One Bank, One UniCredit.

2018.

Annual report

Banking that matters. | UniCredit Bank

VISION:

Our vision is to be "One bank, one UniCredit": pan-European commercial bank with a simple business model, which is fully plugged in Corporate & Investment Banking, delivering our unique Western, Central and Eastern European network to our extensive client franchise.

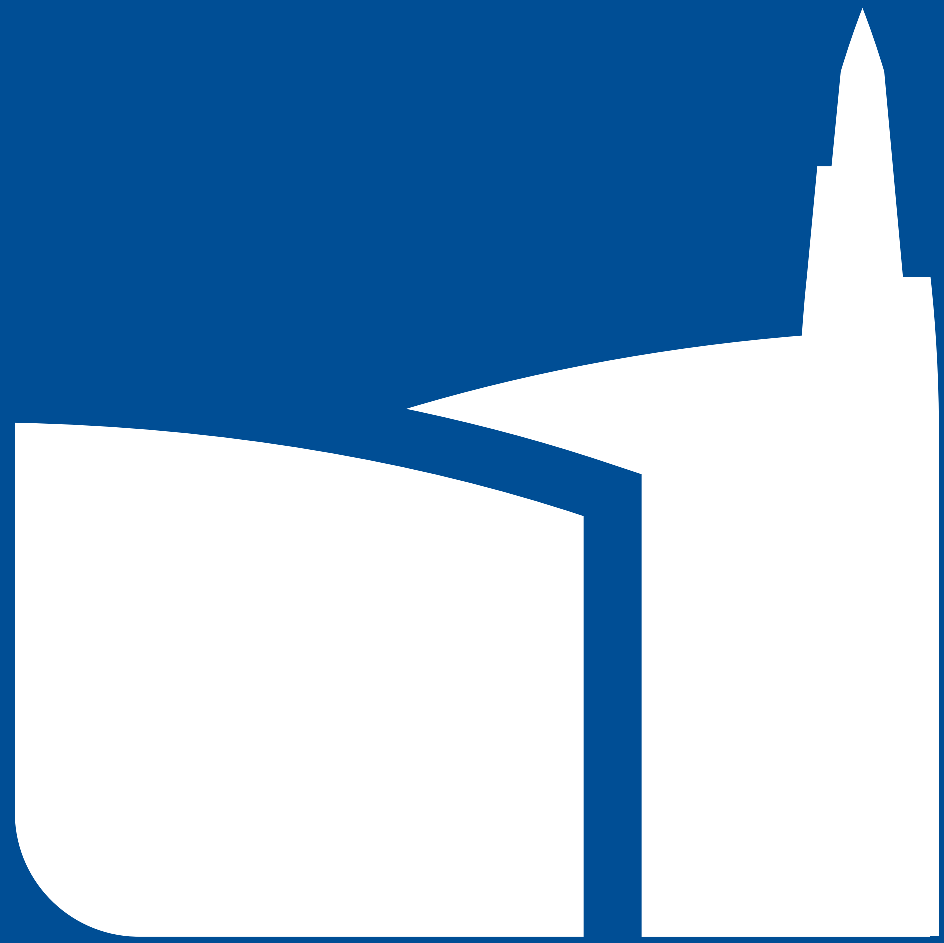
Everything we do to implement our vision is based on our Five Fundamentals.

Our top priority, every minute of the day, is to serve our customers the very best we can (Customers First). To do this, we rely on the quality and commitment of our people (People Development), and on our ability to cooperate and generate synergies as "One Bank, One UniCredit" (Cooperation & Synergies). We take the right kind of risk (Risk Management) whilst being very disciplined in executing our strategy (Execution & Discipline).

Banking that matters. | UniCredit Bank

Contents

Adopt lean but steering center.



We have created a lean but steering center to drive Group-wide performance and ensure accountability. Through leaner support functions and transparent cost allocation, we focus on efficiency and simplification.

Addressing of CEO

"We have continued to involve employees in different volunteering activities throughout Serbia. As a result more than half of the colleagues participated in mentoring programs, charity initiatives and arranging environment."

Feza Tan

ADDRESSING OF CEO

Year 2018 was a period which marked significant growth in all important parameters. Thanks to improved processes, and placement of additional products as well as services, we managed to further strengthen our position as one of the market leaders in terms of profitability, efficiency and productivity. Moreover, for the first time since we started the operations in Serbia, we became bank number 2 in terms of total assets.

The UniCredit Serbia Group net profit reached RSD 9,375 million on consolidated basis which represent the growth of 38% in comparison to 2017. In line with our Group's strategy which is focused on developing strong roots in local markets, UniCredit continued to demonstrate strong commitment to Serbia, as evidenced by the increase of balance sheet assets by 21% year on year to over RSD 448 billion.

Relentless customer focus contributed to increase customer base by almost 11%, both in retail and corporate. Consequently, clients' deposits grew by 18% in comparison to the previous year, exceeding the amount of RSD 220 billion. Even though the local market was showing narrowed creditworthy demand, the volume of net loans in 2018 reached RSD 266 billion, marking an increase of 11% in comparison to previous year.

The fact that we increased the number of employees by 2% reaching to 1,311 by year end proves that we are constantly investing in this market.

In 2018 we engaged extraordinary efforts to position UniCredit Group Serbia as one of the market leader when corporate social responsibility is concerned. We have continued to involve employees in different volunteering activities throughout Serbia. As a result more than half of the colleagues participated in mentoring programs, charity initiatives and arranging environment.

In 2019 we plan to continue our commitment and determination to support expected development of the country, and meet customers' financial needs by expanding our product offer by bringing new, innovative high-value-added services to all our customers. We will continue to build a long-term partnership with our customers based on trustworthiness. Customer Satisfaction remains a crucial indicator of a successful partnership with our customers in the years to come. In line with increased focus of the entire UniCredit Group and leveraging on technological developments, we will continue with the process of digitalization of our core products and services putting the new technologies in hands of our clients.

At the end, I would like to thank all our employees for these excellent achievements which would not have been possible without their commitment and engagement. I would also like to thank our clients for their loyalty, trust and for firmly believing that UniCredit Serbia Group is their bank of the first choice.

Feza Tan

MACROECONOMIC OVERVIEW

Serbia's GDP grew 4.3% year-on-year (latest estimation for 2018) on the back of higher domestic consumption, exports and investments, coupled with strong growth of agriculture and construction. More dynamic growth compared to the previous year is aided by favorable economic outlook abroad, stable macroeconomic fundamentals at home and low base (GDP grew 2.0% in 2017).

The economic growth in 2018 was led by agriculture, construction, industry and trade. The economic growth is well-diversified, the level of public investment is increasing and work on improving the business climate and regulatory changes have started creating a positive result. Overall increase in net exports, industrial production and investments were helped by the reinforced confidence on country's economic outlook.

Macroeconomic indicators have strengthened in 2018 and led to Country Credit Rating increase and the National Bank of Serbia (NBS) decision to continue with the policy of monetary easing (two policy rate cuts in 2018). Economic program was successfully implemented with the assistance of the IMF Policy Coordination Instrument (PCI) and European Union monitoring mechanisms. PCI was signed in July 2018 with the aim to anchor macroeconomic and fiscal stability and assist the implementation of structural reforms necessary for sustainable economic growth in the future and growth of living standard.

Serbia has made a solid progress in Accession negotiations with the European Union this year: four additional chapters were opened (13-Fisheries, 17-Economic and monetary policy, 18-Statistics, 33-Financial and budget provisions) while certain development was noted on national minority rights issues, money laundering prevention and asylum. Sixteen out of thirty five negotiation chapters have been opened, while two chapters are temporarily closed. However, the key areas where much progress have not been seen are as follows: judiciary, rule of law, media freedom and corruption decrease. Negotiations with Kosovo did not result in improving the relations of two countries, and recent decision of Kosovo to increase tariffs on imports from Serbia resulted in further deterioration of the situation.

According to „Doing Business" list surveyed by the World Bank, Serbia takes 48th position out of total 190 countries participating in the survey, recording decrease of five positions compared to the previous year. The procedure for granting construction permits recorded highest marks, while getting an electricity connection to the network the lowest. Serbia made progress in all surveyed areas except functioning of institutions according to Global Competitiveness Index published by the World Economic Forum. The best scores were noted in the health system, macroeconomic stability and infrastructure.

Successfully implemented fiscal consolidation (2014-2017) and well defined fiscal policy framework led to good fiscal result also in 2018. The central government recorded RSD 61.1 billion surplus (1.5% GDP) in January-October 2018, leading to projected fiscal deficit of 0.5% for 2018. Revenues are growing at a slower pace than expenditures due to lower payment of corporate profit tax and excise tax. While the austerity measures have produced good result so far, fiscal discipline is required to continue in 2019 and beyond in order to further reduce public debt (56.2% in November). The figures for public debt are estimated to be reduced for the third time running, due to excellent fiscal result in this year.

