value through profit or loss	148,895	207,458
Net expense based on changes in value of securities at fair value through profit or loss	(3,333)	(3,550)
Net gains from change in fair value of financial instruments	**145,562**	**203,908**

10. NET GAINS FROM DERECOGNITION OF THE FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE

Net gains from derecognition of the financial instruments measured at fair value include:

	2018	2017
Net gain from the sale of securities measured at fair value through other comprehensive income/securities available for sale	105,318	261,172
Net gain from the sale of securities measured at fair value through profit or loss	67,188	44,559
Net gains from derecognition of the financial instruments measured at fair value	**172,506**	**305,731**

11. NET LOSSES ON HEDGING

Net losses on hedging include:

	2018	2017
Net income/(expenses) from changes in value of loans, receivables and securities	35,249	(90,429)
Net (expense)/income from the change in value of hedging derivatives	(45,954)	56,564
Net losses on hedging	**(10,705)**	**(33,865)**

12. NET EXCHANGE RATE GAINS FROM AGREED CURRENCY CLAUSE

Net exchange rate gains and gains from agreed currency clause include:

	2018	2017
Foreign exchange gains and positive currency clause effects	46,726,986	62,061,049
Foreign exchange losses and negative currency clause effects	(45,311,054)	(60,689,113)
Net foreign exchange gains and positive currency clause effects	**1,415,932**	**1,371,936**

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13. NET EXPENSES ON IMPAIRMENT OF FINANCIAL ASSETS NOT MEASURED AT FAIR VALUE THROUGH INCOME STATEMENT

Net expenses on impairment of financial assets not measured at fair value through income statement include:

	2018.	2017.
Loans and receivables from clients		
Individual impairment allowance charge, net	2,007,273	2,359,715
Collective impairment allowance charge, net	1,069,893	518,049
	3,077,166	2,877,764
Net impairment of securities measured at fair value through other comprehensive income	309,024	-
Contingent liabilities		
Individual impairment allowance (reversal)/charge, net (Note 40)	(36,848)	27,069
Collective impairment allowance (reversal)/charge, net (Note 40)	(39,398)	537
	(76,246)	27,606
Losses arising from the modification of financial instruments	(46)	-
Direct write-off	444	1,199
Collection of receivables previously written off	(406,117)	(202,208)
Total	**2,904,225**	**2,704,361**

14. NET GAINS FROM DERECOGNITION OF THE FINANCIAL INSTRUMENTS MEASURED AT AMORTISED COST

The Bank realized net gains from derecognition of the financial instruments measured at amortised cost by selling of loan for liquidity and working capital granted to client from the sector of the economy.

	2018.	2017.
Net gains from derecognition of the financial instruments measured at amortised cost	2,099,033	12,760
Total	**2,099,033**	**12,760**

15. NET GAINS FROM DERECOGNITION OF INVESTMENTS IN ASSOCIATED COMPANIES AND JOINT VENTURES

The Bank realized net gains from derecognition of investments in associated companies and joint ventures by selling shares in company MasterCard in 2017.

	2018.	2017.
Gains on the sale of investments	-	120,379
Total	**-**	**120,379**

16. OTHER OPERATING INCOME

Other operating income includes:

	2018.	2017.
Dividend income	-	120
Other operating income	46,642	41,827
Total other operating income	**46,642**	**41,947**

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17. STAFF COSTS

Staff costs comprise:

	2018.	2017.
Net salaries	1,806,566	1,609,009
Payroll taxes and contributions	685,744	629,663
Net provisioning for retirement benefits and unused annual leaves (vacations)	15,889	5,613
Other staff costs	513,255	572,036
Total	**3,021,454**	**2,816,321**

18. DEPRECIATION AND AMORTIZATION CHARGE

Depreciation and amortization charge includes:

	2018.	2017.
Amortization of intangible assets (Notes 30.2, 30.3)	314,064	271,501
Depreciation of investment property (Note 32)	33	33
Depreciation of property and equipment (Notes 31.2, 31.3)	265,782	264,145
Total	**579,879**	**535,679**

19. OTHER INCOME

Other income include:

	2018.	2017.
Reversal of unrealized provisions for litigation (Note 40)	35,750	19,139
Reversal of unrealized provisions for other liabilities (Note 40)	-	4,895
Other operating income	52,980	57,977
Total	**88,730**	**82,011**

20. OTHER EXPENSES

Other expenses include:

	2018.	2017.
Business premises costs	115,444	89,547
Office supplies	42,647	39,595
Rental costs	723,624	671,491
Information system maintenance	753,842	513,390
Property and equipment maintenance	67,157	55,768
Marketing, advertising, entertainment and donations	248,837	300,575
Lawyer fees, other consultant services and auditing fees	194,382	195,356
Telecommunications and postage services	134,775	138,098
Insurance premiums	843,152	775,071
Insurance of property and security services	93,341	85,509
Professional training costs	21,542	20,432
Servicing	115,355	92,448
Transportation services	16,135	17,504
Employee commuting allowances	39,803	37,998
Accommodation and meal allowance – business travel costs	32,770	30,372
Other taxes and contributions	482,999	451,785
Provisions for litigations and other provisions (Note 40)	194,204	127,009
Losses on disposal of property, equipment and intangible assets	40,447	17,349
Other costs	422,273	389,690
Total	**4,582,729**	**4,048,987**

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21. INCOME TAXES

21.1 Basic components of income taxes as at December 31 were as follows:

	2018.	2017.
Current income tax expense	(889,257)	(472,387)
Increase in deferred tax assets and decrease in deferred tax liabilities	76,575	28,593
Decrease in deferred tax assets and increase in deferred tax liabilities	(7,247)	(20,528)
Total	**(819,929)**	**(464,322)**

21.2 Numerical reconciliation of the effective tax rate is provided below:

	2018.	2017.
Profit before taxes	10,041,576	7,097,641
Effective income tax at the legally prescribed tax rate of 15%	1,506,236	1,064,646
Tax effects of permanent differences:		
Tax effects of expenses not recognized for tax purposes	10,982	5,685
Tax effects of income adjustment	(637,165)	(613,958)
Tax effects of temporary differences:		
Difference between depreciation/amortization calculated for tax and financial reporting purposes	(15,611)	(6,973)
Tax effects of expenses recognized in the forthcoming period	38,477	22,987
Tax Impacts of Reduction:		
Tax effects on the first application of IFRS 9	(13,662)	-
Current income tax expense	889,257	472,387
Effective tax rate	8.86%	6.66%

21.3 Income taxes recognized within other comprehensive income are provided below:

	2018			2017		
	Before taxes	Tax expense	After taxes	Before taxes	Tax expense	After taxes
Actuarial gains/(losses)	3,147	(989)	2,158	(1,967)	(1,478)	(3,445)
Balance at December 31	3,147	(989)	2,158	(1,967)	(1,478)	(3,445)

21.4 The calculated current income tax payable for the year 2018 amounted to RSD 889,257 thousand, of which RSD 427,299 thousand was settled through several tax advance payments. The outstanding current tax liabilities as of December 31, 2018 hence amounted to RSD 461,958 thousand.

22. CASH AND ASSETS HELD WITH THE CENTRAL BANK

22.1 Cash and assets held with the central bank include:

	2018.	2017.
RSD cash on hand	3,163,419	1,577,892
Gyro account balance	24,920,533	17,645,389
Foreign currency cash on hand	1,523,538	1,034,221
Other foreign currency cash funds	35,899	38,226
Liquidity surplus deposits with NBS	10,000,000	-
Obligatory foreign currency reserve held with NBS	13,762,131	9,365,485
Total	53,405,520	29,661,213
Impairment allowance	(211)	(196)
Balance at December 31	**53,405,309**	**29,661,017**

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22. CASH AND ASSETS HELD WITH THE CENTRAL BANK (continued)

The gyro account balance includes the RSD obligatory reserves, which represent the minimum amount of RSD reserves allocated in accordance with the Decision on Obligatory Reserves Held with the NBS. In accordance with the said Decision, the obligatory RSD reserves are calculated based on the average daily carrying amount of RSD deposits, loans, securities and other RSD liabilities during a single calendar month, using a rate in the range between 0% and 5%, depending on the maturity of liabilities and their sources of funding. The reserve is thereafter held on the Bank's gyro account. In 2018 NBS paid interest on the balance of the Bank's obligatory RSD reserve at the annual interest rate of 1.75% until March, at 1.50% in April, and at 1.25% from May.