Current account deficit increased by 21% in 2018 to estimated 5.8%, due to higher increase of domestic demand in relation to total produced goods and services domestically, coupled with the strengthening of dinar. Domestic demand in 2018 is 9% higher than GDP, while the average in CEE is 3% lower (on average). Inflow of foreign direct investment (FDI) increased in 2018 to EUR 2.5 billion (15% increase compared to the previous year). Current account deficit is fully funded by FDIs in 2018. Foreign currency reserves represent 6 months of current external payments, providing a relatively good buffer against any external shocks.

Serbia's foreign trade deficit continues to widen in 2018. In January-November 2018 foreign trade exchange reached EUR 35.1 billion, which is 11.2% higher compared to the same period last year. Foreign trade deficit is 30.7% higher year-on-year and has reached EUR 4.9 billion. Imports grew faster than exports during 2018 (13.3% yoy vs. 8.6% yoy). Export-import ratio was reduced to 75.2% (78.5% for the same period in 2017). The major export trade partners for Jan-Nov 2018 were: Italy (EUR 1.8 bn), Germany (EUR 1.8 bn), Bosnia and Herzegovina (EUR 1.1 bn), Romania (EUR 0.9 bn) and the Russian Federation (EUR 0.8 bn).

The National Bank of Serbia was successful in keeping the prices stable in 2018 due to strengthened credibility of monetary policy and its full coordination with fiscal policy. The inflation moved within lower half of targeted corridor during the period. Average inflation for 2018 amounted to 2.0% while core inflation has been low and stable (average 1.0%). The National Bank of Serbia eased the policy rate twice: by 0.25% in March and by 0.25% in April. NBS confirmed that the targeted inflation limits will remain the same ($3 \pm 1.5\%$) until 2021, and by doing so anchored inflation expectations, which proved to be a successful policy so far.

Positive trends were recorded on the labor market in 2018 that are expected to continue in 2019. All employment indicators are increasing: total employment (1.6%), formal employment (3.4%), registered employment (3.3%), while at the same time the number of registered unemployed in the National Employment Bureau is decreasing (10.5% decreased in third quarter of 2018 compared to the same period in 2017). Privatization and active measures for curbing the grey economy have increased the number of employed in the private sector. Unemployment was reduced to 11.3%. Average monthly net salary in 2018 was EUR 420, and is nominally higher by 8.0% year on year, and 5.7% higher in real terms.

Implementation of reform laws adopted over the last three years has started producing some positive results: better tax collection, introduction of new electronic services for citizens and business, development of capital markets, more efficient procedure for registering real estate, reform of charges for business. The State is also working on introducing e-building permits system nationwide, creating integrated inspection information system, introducing measures for curbing the grey economy, strengthening public investment management system and implementing e-government strategy. Public administration rightsizing target was met by strictly enforcing an employment attrition rule, business start-ups have received tax relief in first two years of operating, while electronic way of doing business is becoming reality in Serbia following adoption of legislation on e-business and e-government.

Strengthen and optimise capital.

We will maintain a strong capital position by generating solid profit. We confirm our MDA buffer. The Group fared well in the EBA stress test results, with the third highest CET1 ratio among systemic banks in the Eurozone.

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BANKING SECTOR

In line with an enhanced macroeconomic stability and improved business environment, the Serbian banking sector continued to operate on stable grounds, led by the growth of credit activity in 2018 and supported by further activities on NPL reduction which resulted in a considerably better asset quality level on the local market and continued the recovery trend initiated a few years back.

A low inflation environment over a multiyear period has led to further monetary policy easing in 2018 by the Serbian National Bank via two 25 basis point rate cuts to a level of 3.0%, which in turn further reduced the local currency lending rates. At the same time the extended expansionary monetary policy of the European Central Bank has contributed to the further decline of euro-indexed interest rates.

The consolidation trend of the banking sector continued throughout 2018 driven by increased market competition, limited organic growth opportunities and harsher survival conditions for smaller banks on the Serbian market. Two smaller banks have changed their ownership, while one bank in state ownership was delicensed due to its inability to maintain minimal capital requirements. In the upcoming period, this trend can be expected to continue, especially within top ten banks ranked by total assets, due to the pronounced consolidation process present within international banking groups in the region and the announced sale of shares in certain banks where the state is in the ownership structure, which will potentially reduce its presence in the Serbian banking sector. Acquisitions of banks by local buyers represent a sign of a stable banking sector which is resilient to the risks and which has favorable outlooks in terms of lending acceleration in the period ahead. Improved macroeconomic environment coupled with a better business and investment climate and higher country rating of the Republic of Serbia have led to a better perception of investors regarding investment opportunities on the local market and hence new international banks can be expected to enter the Serbian financial market.

The banking sector finished the third quarter of 2018 with 28 commercial banks and total net assets of RSD 3,563 billion, posting a nominal growth rate of 8.2% compared to the same period last year. In gross terms, total loans expanded 7.7% year-on-year excluding the FX rate effect, despite the continuance of significant NPL write-offs and sales. This represents better growth compering the same period last year. During this period retail lending has grown 12.3%, while corporate loans posted a 4.1% increase. The demand on the retail side was driven by cash and refinancing loans which were disbursed mainly in RSD and accounted for over 60% of newly approved loans to private individuals, while almost three quarters of them were disbursed with a maturity of over five years. Additionally, a high amount housing loans has continued to be disbursed driven by the recovery of the labor and real-estate market which resulted in more housing loans disbursed in the first nine months of 2018 then throughout the whole of last year. When corporate sector is concerned, the growth was driven mainly by working capital loans and to a smaller extent investment loans.

Compared to the end of 2017 level, the "dinarization" of loans was somewhat reduced, given that the share of dinar loans in total corporate and retail lending in the first nine months of 2018 decreased by 0.2 percentage points to 32.8%. Private individuals continued mainly to take dinar loans, which led us to a new record of 53% of total outstanding loans to private individuals in dinars. The share of dinar loans to corporates decreased as of September 2018 to a level of 14.6%. The share of RSD deposits of households and corporates in total deposits increased by 0.2 percentage points compared to year-end level and reached 31% at the end of September, owing to a low and stable inflation environment and a relatively stable exchange rate. Sight deposits increased for the first nine months of 2018 mainly owing to the growth of household sight deposits, while corporate sight deposits also experienced a one-year upward trend owing to the acceleration of economic activity. Term deposits in RSD also posted growth rates in the first nine months mostly owing to increased corporate deposits, which was supported by the growth of household savings in RSD which grew throughout the year and reached a historic maximum of RSD 60 billion at the end of September 2018. On the other side, the growth of foreign currency term deposits was driven mainly by households which also reached a new historic maximum of EUR 9.5 billion. Despite historic low interest rates on household and corporate deposits their stability in the funding structure was preserved, accounting for 47% and 25% of total liabilities respectively.

At the end of the third quarter of 2018 the banking sector employed 23,067 people, which represents a reduction of 275 employees compared to the same period last year. The branch network consisted of 1,610 different organizational units, down by 61 unit in comparison to the beginning of the year.

In order to harmonize the domestic regulation with the legislative framework of the European Union in the field of banking supervision and to improve the resilience of the banking sector, the National Bank of Serbia has introduced new regulations in line with the provisions of the Basel III standard, including a set of macro-prudential buffers with the aim to limit the systemic and structural risks. At the end of the third quarter of 2018 the average capital adequacy ratio of the banking sector amounted to 22.8% which is significantly higher than the required minimum of 8% and 0.2 percentage points higher than at the end of 2017.

After a historic reduction of the NPL ratio in 2017 by 7.2 percentage points, the positive trends continued also in 2018, for which both absolute and relative indicators have been significantly reduced in the first nine months, due to the accounting write-off, sales and a pronounced contribution of collection, as well as the effects of lending activity acceleration. The NPL ratio was reduced to 6.4% at the end of September, which represents its lowest level since 2008 when this ratio was introduced.

SERBIAN FINANCIAL SECTOR (Continued)

Given that the banking sector is oriented towards international standards and sound risk management principles, the banks continued to add provisioning levels in order to provide insulation against credit losses, covering the NPL's with more than 61.3% with IFRS provisions, despite the high level of write-offs, and 153.3% with NBS provisions.

The profitability indicators of the Serbian banking sector as of third quarter of 2018 remained high. The aggregated profit before tax of all twenty eight banks amounted to RSD 53.9 billion and recorded a year-on-year increase. The Return on assets (ROA) indicator amounted to 2.1% at the end of the third quarter of 2018 (Q3 2017 was 2.2%), while in the same period the Return on equity (ROE) indicator amounted to 10.7% (Q3 2017 was 11.0%).