The obligatory foreign currency reserve with the National Bank of Serbia represent the minimum foreign currency reserve amount allocated in accordance with the Decision on Obligatory Reserves Held with the NBS. In accordance with the said Decision, the obligatory foreign currency reserves are calculated based on the average daily carrying amount of foreign currency deposits, loans and other foreign currency liabilities or those in RSD with a currency clause index (EUR to RSD) during a single calendar month. The obligatory foreign currency reserve rates remained unaltered during 2018 and equaled 20% for foreign currency deposits with maturities of up to 2 years and 13% for foreign currency deposits with maturities of over 2 years. The rate applied to the portion of the foreign currency reserve comprised of RSD liabilities with a currency clause index was 100%.

The Bank is under obligation to maintain the average daily balance of the allocated foreign currency reserve in the amount of the calculated foreign currency obligatory reserve on the foreign currency accounts held with NBS. Foreign currency obligatory reserve does not accrue interest.

As at 31 December 2018, the Bank deposited excess liquid assets with NBS.

22.2 Movements on the account of impairment allowance of cash and assets held with the central bank during the current year are provided in the table below:

	Individual level		Group level	
	2018	2017	2018	2017
Balance at January 1	-	-	(196)	(775)
Effect of first application of IFRS 9 (Note 2g(ii))	-	-	43	-
Initial balance after first application of IFRS 9	-	-	(153)	(775)
Impairment loss:				
(Charge for the year)/reversal	-	-	(59)	497
Foreign exchange effects	-	-	1	82
Total impairment allowance	-	-	(58)	579
Balance at December 31	**-**	**-**	**(211)**	**(196)**

22.3 The gross carrying amount of cash and assets held with the central bank per stages and the corresponding allowance for impairment are shown in the following table:

	Gross carrying amount	Impairment loss	Net carrying amount
Stage 1	53,369,621	(211)	53,369,410
Stage 2	35,899	-	35,899
Stage 3	-	-	-
POCI	-	-	-
Balance at December 31	**53,405,520**	**(211)**	**53,405,309**

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22. CASH AND ASSETS HELD WITH THE CENTRAL BANK (Continued)

22.4 Movement in the allowance for impairment losses per stages within the position "Cash and assets held with the central bank" during 2018 is presented in the table below:

Level of impairment	As at December 31st 2017	Effect of first application of IFRS 9	As at January 1st 2018	Increase due to recognition and acquisition	Increase / (decrease) due to changes in credit risk	Effects of modification	Reduction due to direct write-off	Other changes	As at December 31st 2018
Stage 1	(196)	43	(153)	-	(59)	-	-	1	(211)
Stage 2	-	-	-	-	-	-	-	-	-
Stage 3	-	-	-	-	-	-	-	-	-
POCI	-	-	-	-	-	-	-	-	-
TOTAL	**(196)**	**43**	**(153)**	**-**	**(59)**	**-**	**-**	**1**	**(211)**

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23. RECEIVABLES UNDER DERIVATIVES

Receivables under derivatives include:

	2018.	2017.
FX swaps and forwards	58,163	28,180
Interest rate swaps	599,401	157,024
Interest rate options	25,259	-
Balance at December 31	**682,823**	**185,204**

24. SECURITIES

24.1. Securities include:

	2018.	2017.
Securities measured at amortized cost	36,928	-
Securities held to maturity	-	79,534
Securities measured at fair value through other comprehensive income	100,974,120	-
Securities available for sale	-	82,171,636
Securities measured at fair value through profit or loss	1.493.552	-
Securities held for trading	-	2,095,845
Total	102,504,600	84,347,015
Impairment allowance	(577,307)	(1,648)
Balance at December 31	**101,927,293**	**84,345,367**

24.2. Movements on the account of impairment allowance of securities measured at amortized cost and securities measured at fair value through other comprehensive income over the year are presented in the following table:

	Individual level		Group level	
	2018	2017	2018	2017
Balance at January 1	-	(623)	(1,648)	(569)
Effect of first application of IFRS 9 (Note 2g (ii))	-	-	(317,660)	-
Initial balance after first application of IFRS 9	-	(623)	(319,308)	(569)
Impairment loss:				
Charge for the year	-	-	(257,231)	(1,079)
Effects of foreign exchange rate change	-	-	(768)	-
Write-off without debt acquittal	-	623	-	-
Total impairment allowance	-	623	(257,999)	(1,079)
Balance at December 31	**-**	**-**	**(577,307)**	**(1,648)**

24.3. The gross carrying amount of securities that are measured at amortized cost and securities measured at fair value through other comprehensive income per stages as well as the corresponding allowance for impairment are shown in the following table:

	Gross carrying amount	Impairment loss	Net carrying amount
Stage 1	101,001,908	(577,307)	100,424,601
Stage 2	9,140	-	9,140
Stage 3	-	-	-
POCI	-	-	-
Balance at December 31	**101,011,048**	**(577,307)**	**100,433,741**

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24. SECURITIES (Continued)

24.4. Movements in the allowance for impairment losses per stages of securities measured at amortized cost and securities measured at fair value through other comprehensive income during 2018 are presented in the table below:

Level of impairment	As at December 31st 2017	Effect of first application of IFRS 9	As at January 1st 2018	Increase due to recognition and acquisition	Increase / (decrease) due to changes in credit risk	Effects of modification	Reduction due to direct write-off	Other changes	As at December 31st 2018
Stage 1	(1,648)	(317,660)	(319,308)	(7,855)	(249,376)	-	-	(768)	(577,307)
Stage 2	-	-	-	-	-	-	-	-	-
Stage 3	-	-	-	-	-	-	-	-	-
POCI	-	-	-	-	-	-	-	-	-
TOTAL	**(1,648)**	**(317,660)**	**(319,308)**	**(7,855)**	**(249,376)**	**-**	**-**	**(768)**	**(577,307)**

24.5. Securities according to the measurement and the issuer are shown in the table below:

	2018. IFRS 9 measurement	2018. Total	2017. IAS 39 measurement	2017. Total
Receivables per discounted bills of exchange	Amortized cost	36,923	Amortized cost	77,886
Treasury bills of Republic of Serbia	FV through other comprehensive income	93,445,489	FV through other comprehensive income	70,123,561
	FV through profit or loss	1,493,552	FV through profit or loss	2,095,845
Local municipality bonds	FV through other comprehensive income	44,035	FV through other comprehensive income	58,851
Treasury bills of Republic of Serbia and Local municipality bonds - hedged items	FV through other comprehensive income	6,907,294	FV through other comprehensive income	11,989,224
Balance at December 31		**101,927,293**		**84,345,367**

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24. SECURITIES (Continued)

Receivables for discounted bills of exchange as of December 31, 2018 amounted to RSD 36,923 thousand and represent investments with maturities of up to one year and at a discount rate equal to one-month BELIBOR, increased by 2% annually.

As of December 31, 2018 investments in securities measured at fair value through profit or loss in the amount of RSD 1,493,552 thousand represent investments in the Treasury bills of Republic of Serbia with maturities up to 2028.

As of December 31, 2018 investments in securities measured at fair value through other comprehensive income in the amount of RSD 6,907,294 thousand represent investments in bonds issued by local municipalities and the RS Treasury bills - hedging items with maturities up to 2023, while the amount of RSD 44,035 thousand represents investment in local municipalities bonds with maturities up to 2021 and the amount of RSD 93,445,489 thousand represents investments in RS Treasury bills with maturities up to 2028.

For hedging local municipality and RS Treasury bills against interest rate risk, the Bank has implemented micro fair value hedging, i.e., designated as hedged items investment in bonds issued by local municipalities and the RS Treasury bills with the total nominal value of EUR 54,500,000 while interest rate swaps with total nominal value of EUR 54,500,000 were designated as hedging instruments. As of December 31, 2018, an effectiveness test was performed, which showed that the hedging was highly effective.

25. LOANS AND RECEIVABLES FROM BANKS AND OTHER FINANCIAL ORGANISATIONS

25.1. Loans and receivables from banks and other financial organisations include:

	2018.	2017.
Foreign currency accounts held with:		
- other banks within UniCredit Group	562,392	712,860
- other foreign banks	419,488	1,797,310
Total foreign currency accounts	981,880	2,510,170
Overnight deposits:		
- in foreign currencies	14,183,352	7,463,780
Total overnight deposits	14,183,352	7,463,780
Guarantee foreign currency deposit placed for purchase and sale of securities	4,728	4,739
Foreign currency special purpose deposits	12,006	11,509
Short-term loans:		
- in RSD	591,697	678
Total short-term loans	591,697	678
Long-term loans:		
- in RSD	214,644	1,786,030
Total long-term loans	214,644	1,786,030
NBS Placements by REPO Transactions in Dinars	5,002,000	-
Other foreign currency placements	1,991	57,261
Total	20,992,298	11,834,167
Impairment allowance	(17,362)	(8,517)
Balance at December 31	**20,974,936**	**11,825,650**

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25. LOANS AND RECEIVABLES FROM BANKS AND OTHER FINANCIAL ORGANISATIONS (Continued)

25.2. Movements on the account of impairment allowance of loans and receivables from banks and other financial organizations are provided in the table below:

	Individual level		Group level	
	2018	2017	2018	2017
Balance at January 1	-	(7)	(8,517)	(31,377)
Effect of first application of IFRS 9 (Note 2g (ii))	-	-	(2,126)	-
Initial balance after first application of IFRS 9	-	(7)	(10,643)	(31,377)
Impairment loss:	-			
(Charge for the year) / reversal	-	7	(6,802)	22,626
Foreign exchange effects	-	-	69	234
Write-off without debt acquittal	-	-	14	-
Total impairment allowance	-	7	(6,719)	22,860
Balance at December 31	**-**	**-**	**(17,362)**	**(8,517)**

25.3. The gross carrying amount of loans and receivables from banks and other financial organizations per stages as well as the corresponding allowance for impairment are shown in the following table:

	Gross carrying amount	Impairment loss	Net carrying amount
Stage 1	20,964,633	(16,485)	20,948,148
Stage 2	27,665	(877)	26,788
Stage 3	-	-	-
POCI	-	-	-
Balance at December 31	**20,992,298**	**(17,362)**	**20,974,936**

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25. LOANS AND RECEIVABLES FROM BANKS AND OTHER FINANCIAL ORGANISATIONS (Continued)

25.4. Movements in allowance for impairment losses per stages within the position "Loans and receivables to banks and other financial organizations" during 2018 are presented in the table below:

Level of impairment	As at December 31st 2017	Effect of first application of IFRS 9	As at January 1st 2018	Increase due to recognition and acquisition	Increase / (decrease) due to changes in credit risk	Effects of modification	Reduction due to direct write-off	Other changes	As at December 31st 2018
Stage 1	(8,508)	(2,124)	(10,632)	(713)	(5,140)	-	-	-	(16,485)
Stage 2	(2)	(2)	(4)	-	(942)	-	-	69	(877)
Stage 3	(7)	-	(7)	-	(7)	-	14	-	-
POCI	-	-	-	-	-	-	-	-	-
TOTAL	**(8,517)**	**(2,126)**	**(10,643)**	**(713)**	**(6,089)**	**-**	**14**	**69**	**(17,362)**

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25. LOANS AND RECEIVABLES FROM BANKS AND OTHER FINANCIAL ORGANISATIONS (Continued)

25.5. The structure of foreign currency accounts with banks within the UniCredit Group is shown in the table:

	2018.	2017.
UniCredit Bank Austria AG. Vienna	418,828	619,359
UniCredit Bank AG. Munich	27,526	26,109
UniCredit Bank Hungary Z.r.t.. Hungary	13,640	5,212
UniCredit Bank Czech Republic and Slovakia a.s.	181	6
UniCredit S.P.A. Milano	89,003	51,262
Zagrebačka banka d.d.	4,361	550
UniCredit Bank BIH	2,221	416
UniCredit Bulbank. Sofia	128	22
UniCredit Bank ZAO Moscow	6,504	9,924
Balance at December 31	**562,392**	**712,860**

25.6. Deposits that mature within one day (overnight) in foreign currency shown in Note 25.1. represent deposits with UniCredit S.P.A. Milano.

26. LOANS AND RECEIVABLES FROM CLIENTS

26.1 Loans and receivables due from clients include:

	2017	2016
Short-term loans:		
- in RSD	26,682,876	27,469,938
- in foreign currencies	338,104	3,023,971
Total short-term loans	27,020,980	30,493,909
Long-term loans:		
- in RSD	212,576,946	194,066,817
- in foreign currencies	20,083,265	10,849,201
Total long-term loans	232,660,211	204,916,018
Receivables in respect of acceptances, sureties and payments made per guarantees:		
- in RSD	9,612	49,474
- in foreign currencies	5,457	14,807
Total	15,069	64,281
RSD factoring receivables	890,364	560,067
Other RSD placements	1,973,176	5,892,542
Total	262,559,800	241,926,817
Impairment allowance	(6,916,980)	(9,373,710)
Balance at December 31	**255,642,820**	**232,553,107**

Loans with a currency clause index (EUR, CHF, and USD) are presented within RSD loans.

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26. LOANS AND RECEIVABLES FROM CLIENTS (Continued)

26.2. Movements on the account of impairment allowance of loans and receivables from clients are presented in the table below:

	Individual level		Group level	
	2018	2017	2018	2017
Balance at January 1	(7,480,787)	(14,704,397)	(1,892,923)	(1,285,861)
Effect of first application of IFRS 9 (Note 2g(ii))	-	-	(135,875)	-
Initial balance after first application of IFRS 9	(7,480,787)	(14,704,397)	(2,028,798)	(1,285,861)
Impairment loss:				
(Charge for the year) / reversal	(2,005,250)	(2,377,386)	(1,005,064)	(508,488)
Foreign exchange effects	24,256	644,882	426	(98,574)
Interest revenue correction/time value	(94,855)	(207,918)	-	-
Effects of sale of placements	5,123,296	1,833,636	-	-
Write-off with debt acquittal	36	30,727	-	-
Write-off without debt acquittal*	549,760	7,299,669	-	-
Total impairment allowance	3,597,243	7,223,610	(1,044,638)	(607,062)
Balance at December 31	**(3,883,544)**	**(7,480,787)**	**(3,033,436)**	**(1,892,923)**

*Write-off without debt acquittal, i.e., accounting write-off, is a write-off of receivables made in accordance with the Decision on the Accounting Write-Off of Bank Balance Sheet Assets of the National Bank of Serbia (Official Gazette of RS no. 77/2017), effective as from September 30, 2017. The bank wrote off balance sheet assets with highly unlikely recoverability, i.e., made a full accounting write-off of impaired receivables. Within the meaning of the aforesaid Decision, the accounting write-off entailed transfer of the written-off receivables from the Bank's balance sheet assets to its off-balance sheet items.