In the short term the banking sector is expected to expand at steady rates, facilitated by the effects of macroeconomic stabilization, monetary policy easing, increase of economic activity, growth of employment and wages, low interest rates environment, pronounced competition and loosened credit standards. In the medium term, a gradual slowdown of growth rates can be expected in line with the anticipated slowdown of the economic activity and the gradual exit from a low interest rate environment. Fixed investments in large infrastructure projects, growth of export and private consumption, supported by growth of wages, will remain the key drivers of the lending activity.

Regarding revenue generation it is expected to remain positive, while a strong pressure on NII margin deriving from intense market competition will continue to represent the main challenge in the period ahead. Moreover, after the significant drop of the CoR in 2018 as a result of unprecedented low default rates, and significant sector wide improvements in recovery and NPL resolution strategies in terms of collections and disposals, the period ahead will be characterized by a low default rate environment although with steadily rising trend due to stronger lending recovery in both corporate and retail segments, which will inevitably result in a reversal of low default environment. In addition, net new business growth and IFRS 9 developments represent a new risk factor to the loan loss provision volatility.

Additionally, it is almost certain that the consolidation trend of the banking sector will continue together with the entrance of new players as well as the continuation of the digitalization process of the Serbian financial market

LEASING SECTOR

The positive trend in financial leasing activity was also recorded throughout 2018 thanks to increase in demand which was driven by the recovery in the economic activity, increase in earnings in the private sector and improved macroeconomic outlook.

At the end of third quarter of 2018, according to the statistics of the National Bank of Serbia, 17 financial leasing companies were operating on the Serbian market with total gross assets reaching RSD 83.8 billion. The receivables from finance lease represent the largest share of the total balance sheet assets (89.1%) at the end of third quarter of 2018. These receivables, in absolute terms, amounted to RSD 74.7 billion and were 14.4% higher compared to the end of 2017 (RSD 65.3 billion).

The leasing sector recorded a profit before tax of RSD 1.1 billion as of third quarter of 2018, which is 39.4% higher than in same period of 2017, thanks to lower interest expenses, lower net expense from foreign exchange differences and provisioning, but also higher interest income. Eleven financial leasing companies were profitable while six recorded a negative result. ROA increased to 1.9% at the end of third quarter of 2018, up from 1.5% at the end of the third quarter of 2017. Also, the rate of return on total equity (ROE) at the end of third quarter amounted to 15.8% and posted an increase compared to the same period 2017 when this indicator stood at 11.8%. Number of employees in the financial leasing sector at the end of the quarter totaled at 358, which is 1.4% lower comparing Financial leasing institutions are still financing mainly freight vehicles, minibuses and buses (43%) and passenger vehicles (36%), while financing is mainly concentrated in the following sectors: transportation, storage, information and communications (31.6%). Significant participation at the end of third quarter of 2018 had manufacturing industry, mining and water supply (14%) and construction sector (9.8%).

Net interest margin was reduced compared to 2017 level and amounted to 3.09% at the end of third quarter 2018. The average active interest rate was reduced and amounted to 3.92%, as well as the average passive to 2017 level.interest rate, which at the end of the third quarter of 2018 stood at 0.85%.

In 2019, further growth in financial leasing market is expected, in line with the expected growth of the economic activity, salaries and domestic demand. The growth is expected predominantly in vehicle product segment, construction machines and equipment, as well as transport and logistic sector. More favorable interest rates and simplified processes are likely to bring more interest for financing through leasing in the coming period.

FINANCIAL PERFORMANCE OF UNICREDIT SERBIA GROUP IN 2018

Unicredit Serbia Group			
in thousands RSD	**2018**	**2017**	**Change**
Income statement			
Net interest income	13.939.697	12.363.571	12,7%
Net fee and commission income	3.563.310	3.006.788	18,5%
Other non-interest income	3.919.489	2.089.001	87,6%
Operating expenses	-8.312.143	-7.537.980	-10,3%
Net impairment loss on financial assets	-2.879.851	-2.626.765	-9,6%
Profit after tax	9.374.655	6.781.517	38,2%
Balance sheet			
Loans and receivables to banks	21.019.696	11.885.064	76,9%
Loans and receivables to customers	266.406.450	240.608.342	10,7%
Deposits and other liabilities from banks	142.879.336	106.676.158	33,9%
Deposits and other liabilities from customers	220.931.036	186.658.833	18,4%
Equity	78.805.890	70.144.383	12,3%
Total balance sheet assets	448.279.401	370.781.331	20,9%
Capital adequacy			
Total risk weighted assets	288.657.574	263.992.015	9,3%
Regulatory capital	57.464.942	49.266.299	16,6%
Capital adequacy ratio	19,9%	18,7%	+120 bp
Key performance indicators			
Cost/Income ratio	38,8%	43%	-437 bp
ROA (Return on assets after tax)	2,3%	1,9%	+37 bp
ROE (Return on equity after tax)	12,6%	10,0%	+254 bp
Loans to Deposits ratio	120,6%	128,9%	-832 bp
Asset(avg)/Number of employees(avg)	315.387	280.246	12,5%
Cost of risk	1,1%	1,2%	-3 bp
Resources			
Number of employees	1.311	1.286	25,0
Number of branches	72	71	1,0

In 2018 UniCredit Bank confirmed its strong orientation towards continuous growth and preservation of high standards in terms of profitability, productivity and efficiency. According to Q3 2018 data, Bank was positioned as bank number 2 in total assets, with market share of 11.7%. Total assets at the end of December 2018 stood at RSD 437.4 billion which is 21% higher than previous year end.

Driven by strong year-on-year growth of customer loans of 10%, Bank further improved market share in Net loans to customers (12.3% based on Q3 data), considerably entrenching its second position in loan portfolio ranking on the market. Growth is driven by both excellent lending activity to private individuals and successful performance of the corporate sector. This growth was financed by strong growth of customer deposits by 18% bringing the Customer Loan to Deposit ratio to 116% as of 2018 year end. Continued improvement of deposit base, on both corporate and retail side, can be seen as a confirmation of UniCredit Bank image as one of the most sound and reliable on local market.

The Bank has continued with successful management of NPLs, which is evidenced by significant decrease of NPL ratio, dropping to 3.5% as of December 2018 from 5.7% at the end of December 2017, also being well below sector average (6.4% as of September 2018). In this regard, significant positive effects on P&L are realized, thanks to prudent recognition of income from loans that are overdue more than 90 days.

At the end of 2018 the Bank realized net profit after taxes of RSD 9.2 billion, which represents the new best result in Bank's history, bringing the ROE to 12.5%. This remarkable result is highly impacted by the sale of large NPL with price above the net value. Bank confirmed its earning capability by recording 22.8% year-on-year growth of total revenues, mainly driven by strong increase in net fees and commission income by 18.4%. The double-digit annual growth of net interest income of 12.6% was achieved, which was driven by the growth of customer loans. Bank has also continued to successfully trade with financial instruments as the leader on local and international market.

Achieved Cost-to-income ratio of 39%, one of the lowest in the sector, confirmed once again Bank's ability to maintain high standards in terms of operational efficiency.

Strategic focus on quality of service and customers satisfaction enables Bank to constantly enlarge its client base. The number of client compared to December 2017 increased by almost 40,000. At the same time, excellent results are made in increasing number of active users of internet and mobile banking, thank to successful implementation of digital banking channels.

In spite of negative trend in the sector, Bank has increased number of employees confirming its orientation towards constant growth and positioning as an employer of choice on the market.

UniCredit Leasing continued with the expansion, increasing its market share in new business to 15.09% as at end of December 2018. Driven by growth of customer loans standing at 32% higher level compared to 2017, UniCredit Leasing recorded year-on-year growth of total assets of 32%, steering its business mainly towards financing of large and medium enterprises with constant effort on increasing its market share in small business segment.

UniCredit Partner confirmed its successful performance at the end of 2018, by recording 25% higher operating income from agency in insurance, compared to 2017.

Overall, UniCredit Serbia Group completed business year 2018 with excellent results, achieving historically high net profit after tax amounting to RSD 9.3 billion, followed with return on equity of 12.6%.

With total capital adequacy ratio of 19.9%, UniCredit Serbia Group holds solid capital base, fully comprised of high quality common equity tier one instruments and significantly exceeding regulatory requirements for maintaining of total combined capital buffers.

STRATEGY FOR PERIOD 2019-2021

Main strategic goal of the Bank for the next three years is further improvement of the one of the top market player position, relying on strong operating profitability, efficiency and sound risk management practices supported by excellent customer satisfaction, based on following key elements:

Customers – focus on existing clients and acquisition of the new ones, by offering high quality products and services;

Products – further improvement of products and services, with clear focusing on selected products, but also on the development of new and innovative based on the specific customer's needs;

Channels – further development of alternative sales channels, acceleration of digital transformation process together with synergy between Corporate and Investment Banking Division, Retail Divisions and Leasing;

Operating model – major processes and system improvements leveraging on changing market environment and

Risk Management – maintain and improve portfolio quality along with strengthening of common Risk culture among all Bank's employees.