26.3. The gross carrying amounts of loans and advances from clients per stages as well as the corresponding allowance for impairment are shown in the following table:

	Gross carrying amount	Impairment loss	Net carrying amount
Stage 1	231,376,060	(875,299)	230,500,761
Stage 2	22,106,484	(983,074)	21,123,410
Stage 3	9,077,256	(5,058,607)	4,018,649
POCI	-	-	-
Balance at December 31	**262,559,800**	**(6,916,980)**	**255,642,820**

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26. LOANS AND RECEIVABLES FROM CLIENTS (Continued)

26.4. Movements in allowance for impairment losses per stages within the position "Loans and receivables from clients" in 2018 are presented in the following table:

Level of impairment	As at December 31st 2017	Effect of first application of IFRS 9	As at January 1st 2018	Increase due to recognition and acquisition	Increase / (decrease) due to changes in credit risk	Effects of modification	Reduction due to direct write-off	Other changes	As at December 31st 2018
Stage 1	(1,048,169)	294,461	(753,708)	(436,338)	314,128	-	-	619	(875,299)
Stage 2	(242,510)	(232,620)	(475,130)	(334,439)	(173,313)	-	-	(192)	(983,074)
Stage 3	(8,083,031)	(197,716)	(8,280,747)	(158,172)	(2,222,180)	-	549,796	5,052,696	(5,058,607)
POCI	-	-	-	-	-	-	-	-	-
TOTAL	**(9,373,710)**	**(135,875)**	**(9,509,585)**	**(928,949)**	**(2,081,365)**	**-**	**549,796**	**5,053,123***	**(6,916,980)**

* Within other changes, the effects of sales of placements, interest revenue correction/time value and the effect of foreign exchange rate change are presented.

26.5. Structure of loans and receivables from clients is presented in table below:

	2018			2017		
	Gross Amount	Impairment Allowance	Carrying Amount	Gross Amount	Impairment Allowance	Carrying Amount
Public sector	5,361,551	(7,240)	5,354,311	11,085,390	(26,499)	11,058,891
Corporate customers	164,768,207	(4,684,550)	160,083,657	150,134,535	(8,285,016)	141,849,519
Retail customers	92,430,042	(2,225,190)	90,204,852	80,706,892	(1,062,195)	79,644,697
Balance at December 31	**262,559,800**	**(6,916,980)**	**255,642,820**	**241,926,817**	**(9,373,710)**	**232,553,107**

26. LOANS AND RECEIVABLES FROM CLIENTS (Continued)

26.6. Corporate loans were mostly approved for maintaining daily liquidity (current account overdrafts), financing working capital, imports and investments. They were used for funding business activities in trade and services, manufacturing industry, construction industry, agriculture and food industry and other purposes. Short-term loans were approved for periods ranging from 30 days to a year. Interest rates on short-term loans with a currency clause index ranged from 1-month, 3-month or 6-month EURIBOR increased by 2.45%, on the average, while RSD short-term loans accrued interest at the rates between 1-month, 3-month or 6-month BELIBOR increased by 0.71% on the average.

Long-term loans were approved for periods from 2 to 10 years. Interest rate applied to long-term loans with a currency clause index ranged from 1-month, 3-month or 6-month EURIBOR increased by 2.56% annually on the average, while RSD long-term loans accrued interest at the rates between 1-month, 3-month or 6-month BELIBOR increased by 1.17% annually on the average, according to other costs and the Bank's interest rate policy.

Retail housing loans were approved for periods of 5 to 30 years, at the nominal interest rates ranging from 6-month EURIBOR plus 2.6% to 3.9% annually. In early October 2017 the Bank launched a campaign where up to the end of the year the clients were allowed to apply for pre-approval of housing loans, whereby the loan approval process was optimized in accordance with the clients' needs and requirements. The Bank included in its product mix housing loans with combined and fixed interest rates thus responding to the needs of its clients with regard to the volatility of the interest rates.

In May 2018, the Bank initiated a campaign in which clients had the opportunity to apply for cash loans with a repayment period of up to 10 years, both with variable and fixed interest rates, thus responding to customer needs when it comes to interest rate variability and for this type of loan. Interest rates ranged from a three-month BELIBOR increased by 3.1% to 9.0% per annum.

In 2018. interest rates applied to investment funding of small entities and entrepreneurs equaled 6/12-month EURIBOR plus 3% to 7% annually, while interest rates for working capital loans with maturity up to 42-month ranged from 12-month EURIBOR plus 3.2% to 7.5 annually or, in instances of fixed-interest rate loans, from 3.2% to 7.5%. Interest rates applied to RSD loans equaled 1/3-month BELIBOR plus 2.5% to 7% annually.

As a hedge against interest rate risk, the Bank implemented micro fair value hedging, i.e., it designated as a hedged item a customer loan with the present value of EUR 1,152,494 as at December 31, 2018, while an interest swap of the same amount was designated as a hedging instrument. The Bank also implemented macro fair value hedging, where loan portfolios with the net carrying value of CHF 20,100,000 and EUR 222,718 were designated as hedged items, while interest swaps of the same notional amounts were designated as hedging instruments. As of December 31, 2018 an effectiveness test was performed, which showed that the hedging was highly effective.

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26. LOANS AND RECEIVABLES FROM CLIENTS (Continued)

26.7 The concentration of total loans and receivables from clients per industry was as follows:

	2018	2017
Corporate customers		
- Energy	4,315,114	2,298,746
- Agriculture	5,883,494	6,471,833
- Construction industry	13,724,439	7,615,611
- Mining and industry	53,026,400	54,175,376
- Trade	41,393,072	39,030,404
- Services	20,972,285	22,051,341
- Transportation and logistics	16,515,129	13,954,059
- Other	8,938,274	4,537,165
	164,768,207	150,134,535
Public sector	5,361,551	11,085,390
Retail customers		
- Private individuals	87,831,210	77,279,149
- Entrepreneurs	4,598,832	3,427,743
	92,430,042	80,706,892
Total	**262,559,800**	**241,926,817**
Impairment allowance	(6,916,980)	(9,373,710)
Balance at December 31	**255,642,820**	**232,553,107**

The Bank' management structures the levels of credit risk it assumes by placing credit risk exposure limits for a single borrower or a group of borrowers as well as per geographic area and industry segments. This risk is monitored on an ongoing basis and is subject to an annual or more frequent review. Exposure to credit risk is managed by the regular solvency analysis, i.e., analysis of the ability of borrowers and potential borrowers to meet interest and principal repayment obligations, and by changing the limits set for a single borrower, as appropriate. Exposure to credit risk is also partially managed by obtaining collaterals.

27. CHANGE IN FAIR VALUE OF HEDGED ITEMS

Change in fair value of hedged items include:

	2018	2017
Change in fair value of hedged items	222,773	192,251
Balance at December 31	222,773	192,251

As a hedge against the interest rate risk inherent in loans approved in CHF and EUR at fixed interest rates, the Bank implemented macro fair value hedging (Note 26.6). As of December 31, 2018 an effectiveness test was performed, which showed that the hedging was highly effective.

28. RECEIVABLES UNDER HEDGING DERIVATIVES

Receivables under hedging derivatives comprise:

	2018	2017
Fair value adjustments of hedging derivatives		
-micro hedging	-	9,195
-macro hedging	2	-
Balance at December 31	**2**	**9,195**

In 2018, the change in the fair value of hedging derivatives relates to macro hedging fair value where a portfolio of loans in EUR with a fixed interest rate is indicated as a hedging item (Note 26.6). In 2017, the fair value adjustments of hedging derivatives referred to the micro fair value hedging (Note 26.6).

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29. INVESTMENTS IN SUBSIDIARIES

Investments in subsidiaries represent equity investments in the following entities, where the Bank holds 100% equity interests:

	2018	2017
UniCredit Leasing d.o.o.	-	-
UniCredit Partner d.o.o.	112,644	112,644
	112,644	112,644
Impairment allowance	-	-
Balance at December 31	**112,644**	**112,644**

30. INTANGIBLE ASSETS

30.1 Intangible assets, net:

	2018	2017
Intangible assets	1,229,188	1,001,317
Investments in progress	388,667	161,141
Balance at December 31	**1,617,855**	**1,162,458**

30.2 Movements on the account of intangible assets in 2018 are presented in the table below:

	Intangible Assets	Investment in Progress	Total
Cost			
Balance at January 1, 2018	3,324,128	161,141	3,485,269
Additions	558,046	240,980	799,026
Disposal and retirement	(25,320)	(13,454)	(38,774)
Balance at December 31, 2018	3,856,854	388,667	4,245,521
Accumulated amortization and impairment losses			
Balance at January 1, 2018	2,322,811	-	2,322,811
Amortization charge for the year	314,064	-	314,064
Disposal and retirement	(9,209)	-	(9,209)
Balance at December 31, 2018	2,627,666	-	2,627,666
Net book value at December 31, 2018	**1,229,188**	**388,667**	**1,617,855**
Net book value at January 1, 2018	**1,001,317**	**161,141**	**1,162,458**

30.3 Movements on the account of intangible assets in 2017 are presented in the table below:

	Intangible Assets	Investment in Progress	Total
Cost			
Balance at January 1, 2017	2,976,237	195,869	3,172,106
Additions	550,877	(23,379)	527,498
Disposal and retirement	(202,986)	(11,349)	(214,335)
Balance at December 31, 2017	3,324,128	161,141	3,485,269
Accumulated amortization and impairment losses			
Balance at January 1, 2017	2,254,296	-	2,254,296
Amortization charge for the year	271,501	-	271,501
Disposal and retirement	(202,986)	-	(202,986)
Balance at December 31, 2017	2,322,811	-	2,322,811
Net book value at December 31, 2017	**1,001,317**	**161,141**	**1,162,458**
Net book value at January 1, 2017	**721,941**	**195,869**	**917,810**

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31. PROPERTY, PLANT AND EQUIPMENT

31.1 Property, plant and equipment comprise:

	2018	2017
Buildings	551,776	566,288
Equipment and other assets	739,870	728,758
Leasehold improvements	175,376	200,575
Investments in progress	122,651	55,768
Balance at December 31	**1,589,673**	**1,551,389**

31.2 Movements on the account of property, plant and equipment in 2018 are presented below:

	Buildings	Equipment and other assets	Leasehold improvements	Investments in progress	Total
Cost					
Balance at January 1, 2018	671,034	1,649,707	481,944	55,768	2,858,453
Additions	-	-	-	319,101	319,101
Transfer from investments in progress	-	237,731	14,487	(252,218)	-
Disposal and retirement	-	(103,704)	(7,111)	-	(110,815)
Other	-	(83)	-	-	(83)
Balance at December 31, 2018	671,034	1,783,651	489,320	122,651	3,066,656
Accumulated depreciation and impairment losses					
Balance at January 1, 2018	104,746	920,949	281,369	-	1,307,064
Depreciation charge for the year	14,512	211,585	39,685	-	265,782
Impairment losses	-	-	-	-	-
Disposal and retirement	-	(88,715)	(7,110)	-	(95,825)
Other	-	(38)	-	-	(38)
Balance at December 31, 2018	119,258	1,043,781	313,944	-	1,476,983
Net book value at December 31, 2018	**551,776**	**739,870**	**175,376**	**122,651**	**1,589,673**
Net book value at January 1, 2018	**566,288**	**728,758**	**200,575**	**55,768**	**1,551,389**

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31. PROPERTY, PLANT AND EQUIPMENT (Continued)

31.3 Movements on the account of property, plant and equipment in 2017 are presented below:

	Buildings	Equipment and other assets	Leasehold improvements	Investments in progress	Total
Cost					
Balance at January 1, 2017	671,034	1,813,957	480,187	46,916	3,012,094
Additions	-	-	-	248,334	248,334
Transfer from investments in progress	541	209,631	29,310	(239,482)	-
Disposal and retirement	(541)	(366,330)	(27,553)	-	(394,424)
Other	-	(7,551)	-	-	(7,551)
Balance at December 31, 2017	671,034	1,649,707	481,944	55,768	2,858,453
Accumulated depreciation and impairment losses					
Balance at January 1, 2017	90,320	1,086,280	258,169	-	1,434,769
Depreciation charge for the year	14,502	202,351	47,292	-	264,145
Impairment losses	-	-	-	-	-
Disposal and retirement	(76)	(360,452)	(24,092)	-	(384,620)
Other	-	(7,230)	-	-	(7,230)
Balance at December 31, 2017	104,746	920,949	281,369	-	1,307,064
Net book value at December 31, 2017	**566,288**	**728,758**	**200,575**	**55,768**	**1,551,389**
Net book value at January 1, 2017	**580,714**	**727,677**	**222,018**	**46,916**	**1,577,325**

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32. INVESTMENT PROPERTY

Movements on the account of investment property in 2018 are presented below:

	Investment property	Investments in progress	Total
Cost			
Balance at January 1, 2018	1,642	-	1,642
Balance at December 31, 2018	1,642	-	1,642
Accumulated depreciation and impairment losses			
Balance at January 1, 2018	278	-	278
Depreciation charge for the year	33	-	33
Balance at December 31, 2018	311	-	311
Net book value at December 31, 2018	**1,331**	**-**	**1,331**
Net book value at January 1, 2018	**1,364**	**-**	**1,364**

33. DEFERRED TAX ASSETS AND LIABILITIES

33.1 Deferred tax assets and liabilities relate to:

	2018			2017		
	Assets	Liabilities	Net	Assets	Liabilities	Net
Difference in net carrying amount of tangible assets for tax and financial reporting purposes	20,160	-	20,160	27,407	-	27,407
Deferred tax assets in respect of unrecognized current year expenses	165,090	-	165,090	143,164	-	143,164
Deferred tax assets on the basis of first-time adoption of IFRS 9	54,649	-	54,649	-	-	-
Deferred tax (liabilities)/assets in respect of actuarial gains based on defined benefit plans	-	(381)	(381)	608	-	608
Total	**239,899**	**(381)**	**239,518**	**171,179**	**-**	**171,179**

33.2 Movements on temporary differences during 2018 are presented as follows:

	Balance at January 1	Recognized in Profit or Loss	Recognized in Other Comprehensive Income	Balance at December 31
Difference in net carrying amount of tangible assets for tax and financial reporting purposes	27,407	(7,247)	-	20,160
Deferred tax assets in respect of expenses not recognized in the current year	143,164	21,926	-	165,090
Deferred tax assets on the basis of first-time adoption of IFRS 9	-	54,649	-	54,649
Deferred tax liabilities in respect of actuarial gains based on defined benefit plans	608	-	(989)	(381)
Total	**171,179**	**69,328**	**(989)**	**239,518**

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34. OTHER ASSETS

34.1. Other assets relate to:

	2018	2017
Other assets in RSD:		
Fee and commission receivables calculated per other assets	58,376	62,433
Advances paid. deposits and retainers	14,085	13,848
Receivables per actual costs incurred	428,324	344,889
Receivables from the RS Health Insurance Fund	51,528	63,596
Other receivables from operations	342,590	397,579
Assets acquired through collection of receivables	4,927	4,927
Other investments	-	4,992
Accrued other income receivables	16,430	15,434
Deferred other expenses	76,209	88,596
	992,469	996,294
Other assets in foreign currencies:		
Fee and commission receivables calculated per other assets	685	320
Other receivables from operations	4,201	12,086
Accrued other income receivables	322	1,439
	5,208	13,845
Total	997,677	1,010,139
Impairment allowance	(14,746)	(32,412)
Balance at December 31	**982,931**	**977,727**

34.2. Movements on the impairment allowance accounts of other assets are provided in the table below:

	Individual level		Group level	
	2018	2017	2018	2017
Balance at January 1	(252)	(315,567)	(32,160)	(559)
Effect of first application of IFRS 9 (Note 2g(ii))	-	-	(1,223)	-
Initial balance after first application of IFRS 9	(252)	(315,567)	(33,383)	(559)
Impairment loss:				
(Charge for the year)/reversal	(2,023)	17,664	(58,089)	(31,605)
Foreign exchange effects	9	561	3	4
Effects of sale of placements	-	38,515	-	-
Write-off with debt acquittal	64	12,675	-	-
Write-off without debt acquittal	1,418	245,900	77,507	-
Total impairment allowance	(532)	315,315	19,421	(31,601)
Balance at December 31	**(784)**	**(252)**	**(13,962)**	**(32,160)**

34.3. The gross carrying amount of other assets per stages as well as the corresponding allowance for impairment are shown in the following table:

	Gross carrying amount	Impairment loss	Net carrying amount
Stage 1	928,478	(127)	928,351
Stage 2	52,597	(664)	51,933
Stage 3	16,602	(13,955)	2,647
POCI	-	-	-
Balance at December 31	**997,677**	**(14,746)**	**982,931**

Translation of the Auditors' Report issued in the Serbian language

All amounts expressed in thousands of RSD, unless otherwise stated.