UniCredit Bank Serbia, as member of UniCredit Group, participates in the Group "Transform 2019" Program, which assumes implementation of several strategic initiatives with the aim to further strengthen market position by driving forward the digital transformation, by acquiring new international CIB and Retail customers, by constant focus on cost management as well as applying a strict risk discipline.

Multi-Year plan of the Bank assumes full enforcement and alignment with all regulatory requests and set limits followed by balanced growth. Plan also assumes keeping strong track record of out-performance in terms of business growth, operating profitability and efficiency, with focus on process and system improvements, along with aim to improve portfolio quality together with enlargement of active client base, in order to enable sustainable growth.

Improve asset quality.

We are continuing to improve our asset quality by de-risking our balance sheet, fully on track for the accelerated rundown of our Non Core portfolio by 2021. A disciplined risk management approach guarantees high quality origination across the Group.

ORGANISATIONAL STRUCTURE OF UNICREDIT SERBIA GROUP

ORGANIZATIONAL STRUCTURE OF THE BANK

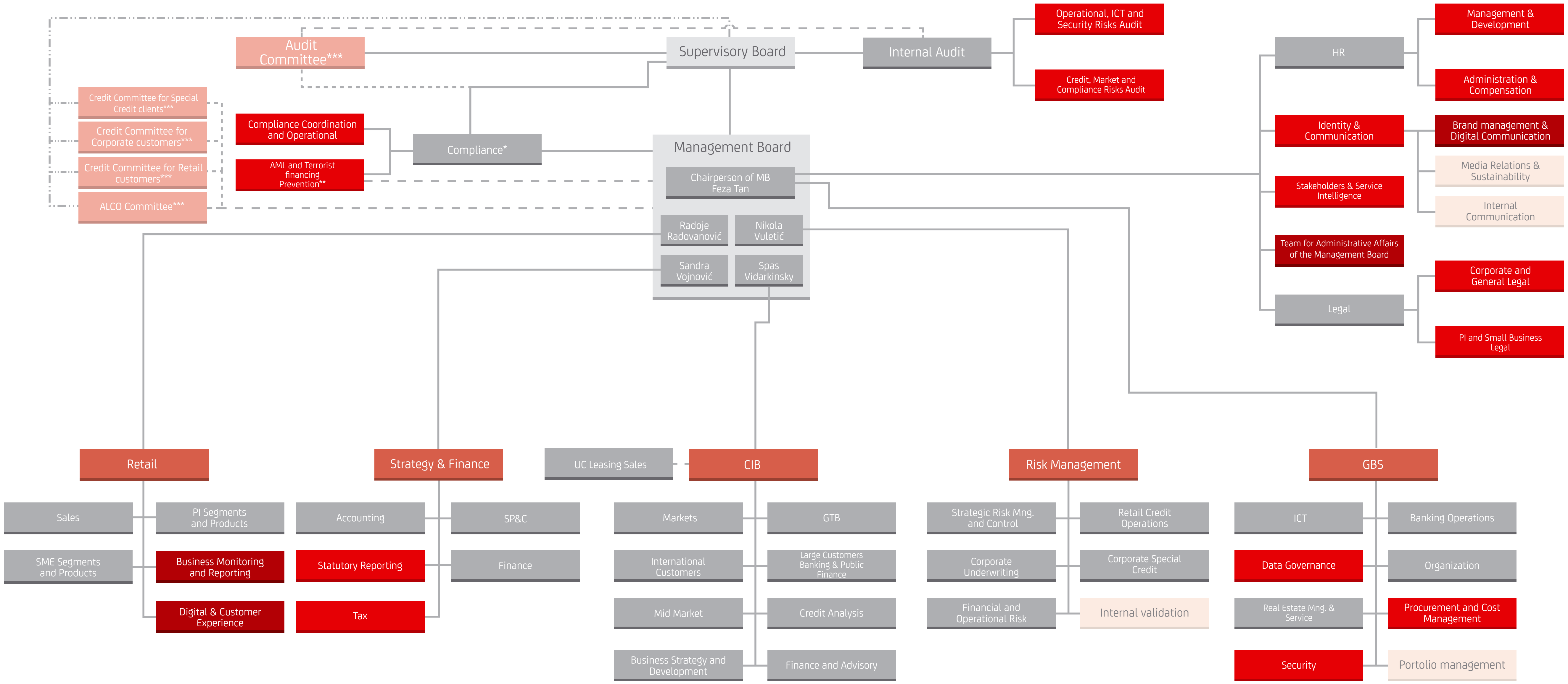
UNICREDIT BANK SERBIA JSC. BEOGRAD

SUPERVISORY BOARD
Marco Lotteri, Chairman
Luca Pierluigi Rubaga, Member
Silvano Silvestri, Member
Boris Begović, Member
Svetlana Kisić Zajčenko, Member

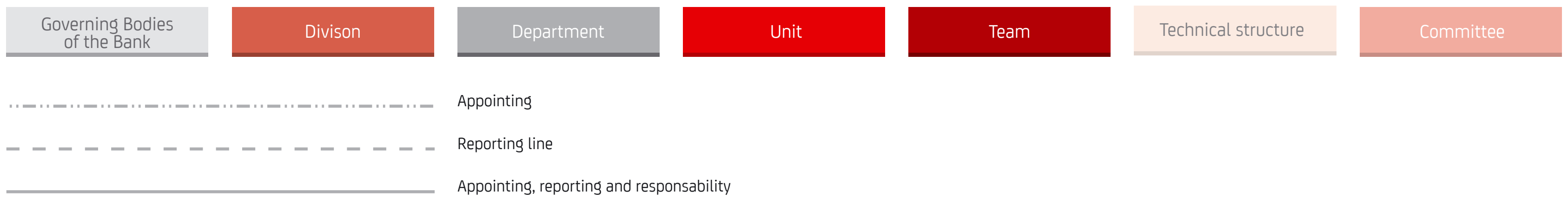
EXECUTIVE BOARD
Feza Tan, Chairwoman
Nikola Vuletić, Member
Sandra Vojnović, Member
Spas Vidarkinsky, Member
Radoje Radovanović, Member

ORGANISATIONAL STRUCTURE OF UNICREDIT SERBIA GROUP

ORGANIZATIONAL STRUCTURE OF THE BANK



* Compliance Department – Reporting to the Audit committee and Management Board and periodically to the Supervisory Board
**Chairperson of MB is responsible for the work of AML and Terrorist financing and prevention Unit
***Members of the Committees are appointed by Supervisory Board. Audit Committee reports to the Supervisory Board according to the law. ALCO and Credit Committees report to the Management Board according to the internal acts.



ORGANISATIONAL STRUCTURE OF UNICREDIT SERBIA GROUP

ORGANIZATIONAL STRUCTURE OF THE BANK

As of 2016, members of UniCredit Group Serbia besides UniCredit Bank Serbia JSC are UniCredit Leasing Srbija doo Beograd and UniCredit Partner doo for representation in insurance Belgrade. Following UniCredit Group entities were performing business also in Serbia in 2018: UniCredit Rent, UCTAM and Ambassador Parc Dedinje doo, which are representing parties related to the Bank.

UNICREDIT LEASING SRBIJA D.O.O. BEOGRAD

SUPERVISORY BOARD
Nikola Vuletić, Chairman
Spas Vidarkinsky, Member
Branko Radulović, Member

MANAGEMENT BOARD
Ana Milić, Chairwoman
Ratko Petrović, Member

UNICREDIT PARTNER BEOGRAD
Zvonko Buden, Director
UniCredit Partner has no Supervisory or Management Board.

CORPORATE INVESTMENT BANKING

Growth of the economic activity driven by exports and investments, macroeconomic stability and further easing of monetary policy stimulated corporate sector credit activity in 2018, particularly in the second half of the year. Namely, despite significant write-offs of NPLs (11.3% growth once effect of non-performing loans write-off is excluded from the calculation) credit activity recorded 4.1% annual growth. The growth is predominantly the result of the credit activity increase of private companies with 91.2% share in total loans of the corporate sector.

According to its purpose, corporate loans were mostly approved as working capital (46%), followed by investment loans (30%) in 2018. The break down by sectors shows that the growth was led by trade, agriculture and construction sectors.

The share of dinar loans declined by 3 percentage points to 14.6%, largely due to the write-off of dinar loans in 2018. Loans in euros and indexed in euros still account for the lion's share of loans to the corporate sector (84.6%), while share of loans in US dollar and Swiss francs is decreasing in the loan portfolio (0.6% and 0.2% respectively).

Downward trend in interest rates continued in 2018 due to the easing of the monetary policy, stable macroeconomic environment, increase in banks' competition on the credit market and reduction of interest rates on the international money market impacting interest rates on euro-denominated loans. The interest rates on newly approved dinar loans at the end of November 2018 amounted to an average of 5.1%, while the interest rate stood at 2.4% on the Euro and Euro-indexed loans.