34. OTHER ASSETS (Continued)

34.4. Movement in allowance for impairment losses per stages within the "Other assets" position in 2018 is presented in the following table:

Level of impairment	As at December 31st 2017	Effect of first application of IFRS 9	As at January 1st 2018	Increase due to recognition and acquisition	Increase / (decrease) due to changes in credit risk	Effects of modification	Reduction due to direct write-off	Other changes	As at December 31st 2018
Stage 1	(28)	(76)	(104)	(25)	2	-	-	-	(127)
Stage 2	(513)	13	(500)	(209)	42	-	-	3	(664)
Stage 3	(31,871)	(1,160)	(33,031)	(8,525)	(51,397)	-	78,989	9	(13,955)
POCI	-	-	-	-	-	-	-	-	-
TOTAL	**(32,412)**	**(1,223)**	**(33,635)**	**(8,759)**	**(51,353)**	**-**	**78,989**	**12**	**(14,746)**

34.5. Other investments include equity investments of up to 10% and which hold at fair value through other comprehensive income. Considering that the Bank estimates that the "cost" method is the best approximation of fair value, they are kept by "cost" or net present value which was zero at the date of first application of IFRS 9 (Note 2g(i)).

	2018	2017
FAP Korporacija a.d., Priboj*	-	4,737
Fond za doškolovavanje mladih poljoprivrednika	-	147
Tržište novca a.d.	-	108
	-	4,992
Impairment allowance	-	(4,992)
Balance at December 31	**-**	**-**

* Based on the decision of the Commercial Court in Uzice (Subsection No.2.St.11 / 2017) in the procedure against the bankruptcy debtor of FAP Corporation, which confirms by the court that all the actions of the bankruptcy debtor that existed before the adoption of the pre-prepared reorganization plan (UPPR) withdrawn and cancelled. In 2018 the Bank made a write-off of participation in the legal entity FAP Korporacija ad. Priboj.

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35. LIABILITIES UNDER DERIVATIVES

Liabilities under derivatives include:

	2018	2017
Types of instruments:		
- FX swaps and forwards	72,338	54,455
- Interest swaps	626,035	152,548
- Interest options	25,259	-
Balance at December 31	**723,632**	**207,003**

36. DEPOSITS AND OTHER LIABILITIES TO BANKS, OTHER FINANCIAL ORGANISATIONS AND CENTRAL BANK

36.1. Deposits and other liabilities to banks, other financial organisations and central bank include:

	2018	2017
Demand deposits:		
- in RSD	4,369,333	4,679,346
- in foreign currencies	420,030	1,182,722
Total demand deposits	4,789,363	5,862,068
Overnight deposits:		
- in RSD	349,849	672,376
- in foreign currencies	28,240,795	14,223,612
Total overnight deposits	28,590,644	14,895,988
Short-term deposits:		
- in RSD	4,894,074	3,202,788
- in foreign currencies	19,135,850	15,937,684
Total short-term deposits	24,029,924	19,140,472
Long-term deposits:		
- in RSD	1,533,901	617,334
- in foreign currencies	58,334,268	39,536,765
Total long-term deposits	59,868,169	40,154,099
Long-term borrowings:		
- in RSD	601,027	-
- in foreign currencies	14,967,422	19,374,495
Total long-term borrowings:	15,568,449	19,374,495
Other financial liabilities:		
- in foreign currencies	231,586	106,451
Total other financial liabilities:	231,586	106,451
Balance at December 31	**133,078,135**	**99,533,573**

Short-term time deposits of banks in dinars were deposited for a period of up to one year with an interest rate of 1.4% to 2.61% per annum. Short-term time deposits of banks in foreign currency were deposited for a period of up to one year with an interest rate ranging from -1.1% to 2.6% per annum, depending on the currency. Long-term time deposits of banks in foreign currency are deposited for a period of 1.5 to 15 years with an interest rate ranging from 0.01% to 1.78%.

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36. DEPOSITS AND OTHER LIABILITIES TO BANKS. OTHER FINANCIAL ORGANISATIONS AND CENTRAL BANK (Continued)

36.2. Breakdown of foreign borrowings from banks is provided below:

	2018	2017
European Bank for Reconstruction and Development (EBRD)	1,424,820	3,318,653
Kreditanstalt fur Wiederaufbau Frankfurt am Main (KfW)	444,023	1,125,387
European Investment Bank. Luxembourg	-	672,252
International Financial Corporation. Washington	1,036,687	1,385,101
European Fund for Southeast Europe SA. Luxembourg	9,536,299	9,245,983
Green for Growth Fund. Southeast Europe. Luxembourg	2,344,706	2,348,419
UniCredit Bank Austria AG	781,914	1,278,700
Balance at December 31	**15,568,449**	**19,374,495**

The above listed long-term borrowings were approved to the Bank for periods from 5 to 12 years at nominal interest rates ranging from 0.96% to 4.23% per annum.

37. DEPOSITS AND OTHER FINANCIAL LIABILITIES TO CLIENTS

37.1. Deposits and other financial liabilities to clients comprise:

	2018	2017
Demand deposits:		
- in RSD	71,553,086	45,701,976
- in foreign currencies	83,310,209	76,454,097
Total demand deposits	154,863,295	122,156,073
Overnight deposits:		
- in RSD	1,704,277	1,775,281
- in foreign currencies	2,700,968	2,475,327
Total overnight deposits	4,405,245	4,250,608
Short-term deposits:		
- in RSD	24,900,813	22,531,919
- in foreign currencies	20,641,348	20,425,493
Total short-term deposits	45,542,161	42,957,412
Long-term deposits:		
- in RSD	2,337,927	2,878,358
- in foreign currencies	10,701,763	8,226,646
Total long-term deposits	13,039,690	11,105,004
Long-term borrowings		
- in foreign currencies	2,559,134	5,845,446
Total long-term borrowings	2,559,134	5,845,446
Other financial liabilities		
- in RSD	243,998	136,031
- in foreign currencies	277,513	208,259
Total other financial liabilities	521,511	344,290
Balance at December 31	**220,931,036**	**186,658,833**

37.2. Breakdown of deposits and other financial liabilities to clients:

	2018	2017
Public sector	761,318	1,243,399
Corporate customers	153,440,908	122,593,576
Retail customers	64,169,676	56,976,412
Long-term borrowings (Note 37.3)	2,559,134	5,845,446
Balance at December 31	**220,931,036**	**186,658,833**

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37. DEPOSITS AND OTHER FINANCIAL LIABILITIES TO CLIENTS (Continued)

RSD demand deposits of corporate customers accrued interest at the annual rate of 0.48%, on the average, while EUR-denominated demand deposits accrued interest at the annual rate of 0.09% on the average.

Corporate RSD term deposits accrued interest at the average rate of 2.44% annually, while EUR-denominated corporate deposits were placed at average interest rate of 0.58% annually.

Retail customers‘ RSD demand deposits accrued interest at annual rates of up to 0.15% Foreign currency retail demand deposits accrued interest at the rates ranging up to 0.1% annually, while funds held on current accounts accrued interest at the annual rate of 0.05%.