The new credit demand was mainly driven by the need to finance working capital and investment. At the end of third quarter working capital and investment loans make 53.8% and 21.1% of the total new loans to corporate sector respectively. The positive trend in investment loans indicates better overall conditions on the credit market and the economy. In 2018, RSD 153.6 billion of investment loans were approved, which is 3.4% more than in the previous year according to the National Bank of Serbia report on credit activity for the third quarter. Nevertheless, operating in the environment of low interest rates and compressed spreads presents unique set of challenges for the Serbian corporate banking sector.

Despite these challenges, UniCredit Bank Corporate and Investment Banking was focused on opportunities and remained committed to the strategy of portfolio consolidation with emphasis on de-concentration of credit risk and selective approach with focus on SME clients. As a result, the loan portfolio amounted to around RSD 150 billion with a 3% year on year increase and 5,316 client base. Deposit position was strengthened through various commercial activities that produced a significant increase of volumes in transaction banking. This resulted in 22% year–on-year growth in deposits, reaching the amount of RSD 148 billion and significant growth in the number of recorded transactions.

Markets Department strengthened its leading position in the local market. National Bank of Serbia's official data for 2018 indicate that UniCredit Bank's Markets Department is the first in providing F/X services to non-residents, while it holds second position in providing F/X services to residents with 46.5% and 17.1% market share respectively. Furthermore, UniCredit Bank ranked first in transaction volumes in interbank exchange in euros with a 17% market share. Overall, revenues of the Markets Department posted a year-on-year growth, continuing with the positive trend established in previous years.

During 2018 the Bank continued its efforts to promote hedging products, as a way to shield businesses from interest rate and FX fluctuations by offering interactive workshop for both large enterprises and medium-sized companies. The Bank continues to be ahead of the competitors with its innovative approach, and affirmed its leadership in the designing and marketing of these products. UniCredit Bank remained market leader in trading with financial instruments on both primary and secondary markets with a market share of 28% and 35% respectively.

In 2018 UniCredit Bank supported small and medium sized business with special SME credit lines, and in doing so contributing to Government-led initiative for strengthening SME sector. The focus on SMEs will continue in 2019, as we implemented InnovFin and COSME Program funded by the EU and EIB. We will also support Energy Efficiency projects through the joint initiative with funds financing Environment protection.

In 2019, Corporate and Investment Banking will continue with the strategy of selective portfolio growth and creation of economic value for Bank by increasing the return on risk-weighted assets through increased cross selling. Division will seek out to increase market share in segments with lower penetration rate and foster long-term partnership with existing customers based on reciprocity and trustworthiness. Furthermore, CIB remains committed to continuous improvement of internal efficiencies through the process of evaluation and optimization. The Bank's business activities will be focused on stimulating the development and supporting the recovery of local economy by expanding our innovative value-added products proposition and advisory services to clients. Furthermore, the Bank will also continue close cooperation with regulators including National Bank and Ministry of Finance, thus actively supporting the improvement of domestic business environment, as well as all development initiatives.

Client focus will continue to drive main ambition of bringing economic value to our clients in aim to produce higher economic activity in our country. Corporate and investment Banking will further support private and public sector including local communities, by fully exploiting our deep knowledge of the Serbian market, global reach of UniCredit Group and expertise in financial products and solutions.

UniCredit Leasing, with total portfolio in the amount of RSD 10.3 billion as of third quarter 2018, holds third place on the local market with 13.9% market share. Successful performance of UniCredit Leasing in 2018 is confirmed by recorded 3% year on year growth of net operating profit.

Based on ALCS report on new business, financial leasing market increased by 16% compared to the previous year, with financed volume of EUR 413 million at the end of the fourth quarter of 2018 (EUR 354 million in 2017). In the same period UniCredit Leasing realized EUR 62 million raising its market share from 13% to 15%. During 2018 UniCredit Leasing focused on further strengthening of SME segment, developing regional presence as well as enhancing cooperation with vendors which led to better performance, higher market share and creation of solid base for next steps. Looking forward, UniCredit Leasing remains committed to financing vehicles in all categories, but also strengthening financing of agriculture equipment and mechanics, construction equipment and IT equipment and infrastructure.

Considering the economic environment and further development, perspectives of the leasing market in Serbia, UniCredit Leasing will seek to increase new business, maintain a good portfolio quality, improve cross-selling with UniCredit Bank in all segments, improve existing products and innovate new ones, as well as strengthen cooperation with clients and partners, by applying highly professional business standards.

RETAIL BANKING

The growing trend of Retail Division was kept also during 2018. Revenues increased for 15% compared to the previous year, while the volume of loans and deposits also recorded a growth of 16%, resulting in the increase of market share.

The Bank has been very active in the segments of Private Individuals and Small business clients, with the aim of strengthening and expanding cooperation with existing and new customers. Number of clients increased by 11% as a result of a focus on customer needs and continuous cooperation with the companies.

Clients continued to show the trust in Bank's product offer and service quality and reliability of the service. Led by interest of the clients, transparency remains the main pillar of Bank's daily business.

Key credit products in 2018:

- Cash loans with the insurance coverage in case of unemployment;
- Housing loans with a variable interest rate;
- Working capital loans for Small business clients.

Bank has continued to provide favorable offer to clients for purchase of their living space. Despite the challenging environment and increased competition, Bank achieved the growth of housing loans of 5% compared to 2017 thanks to further optimization of the approval process and pre-approval concept.

Despite continuous trend of low interest rates on customer's deposits, UniCredit Bank has continued to pay attention to saving products. In 2018 the volume of Retail customer deposits increased for 15.6%, which is certain indicator that UniCredit Bank is recognized as one of the most sound and reliable on the local market.

In accordance with the strategy of further development of digital business, in 2018 UniCredit Bank has continued with the improvement and promotion of the digital banking platforms (mBanking, eBanking, Website, Contact centre). Within mBanking application, improved functionalities were created to satisfy client needs and demand, and contributed to the further growth of number of active mBanking users of 72.5% compared to 2017. At the beginning of 2018, mBanking application for Small business clients was launched. Application is well accepted and is recording continuous growth of number of users and transactions.

In 2018 work on the initiative with the goal to enhance customer experience was continued guided by their expectations and everyday needs, through monitoring of key processes in the Bank and their optimization and through adequate support to branch network.

In the segment of Card business, Bank successfully launched Business Dina Card among the first in the market, in August 2018, and at the same time implemented the model of independent (in house) personalization of Dina Card, both for individuals and legal entities.

In the upcoming period, focus will still be on automations and simplifications with the aim of improvement of efficiency of the business processes. The goal is to continue with the controlled increase of market share based on the good relationship with customers. Regarding loan products, focus will remain on cash and housing loans, as well as on specially created credit offers to small businesses in order to support their further growth. In accordance with modern trends and increased customer expectations, digitalization, as a concept of modernizing business, will continue to be one of the main priorities.

RISK MANAGEMENT

Risk Management Division covers the management of credit, market, operational, liquidity risk and other risks through the work of five departments: Strategic Risk Management and Control Department, Corporate Underwriting Department, Retail Credit Operations Department, Corporate Special Credit Department, Financial and Operational Risk Department. They all report to the Member of the Management Board in charge of Risk Management, which provides control over all loan process phases, as well as a global overview and assessment of the risks to which the Bank is exposed.

In order to define a consistent policy of lending activity and the overall framework of the risk management, the Bank defines a Retail and Corporate credit risk strategy, for each business year. In this way, the Bank provides the proper realization of the adopted business policy within framework that will result in an acceptable level of credit risk when it comes to individual placements and adequate diversification, as well as general quality of the loan portfolio. The Bank also takes into account the analysis of the risk of money laundering and financing of terrorism in deciding on taking credit risk.

During 2018 further improvement of risk management system was focused on enhancement of internal organization, business processes and risk management policies in accordance with the best practices of UniCredit Group, requirements arising from the implementation of Basel standards and regulator requests. In particular, the organizational structure was changed in terms of allocating a special structure - the function of Internal validation, which reports directly to the Head of Risk Management Division and UniCredit Group structures. The internal validation function started in mid-2018, which further emphasized the importance of independent functions in ensuring an adequate internal control system, especially in the specialized and sensitive topic such as the model and risk parameters.

Identification, measurement, control and management of the credit risk on the portfolio level is based on reporting system which provides information about the condition, quality and evolution of the loan portfolio. During 2018 there was a continuity of reporting process improvement through increased automation of calculations and report generation especially relating to monthly IFRS 9 provisioning calculation (fast closing project).

In the area of Basel standards the focus of activities was placed on the confirmation of predictive power of internally developed rating models and appropriate setting of credit risk parameters for the business segments: corporates, private individuals, entrepreneurs and small business clients. In the beginning of 2018, calibration of PD models for entrepreneurs and part of small business segment was performed, in accordance with the recommendations of internal validation.

During 2018, credit risk models have been additionally improved for the purpose of calculation of loan loss provisions according to IFRS 9 standard. Mentioned models have been improved according to methodologies of UniCredit Group and in line with validation and audit recommendations. During the year, the newly developed model parameters have been used to assess the impact of IFRS 9, and they have been amended according to the instructions and methodologies received from the Group.

As a follow-up of the implementation of IFRS 9 and Basel III standards, during 2018, Strategic Risk has continued with further improvement and continuous analysis of implemented calculations with the focus on analysis of 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. During 2018, the NPE Operational Plan has been adopted with continuous monitoring of its implementation in line with relevant GAP analysis and in relation to the relevant regulatory framework and good practice of NPE management.

During 2018 Corporate Special Credit has continued with active approach in decreasing of NPL stock, bringing NPL stock to the lowest level in the latest post financial crises period. Besides continuing with using the sale of a single receivables as a valid NPL strategy, the Bank has also continued with the implementation of the so called accounting write-offs (write-offs without debt release). Most significant sources of corporate NPL decrease were regular collections and solving the biggest single NPL ticket, through sale of receivables. The Bank also continued with implementation and promotion of INSOL principles for management of non-performing loans and clients in multi-creditor situations.

In the Retail segment, for private individuals and small business clients and entrepreneurs, the focus in 2018 was on increasing the efficiency of all processes, improvement of the process of monitoring and collection. Credit process in small business segment is enhanced while NPL stock was decreased in Retail segment through better collection and implementation of Decision of NBS of accounting write-off.

During 2018 Collateral Statistical Monitoring was successfully completed as well as further improvement of cooperation with external valuation companies, licensed appraisers, insurance companies and lender supervisors. Aside from that, general improvements of collateral management processes and practice were also implemented through more agile acquisition of valuations, insurance policies, more detailed tracking of mortgage inscriptions, etc. The Bank was successfully delivering to NBS regular monthly reports regarding real estate valuations which are used for loan securitization purposes. During 2018, the Bank was successfully completed the process of licensing internal appraisers in line with Law on real estate appraisers, which led to further enhancement of control of collaterals which are used for credit risk mitigation purposes.

Relevant market, interest rate and liquidity risk taxonomies are defined for identifying and reporting risk exposures. Accurate and reliable risk data are generated to meet normal and stress/crisis reporting accuracy requirements. Data are aggregated on a largely automated basis, to minimize the probability of errors. Liquidity early warning indicators are defined for monitoring financial markets development and assessing its impact on the bank's liquidity position. The goal is to keep overall liquidity management at an efficient level of liquidity to allow the Bank to meet its payment obligations. Further improvement relating to accuracy, integrity, completeness and adaptability of the reporting processes will continue during next year.

Governance structure of the control system of operational risk management involves all relevant organizational levels and thus contributes to raising awareness about the importance of operational risk. Quantitative elements of operational risk measurement system (internal loss data, risk indicators and scenario analysis) are classified and collected by guaranteeing the data completeness, reliability and timely updates. Permanent working group continue its activities with the aim of identifying potential risk and defining measure for mitigating the risk. The system of identification, assessment and control of operational risk adequately reflects the risk profile and allows timely communication with management in order to mitigate the identified risk.

Based on the foregoing, it can be concluded that during 2018 the Bank further enhanced risk management system, which, along with its capital adequacy and profitability levels, guarantying an adequate management and coverage of the risks to which the Bank is exposed. In previous years integration of risk management functions has been successfully implemented within which, in accordance with the Law on financial leasing, UniCredit Leasing entrusted the tasks of identifying, measuring, assessing and managing risks to the risk management function of the Bank. In 2018 risk management function for Leasing was dedicated to improvement of economies of scale in credit business, support in commercial actions and credit process optimization.

Risk Management Division will continue with the efforts and actions aimed at improving the system of management of all risks to which the Bank is exposed in its operations. Special focus is planned towards further enhancement of the credit process in order to improve efficiency, as well as on creating a comparative advantage in the market through process optimization on one hand, and through improvement of the tools for identifying and mitigation of credit risk, on the other hand. In that way adequate support to all organizational parts will be secured. In 2019 one of the main goals is to maintain and improve portfolio quality and enable base for sustainable growth with focus on further portfolio diversification, but always using proactive approach toward risk management enabling new client acquisition.

GLOBAL BANKING SERVICES

During 2018, beside continued optimization and automation of the banking operation processes and further development of electronic channels and support towards business in further digitalization, main focus of Global Banking Services was on compliance with new regulation, further security improvement - electronic and physical, and continuous improvement of project portfolio process management.

Informational Technologies Department, in cooperation with Security Unit, have continued to improve security infrastructure of the Bank. New group project ICOP has been finalized with the aim of ICT infrastructure improvement through implementation of advanced technologies – firewalls, proxies, email gateways and Anti APT tool (anti advanced persistent treat tool - Fire eye). Identity Access Management tool implementation has been also successfully done whereas access rights management towards bank's systems has been set in safe and controlled environment. In addition, Data Loss Prevention tool has been implemented with the expected full go-live in the first quarter of 2019 along with SIEM tool implementation which extended technical possibilities and enabled better ICT security events monitoring. Furthermore, interlocking cabins have been implemented in bank's branches along with full replacement of systems for technical protection (video surveillance and alarm systems), which additionally improved security level in the branches. The project has been also accompanied with installation of optical links between bank headquarters (data centers) and branches which will enable sustainable functioning of the Control Center (SOC) and backup communication line between branches and both data centers. Migration of secondary data center has been finalized in location "Rajiceva". One of the largest projects in the Bank during the last year, which also affected ICT infrastructure, was Instant Payments implementation.

Agile methodologies have been continually used on projects with further trainings organized throughout the Bank for the work in mentioned methodologies.

Bank continued to improve internal control system by constant process monitoring and setting-up of the new methodology. Banking Operations Department has continued with the further process optimization and automation through checks processing centralization from branches, assessment of the possibility of implementing robotics in banking processes in order to reduce operational risk and increase efficiency. In line with that, improvement of the process of booking client salaries in order to provide full support to business needs has been implemented. Thanks to the efficiency, flexibility and expertize, Banking operations Department has contributed significantly to the business success of the Bank in 2018.

In line with initiative started during 2017 which refers to project initiation improvements, project realization and status tracking, appropriate forums have been formed with top management members with the aim of formalizing project initiation, realization and main KPIs tracking. Forums have been held on regular, monthly basis, with 13 approved and 19 closed projects throughout 2018. All taken actions have additionally contributed to the better project realization – both group and local.

UniCredit Bank Serbia is still having remarkable cost-income ratio keeping one of leading positions on local market in comparison with peer banks. In line with that, it can be certainly said that in 2018 UniCredit Bank was one of the most efficient banks on the market. During 2018, the initiative for raising customer experience to a higher level has been started which resulted with initiation of several process improvement in areas of international payments, booking salaries, cash management in ATMs and current account opening for small business clients.

The targets of Global Banking Support in 2019 will be directed towards successful realization of bank's strategic projects which refer to further digitalization and automatization and process optimization, leading to better business efficiencies as well as further improvements of cost control.

HUMAN RESOURCES HR

By continuing to provide strategic support to the realization of the planned business activities, in 2018 HR Department was focused on:

- empowering the bank towards innovation, agility and focus on the clients;
- development of employees and improving their technical and social skills;
- greater affiliation of employees and positioning of the Bank as the most preferred employer in the market.

In line with the direction in which the bank is developing, as well as the trends and market demands, in 2018 Human resources Department continued to support business in achieving their goals through the improvement of the organisational culture in the field of innovation and agility, as well as developing leadership skills of leaders and talents and motivating and retaining employees with good achievements and high potential.

In cooperation with external consulting companies and expert teams from UniCredit Group, a numerous workshops and trainings for the Management team of the Bank, as well as for other organizational units were organized, with focus on innovations, improvement of mutual cooperation, acquaintance with agile methodologies, all with the aim to provide the best service to the end-user, client of the Bank.

During 2018, the Customer Experience Excellence Initiative (CXE) has started, based on a continuous assessment of our processes and improvement of services, with aim to improve customer experience and add value for our clients as well as for our Bank. Within the mentioned initiative, Human resources Department participated in organization and co-ordinated trainings on international payment transactions for UniCredit' sales network in order to improve our employees' knowledge on this topic.

The Human resources Department supported employees by providing new career opportunities and promotions, as well as by offering cross-divisional changes. Additionally, beside significant number of cross-divisional movements within UniCredit Bank Serbia in the previous year, large number of development opportunities for our employees was offered within the UniCredit Group.