Short-term foreign currency deposits of retail customers were placed at interest rates ranging from 0.05% to 1.5% annually, depending on the period of placement. Short-term RSD deposits of retail customers accrued interest at the rates ranging from 1.3% to 4.0% annually, depending on the period of placement.

RSD deposits placed by small entities and entrepreneurs were deposited at annual interest rates between 0.8% and 1.2% while foreign currency deposits of these customers accrued interest at the rates ranging from 0.1% to 0.65% annually.

37.3. Breakdown of long-term foreign currency borrowings from customers is provided below:

	2018	2017
NBS - European Investment Bank. Luxembourg	2,537,601	5,807,101
Government of the Republic of Italy	21,533	38,345
Balance at December 31	**2,559,134**	**5,845,446**

Long-term borrowings obtained from customers were approved to the Bank for periods from 6 to 13 years at nominal interest rates of up to 2.15% per annum.

38. LIABILITIES UNDER HEDGING DERIVATIVES

Liabilities under hedging derivatives include:

	2018	2017
Liabilities for interest rate swaps designated as hedging instruments		
- micro hedging	170,554	171,399
- macro hedging	318,026	277,395
Balance at December 31	**488,580**	**448,794**

In micro fair value hedging, the Bank uses an interest rate swap to protect against exposure to changes in the fair value of local municipality bonds and RS Treasury bills, as well as loan with a fixed yield rate (Notes 24.5 and 26.6). In the case of macro hedging of fair values, the Bank used an interest rate swap to protect against the exposure to changes in the fair value of portfolio loans in CHF at a fixed interest rate (Note 26.6).

39. SUBORDINATED LIABILITIES

The Bank's obligation under a subordinated long-term loan was due in December 2018 when the loan was fully paid off.

	2018	2017
UniCredit Bank Austria AG. Vienna	-	2,718,490
Balance at December 31	**-**	**2,718,490**

All amounts expressed in thousands of RSD, unless otherwise stated.

40. PROVISIONS

40.1 Provisions relate to:

	2018	2017
Individual provisions for off-balance sheet items	89,729	126,577
Group provisions for off-balance sheet items	152,438	198,264
Provisions for other long-term employee benefits	64,780	59,275
Provisions for potential litigation losses	480,173	344,425
Provisions for other liabilities	343,990	343,990
Balance at December 31	**1,131,110**	**1,072,531**

40.2 Movements on the accounts of provisions during the year are provided below:

	Individual Provisions for Off - Balance Sheet Items	Group Provisions for Off - Balance Sheet Items	Provisions for Long-Term Employee Benefits	Provisions for Potential Litigation Losses	Provisions for Other Liabilities	Total
Balance at 1 January	126,577	198,264	59,275	344,425	343,990	1,072,531
Effects of the first application of IFRS 9	-	(6,428)	-	-	-	(6,428)
Initial balance after first application of IFRS 9	126,577	191,836	59,275	344,425	343,990	1,066,103
Charge for the year:						
- in the income statement	68,696	220,081	13,478	194,204	-	496,459
- in the statement of other comprehensive income	-	-	(6,592)	-	-	(6,592)
	68,696	220,081	6,886	194,204	-	489,867
Release of provisions	-	-	(1,381)	(22,706)	-	(24,087)
Reversal of provisions (Note 19)	(105,544)	(259,479)	-	(35,750)	-	(400,773)
Balance at December 31	**89,729**	**152,438**	**64,780**	**480,173**	**343,990**	**1,131,110**

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41. OTHER LIABILITIES

Other liabilities include:

	2018	2017
Advances received. deposits and retainers:		
- in RSD	15,422	12,761
- in foreign currencies	4,928	3,669
Trade payables:		
- in RSD	294,069	228,352
- in foreign currencies	194,724	294,110
Other liabilities:		
- in RSD	522,377	490,343
- in foreign currencies	678,610	771,940
Fees and commissions payable per other liabilities:		
- in RSD	2,303	8,645
- in foreign currencies	13,898	13,974
Deferred other income:		
- in RSD	271,143	206,619
- in foreign currencies	86,117	56,364
Accrued other expenses:		
- in RSD	545,338	394,339
- in foreign currencies	36,677	35,124
Liabilities per managed funds	31,185	19,288
Taxes and contributions payable	60,168	54,484
Balance at December 31	**2,756,959**	**2,590,012**

42. RECONCILIATION OF OUTSTANDING BALANCES OF RECEIVABLES AND LIABILITIES WITH CREDITORS AND DEBTORS

In accordance with the Law on Accounting, the Bank reconciled its balances of payables and receivables with its debtors and creditors. The balance reconciliations were made as of September 30, 2018. Out of the total amount of receivables for balance reconciliation, unreconciled balances totalled RSD 13,046 thousand, gross, while non-responded balance confirmation requests amounted to RSD 4,934,379 thousand. Out of the total amount of liabilities for balance reconciliation, unreconciled balances totalled RSD 6,114 thousand, while non-responded balance confirmation requests amounted to RSD 74,116,076 thousand. As for off-balance sheet items, the unreconciled balances amounted to RSD 397,908 thousand and confirmation requests totalling RSD 41,301,870 thousand were not responded to.

43. EQUITY

43.1. Equity is comprised of:

	2018	2017
Issued capital – share capital	23,607,620	23,607,620
Share premium	562,156	562,156
Retained earnings	9,221,647	6,633,319
Reserves	44,437,075	38,537,400
Balance at December 31	**77,828,498**	**69,340,495**

As of December 31. 2018 the Bank’s share capital totalled RSD 23,607,620 thousand and comprised 2,360,762 common stock (ordinary) shares with the individual par value of RSD 10,000. All shares issued by the Bank are ordinary shares.

Ordinary shareholders are entitled to dividend payment pursuant to the relevant decision on profit distribution enacted by the Bank’s Supervisory Board and to one vote per share in the Bank’s Shareholder General Meeting.

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43. EQUITY (Continued)

In accordance with the reorganization of the Banking Group's activities in Central and Eastern European countries, under the Demerger and Takeover Agreement executed by and between UniCredit Bank Austria AG and UCG Beteillingsverwaltung GmbH on August 31, 2016 and Merger and Acquisition Agreement executed by and between UCG Beteillingsverwaltung GmbH and UniCredit SpA on September 30, 2016. UniCredit Bank Austria AG transferred its sole (100%) ownership of the Bank to the Austrian holding company UCG Beteillingsverwaltung GmbH. Through merger of UCG Beteillingsverwaltung GmbH with UniCredit SpA. UniCredit SpA became the sole shareholder of UniCredit Bank Srbija a.d., Beograd.

Reserves from fair value adjustments relate to the net cumulative changes in the fair values of securities valued through other comprehensive income.

43.2. Earnings per Share

The basic earnings per share totalled RSD 3,906 in 2018 (2017: RSD 2,810).

Diluted earnings per share are equal to the basic earnings per share given that the Bank has no contingent shares, i.e., shares embedded in other financial instruments or contracts that may entitle their holders to the ordinary shares of the Bank.

43.3. Breakdown of other comprehensive income after taxes is provided in the table below:

	2018	2017
Actuarial gains per defined employee benefits	5,603	8,378
Net fair value adjustments of debt financial instruments measured at fair value through other comprehensive income	651,976	(255,417)
Other comprehensive income, net of taxes	**657,579**	**(247,039)**

44. CASH AND CASH EQUIVALENTS

Breakdown of cash and cash equivalents as reported within the statement of cash flows is provided below:

	2018	2017
In RSD:		
Gyro account (Note 22)	24,920,533	17,645,389
Cash on hand (Note 22)	3,163,419	1,577,892
	28,083,952	19,223,281
In foreign currencies:		
Foreign currency accounts (Note 25)	981,880	2,510,170
Cash on hand (Note 22)	1,523,538	1,034,221
Other cash funds (Note 22)	35,899	38,226
	2,541,317	3,582,617
Balance at December 31	**30,625,269**	**22,805,898**

45. CONTINGENT LIABILITIES AND COMMITMENTS

45.1. Litigation

As of December 31, 2018 there were 1,293 legal suits filed against the Bank (including 12 labour lawsuits) with claims totalling RSD 1,310,981 thousand. In 26 of these proceedings plaintiffs are legal entities and in 1,267 proceedings private individuals appear as plaintiffs.