In order to strengthen and support our employees in the achieving their business goals and improving their performance, continuous trainings for upgrading their expert and social skills have been organized. Human resources Department has supported the development of employees through a numerous local and international seminars, conferences and certifications that colleagues attended during 2018. Also, support was given to development of critical positions and to improvement of the program that provides support to the new employees in the business network (Retail On-boarding Program, CIB On-boarding program). Promotion of the learning culture was also in focus by the "Call for Fun. For Learning. For everyone", which deals with the various topics useful both, in business and private life.

In order to develop a stronger feeling of belonging of employees and positioning the Bank on the market, this year, as well as in the previous one, the employees were involved in creation of the Action plans that were emerged through the People Survey. As the result of the implementation of the Action plans the additional benefit – Day-off for parents whose children are starting the school (first day of the school for first graders in elementary school) was provided. Also, work from home pilot program was created. As well as in the previous year, in 2018 the UniCredit Bank provided private health care insurance for all employees and continued to apply the previously adopted benefits and initiatives ("Birtholiday", "Family Day", "Healthy Wednesday", and "Thanksgiving Cards"). Human resources Department has been trying to encourage employees to take better care of health and good living habits by organizing lectures on the topic "Prevention of heart disease and suitable sitting at work", as well as through support in organization of the event "Sport Day". Cooperation with universities was continued through internship programs, study visits and scholarships for the best students.

Wishing to assist mothers returning from maternity leave in easier adaptation to a new situation, UniCredit Bank has provided possibility for working 4 hours during the first month upon return.

In 2019, the Human Resources Department will work on strengthening of the Bank and employees in the direction of digital transformation, empowerment of talents and improvement of employees' career opportunities, as well as career advancement, with a special focus on expanding the culture of digital learning and empowering women leaders in the organization.

IDENTITY AND COMMUNICATION

In 2018 Identity and Communication Unit continuously worked on additional promotion of the brand while providing support to business in creating innovative products and services which enabled bank to maintain the competitiveness and one of the leading positions on the market.

At the end of 2017, UniCredit Group has launched a new tagline „Banking that matters“. It is used in all communication activates of the Group such as advertising and commercial campaigns, branding and marketing materials in all countries where Group operates in line with its „One Bank, one UniCredit“ approach. New tagline provide in just three words a summary of UniCredit's corporate identity – offering products, services and advice that makes a difference to people in their everyday lives, whether an individual, a family, a small company or a large corporation.

During 2018 several successful campaigns have been conducted, but the most important is that for the first time we had image campaign at the Serbian market since UniCredit Bank started its operations. Leveraging on "Banking that matters" we continued to build our image of strong partner ensuring security to our clients by providing support in what matters to them. Creative visuals and messages of the campaign presented the key enablers in order for our business to be sustainable: customer experience in order to create long time relationship with our clients, support for retail and SME clients, as well as digitalization, from clients' perspective, the time-saver for the things that matter.

Moreover, we presented a campaign for Dinar Cash Loan. Not only that this campaign attracted the attention with its originality, but also significantly contributed to the fact that the Bank further increased market share when this product is concerned. In 2018 we have received for the second time in a raw international Effie award for our campaign for Preapproval of the mortgage loan.

Taking into consideration the increasing importance of social media, in 2018 Bank presented new topics and formats within Facebook and Instagram. These changes enabled it not only to increase the number of followers, but also built a better interaction with the clients. After being the first bank on the Serbian market to introduce Viber stickers in 2017, this year we presented new stickers in line with new tag line "Banking that matters".

Through numerous national and local initiatives in 2018 UniCredit Bank managed to increase the presence in media and thus further contribute to the recognition of the bank as an expert and position ourselves as contact point for different experts' topics. The Bank managed to increase the number of media reports in comparison with previous year and keep the leading position when media coverage on CSR topic is concerned. One of the reasons is the fact that Bank continuously improve the existing relations with the media, but also creating new ones.

Internal communication had an important role in 2018 since it significantly contributed to building better interpersonal relations and feeling of belonging to the bank and the Group. Various activities have been conducted in cooperation with HR Department with aim to create the best place to work and to create constant dialogue with Management Board. Listening Road Show was conducted in the second quarter with the aim to hear directly from employees what bank can improve in order to make job of colleagues who work in the network easier with the aim to further strengthen the relationship with the clients in order to additionally increase their satisfaction. Internal communication was also essential for promotion of volunteerism within the bank. The fact that over 60% of our employees participated in the numerous initiatives confirms that the way of communication is crucial for people engagement.

In 2019 Identity and Communication Unit will further focus on business improvement and increase of client base thanks to carefully designed integrated campaigns. Bank will continue to improve the image of competent interlocutor in media which we previously built, while taking care of the reputation.

CORPORATE SOCIAL RESPONSIBILITY

With aim to contribute to economic and social development of local communities in which it operates and to support young people, vulnerable categories of people and culture, UniCredit Bank supported numerous CSR activities and implemented large number of initiatives in which involved over 60% of its employees.

With the aim to provide society with an added value that can be used in the long run – knowledge and expertise of its employees, UniCredit Bank continued to implement its CSR which implies broader involvement of employees in all activities.

Bank continued to support the activities implemented by the organization called Junior Achievements in Serbia. Namely, within competition "Business Challenge" forty colleagues played a role of mentors and helped over 150 high school students to develop their business ideas through creation of business plans, while some employees were members of Grand Jury.

More than 230 employees and members of their families joined the humanitarian Run of Joy organised by BelHospice during Belgrade Marathon.

Besides that 400 employees participated in volunteering activities of arranging the courtyard of public areas, such as school yards, health centre and parks in four regions in which the bank operates. With these initiatives we have shown not only our commitment to local communities, but we have also strengthened the team spirit, which has certainly improved our mutual relations and positively influenced the better performance at work.

Within the "Old doll for a new smile" initiative, employees collected 150 kilograms of clothes, shoes, toys and books for children of Shelter in Belgrade and Children development center of Parents Association of Kraljevo.

In 2018, the Bank specially focused on gender balance and thanks to the various initiatives that bank conducted with aim to raise awareness of the importance of this topic, the Association of Business Women recognized the bank as one of the leading companies on the domestic market that promotes gender balance, both internally and externally and therefore rewarded with the recognition of the "Flower of Success" for the most gender-sensitive company.

As in previous years, the Bank continued to support traditional manifestation with cultural character and significant importance for local communities, such as Days of Bora Stankovic, Days of Zoran Radmilovic and Days of Mokranjac.

Bank is very proud of the fact that in 2018 the record of employees' participation in numerous initiatives was broken. In 2019 the Bank will continue to implement different activities in order to contribute the improvement of living conditions in the local communities, while at the same time it will work on the additional engagement of the employees in the projects of broader social significance.

CONSOLIDATED 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	21.019.696	11.885.064
Loans and receivables from clients	3.k, 3.o, 26	266.406.450	240.608.342
Change in fair value of hedged items	3.n, 27	222.773	192.251
Receivables under hedging derivatives	3.n, 28	2	9.195
Intangible assets	3.r, 3.t, 29	1.627.558	1.165.916
Property, plant and equipment	3.q, 3.t, 30	1.599.656	1.554.223
Investment property	31	1.331	1.364
Deferred tax assets	3.j, 32	240.617	172.085
Other assets	33	1.145.893	1.000.303
Total assets		**448.279.401**	**370.780.331**
Liabilities under derivatives	3.m, 34	723.632	207.003
Deposits and other liabilities to banks, other financial organisations and central bank	3.k, 3.u, 35	142.879.336	106.676.158
Deposits and other financial liabilities to clients	3.k, 3.u, 36	220.931.036	186.658.833
Liabilities under hedging derivatives	3.n, 37	488.580	448.794
Subordinated liabilities	3.u, 38	-	2.718.490
Provisions	3.v, 3y, 39	1.136.326	1.076.838
Current tax liabilities	3.j, 21.4	451.881	205.253
Deferred tax liabilities	3.j, 32	412	-
Other liabilities	40	2.862.308	2.644.579
Total liabilities		**369.473.511**	**300.635.948**
Share capital	42.1	24.169.776	24.169.776
Profit	42.1	10.198.862	7.437.207
Reserves	42.1	44.437.252	38.537.400
Total equity		**78.805.890**	**70.144.383**
Total liabilities and equity		**448.279.401**	**370.780.331**

CONSOLIDATED INCOME STATEMENT
As of December 31, 2018

(Thousands of RSD)

	Note	2018.	2017.
Interest income	3.d, 7	16.504.300	15.145.641
Interest expenses	3.d, 7	(2.564.603)	(2.782.070)
Net interest income		**13.939.697**	**12.363.571**
Fee and commission income	3.e, 8	4.863.881	4.362.623
Fee and commission expenses	3.e, 8	(1.300.571)	(1.355.835)
Net fee and commission income		**3.563.310**	**3.006.788**
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	1.406.429	1.357.787
Net expenses on impairment of financial assets not measured at fair value through income statement	3.k, 13	(2.879.851)	(2.626.765)
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	10.773	12.639
Total net operating income		**18.446.754**	**14.722.933**
Staff costs	17	(3.094.585)	(2.894.755)
Depreciation expenses	3.q, 3.r, 18	(583.909)	(538.903)
Other income	19	95.891	109.662
Other expenses	20	(4.633.649)	(4.104.322)
Profit before taxes		**10.230.502**	**7.294.615**
Income tax	3.j, 21	(855.847)	(513.098)
Profit after taxes		**9.374.655**	**6.781.517**