The Bank made provisions of RSD 480,173 thousand in respect of the legal suits filed against it (Note 40). The aforesaid amount of provisions includes those for the labour lawsuits filed.

For certain lawsuits, provisions were not made in the exact amount of the claim, primarily based on the estimate of the outcome of such suits as favourable for the Bank, i.e., the estimate that the Bank will incur no outflows in respect of those legal suits or that there are minor contingent liabilities at issue, which require no provisioning.

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45. CONTINGENT LIABILITIES AND COMMITMENTS (Continued)

45.2. The Bank's commitments for operating lease liabilities for business premises (including parking spots and lease of spaces for ATMs) are provided below:

	2018	2017
Commitments due		
- within a year	535,321	451,246
- from 1 to 5 years	1,665,786	1,675,721
- after 5 years	886,238	1,166,115
Total	**3,087,345**	**3,293,082**

45.3. The Bank's contingent liabilities are provided in the table below:

	2018	2017
Contingent liabilities		
Payment guarantees		
- in RSD	11,370,073	11,544,832
- in foreign currencies	11,346,874	11,350,088
Performance bonds		
- in RSD	44,247,908	40,258,699
- in foreign currencies	2,520,761	5,636,983
Letters of credit		
- in RSD	18,056	7,131
- in foreign currencies	3,486,453	2,023,063
Irrevocable commitments for undrawn loans	23,576,208	24,619,436
Other irrevocable commitments	4,877,760	21,323,572
Balance at December 31	**101,444,093**	**116,763,804**

45.4. Breakdown of irrevocable commitments is provided below:

	2018	2017
Commitments		
Current account overdrafts approved	3,769,448	3,629,513
Unused portion of approved credit card loan facilities	995,183	922,145
Unused framework loans	17,813,980	18,675,532
Letters of intent	997,597	1,392,246
Other irrevocable commitments	4,877,760	21,323,572
Balance at December 31	**28,453,968**	**45,943,008**

45.5 As of December 31, 2018 do not have undrawn foreign lines or credit funds (2017: RSD 1,777,091 thousand).

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46. RELATED PARTY DISCLOSURES

The Bank is under control of UniCredit S.p.A., Milan, domiciled and registered in Italy, which is the sole owner of the Bank's common stock shares (100%). In the normal course of business, a number of banking transactions are performed with related parties. These include loans, deposits, investments in equity securities and derivative instruments. Related party transactions are performed at arm's length.

Balances of receivables and payables from related party transactions as of the year-end are provided in the table below:

		2018	2017
Statement of financial position			
Loans and receivables from banks and other financial organizations			
1.	UniCredit Bank Austria AG. Vienna	418,828	619,359
2.	UniCredit Bank AG. Munich	27,526	26,109
3.	UniCredit Bank Czech Republic and Slovakia a.s.	181	6
4.	UniCredit Bulbank. Sofia	128	22
5.	UniCredit S.P.A. Milano	14,272,355	7,515,042
6.	Zagrebačka banka d.d.. Croatia	4,361	550
7.	UniCredit Bank Hungary Z.r.t.. Hungary	13,640	5,212
8.	UniCredit Bank ZAO Moscow	6,504	9,924
9.	UniCredit Bank BIH	2,221	416
		14,745,744	8,176,640
Loans and receivables from clients			
1.	Bank's Management Board	21,151	22,205
2.	UCTAM D.O.O.	119,848	82,004
		140,999	104,209
Other assets			
1.	UniCredit S.P.A. Milano	18,164	12,040
2.	UniCredit Bank Austria AG. Vienna	9,627	2,493
3.	UniCredit Bank AG. Munich	1,025	2,518
4.	Zagrebačka banka d.d.. Croatia	474	316
5.	UniCredit Bank BIH	265	287
6.	UniCredit Banka Slovenia. Ljubljana	4	4
7.	UniCredit Bank ZAO Moscow	6	6
8.	UniCredit Bank Hungary Z.r.t.. Hungary	53,738	28,538
9.	UniCredit Rent d.o.o.	213	275
10.	UniCredit Partner d.o.o	3	78
11.	UniCredit Leasing Serbia	37	742
12.	UniCredit Bank AG. London	-	1,025
13.	UniCredit Tiriac Bank SA. Romania	1,693	1,483
14.	UCTAM D.O.O	5	80
		85,254	49,885

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46. RELATED PARTY DISCLOSURES (Continued)

		2018	2017
Deposits and other liabilities to banks, other financial institutions and the central bank			
1.	UniCredit Bank Austria AG. Vienna	7,040,693	16.920.170
2.	UniCredit Leasing Srbija d.o.o	976,594	908.295
3.	UniCredit Partner d.o.o	237,439	212.510
4.	UniCredit Bank AD Banja Luka	5,579	241.132
5.	Zagrebačka banka d.d. Croatia	94,734	53.062
6.	UniCredit Bank AG. London	-	36
7.	UniCredit Banka Slovenia. Ljubljana	40,876	4.639
8.	UniCredit Bank AG. Munich	25,978	6.091
9.	UniCredit Bank Hungary Z.r.t.. Hungary	3,743	2.790
10.	UniCredit Bulbank. Sofia	2	2
11.	UniCredit S.P.A. Milano	95,738,635	46.920.057
12.	UniCredit Bank Czech Republic and Slovakia a.s.	9,445	42.071
		104,173,718	65.310.855
Deposits and other financial liabilities to clients			
1.	Bank's Management Board	33,975	25.115
2.	UniCredit Rent d.o.o	47,535	168.222
3.	BA CA Leasing Deutschland GmbH. Germany	4,589	4.591
4.	Ambassador Parc Dedinje d.o.o.	74,529	451.858
5.	UniCredit CAIB AG. Vienna	63	63
6.	UCTAM D.O.O.	150,263	22.433
		310,954	672.282
Subordinated liabilities			
1.	UniCredit Bank Austria AG. Vienna	-	2.718.490
		-	2.718.490
Other liabilities			
1.	UniCredit Bank Austria AG. Vienna	25,666	89.522
2.	UniCredit Bank Hungary Z.r.t.. Hungary	176	155
3.	UniCredit Bank AD Banja Luka	18,591	14.431
4.	UniCredit S.P.A. Milano	75,574	135.619
5.	UniCredit Bulbank. Sofia	4,491	5.552
6.	Yapi ve Kredi Bankasi AS. Turkey	5,410	1.292
7.	UBIS GmbH. Vienna	-	1.412
8.	UniCredit Business Integrated Solutions S.C.P.A. Czech Republic	-	2.793
		129,908	250.776
Liabilities, net as of December 31		**89.642.583**	**60,621,669**

The following table summarizes income and expenses from related party transactions:

	2018	2017
Income statement		
Interest income	15,332	7,353
Interest expenses	(775,385)	(721,642)
Fee and commission income and other income	214,770	176,268
Fee and commission expenses and other expenses	(718,844)	(530,379)
Expenses, net as of December 31	**(1,264,127)**	**(1,068,400)**

Total gross salaries and other remunerations of the Bank's Management Board members in 2018 amounted to RSD 107,231 thousand (2017: RSD 96,388 thousand).

47. EVENTS AFTER THE REPORTING PERIOD

On the day of issuing these financial statements, there were no significant events that would require adjustments to the accompanying financial statements (corrective events).

Belgrade, February 14, 2019

Signed by the management of UniCredit Bank Srbija A.D., Beograd:

Feza Tan
Management Board Chairperson

UniCredit Bank Srbija a.d. Beograd
UniCredit Bank Serbia JSC Belgrade

Sandra Vojnović
Management Board Member
Head of the Strategy and Finance Division

Mirjana Kovačević
Head of Accounting Department