CONSOLIDATED STATEMENT OF OTHER COMPREHENSIVE INCOME As of December 31, 2018

(Thousands of RSD)

	Note	2018.	2017.
PROFIT FOR THE YEAR		**9.374.655**	**6.781.517**
Components of other comprehensive income that cannot be reclassified to profit or loss			
- Actuarial gains		6.800	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	32.2	(1.020)	(1.478)
Total positive/(negative) other comprehensive income for the year	42.2	657.756	(247.039)
TOTAL POSITIVE COMPREHENSIVE INCOME FOR THE YEAR		**10.032.411**	**6.534.478**

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY As of December 31, 2018

(Thousands of RSD)

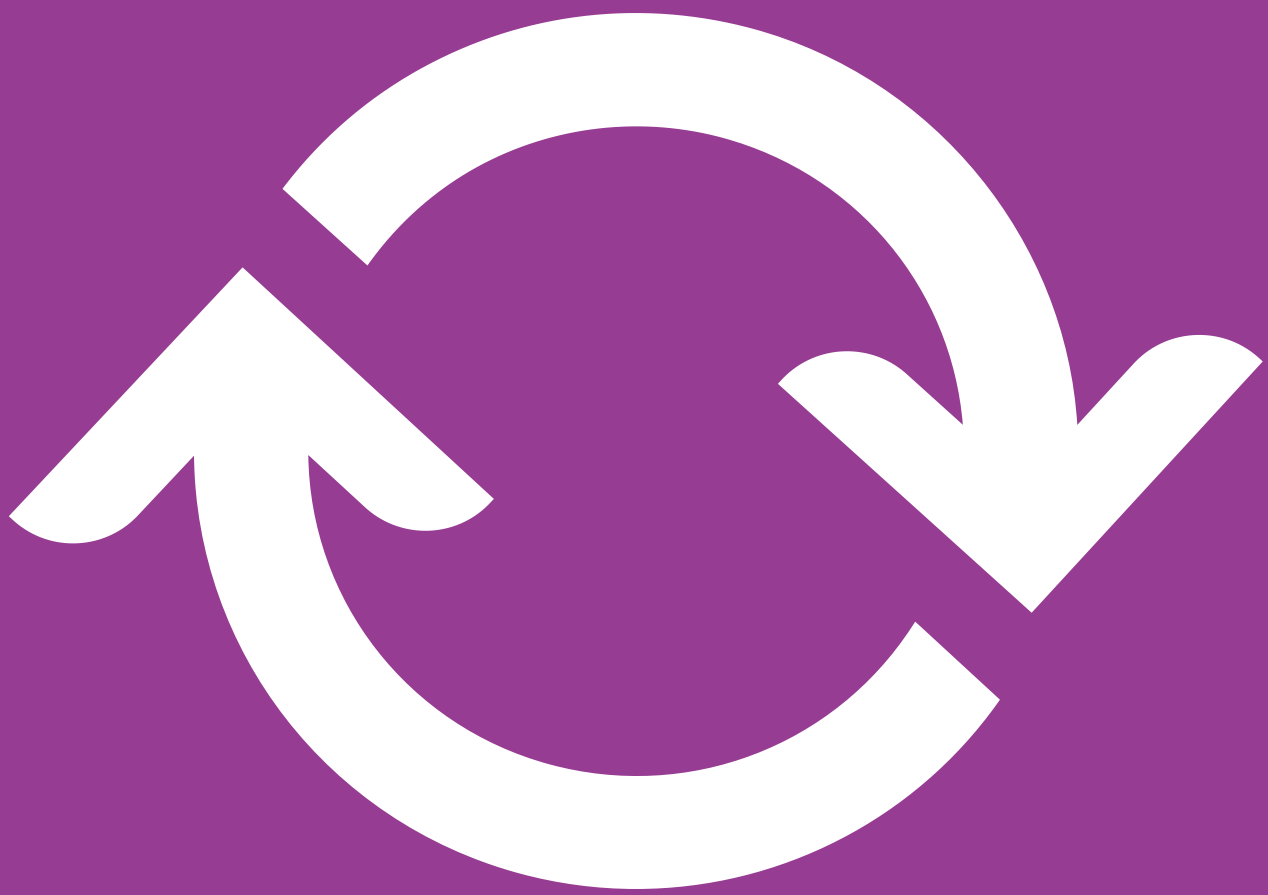
	Note	2018.	2017.
ISSUED CAPITAL			
Balance, beginning of year		23.607.620	23.607.620
Balance, end of year	42.1	23.607.620	23.607.620
SHARE PREMIUM			
Balance, beginning of year		562.156	562.156
Balance, end of year	42.1	562.156	562.156
OTHER RESERVES FROM PROFIT			
Balance, beginning of year		36.997.080	32.020.480
Prior year's retained earnings distribution		4.922.914	4.976.600
Balance, end of year	42.1	41.919.994	36.997.080
PROFIT / (LOSSES) BASED ON CHANGES IN VALUE OF DEBT INSTRUMENTS			
Balance at the beginning of the year		1.543.765	1.799.182
Effects of the first application of IFRS 9	2 (g)	319.182	-
Initial balance after first application of IFRS 9		1.862.947	1.799.182
The effect of the market value adjustment of debt instruments		393.856	(255.417)
The effect of the change in impairment of debt instruments		258.120	-
Balance at the end of the year	42.1	2.514.923	1.543.765
ACTUARIAL LOSSES PER DEFINED BENEFIT PLANS			
Balance at the beginning of the year		(3.445)	(11.823)
Movements during the year		5.780	8.378
Balance at the end of the year	42.1	2.335	(3.445)
RETAINED EARNINGS			
Balance, beginning of year		7.437.207	6.882.290
Effects of the first application of IFRS 9	2 (g)	(435.086)	-
Initial balance after first application of IFRS 9		7.002.121	6.882.290
Prior year's profit distribution – allocation to dividend		(1.255.000)	(1.250.000)
Prior year's profit distribution – allocation to reserves		(4.922.914)	(4.976.600)
Profit for the year		9.374.655	6.781.517
Balance, end of year	42.1	10.198.862	7.437.207
TOTAL EQUITY		**78.805.890**	**70.144.383**

CONSOLIDATED STATEMENT OF CASH FLOWS
As of December 31, 2018

(Thousands of RSD)

	Note	2018.	2017.
Cash inflows from operating activities		**27.039.288**	**25.607.166**
Interest receipts		12.244.358	12.230.574
Fee and commission receipts		4.839.637	4.512.673
Receipts of other operating income		9.955.293	8.863.799
Dividend receipts and profit sharing		-	120
Cash outflows from operating activities		**(17.112.947)**	**(19.191.780)**
Interest payments		(2.438.762)	(2.631.134)
Fee and commission payments		(1.297.274)	(1.356.084)
Payments to, and on behalf of employees		(2.971.452)	(3.052.140)
Taxes, contributions and other duties paid		(544.849)	(588.413)
Payments for other operating expenses		(9.860.610)	(11.564.009)
Net cash inflows from operating activities before an increase or decrease in financial assets and financial liabilities		**9.926.341**	**6.415.386**
Decrease in financial assets and increase in financial liabilities		**73.594.825**	**42.353.214**
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		72.706.733	42.353.214
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		**32.053.646**	**18.042.367**
Income taxes paid		(651.071)	(342.432)
Dividends paid		(1.255.000)	(1.250.000)
Net cash inflow from operating activities		**30.147.575**	**16.449.935**
Cash inflows from investing activities		**17.865**	**120.379**
Other inflows from investing activities		17.865	120.379
Cash outflows from investing activities		**(14.529.742)**	**(3.836.879)**
Outflows per investments in investment securities		(13.397.250)	(3.066.018)
Purchases of intangible assets, property, plant and equipment		(1.132.492)	(770.861)
Net cash outflow from investing activities		**(14.511.877)**	**(3.716.500)**
Outflows of cash from financing activities		**(7.815.474)**	**(6.666.518)**
Outflows for repayment of subordinated liabilities		(2.811.628)	-
Outflows for repayment of borrowings		(5.003.846)	(6.666.518)
Net cash outflow from financing activities		**(7.815.474)**	**(6.666.518)**
Total cash inflows		**100.651.978**	**68.080.759**
Total cash outflows		**(92.831.754)**	**(62.013.842)**
Net cash increase		7.820.224	6.066.917
Cash and cash equivalents, beginning of year	3.I, 43	**22.805.898**	**16.817.106**
Foreign exchange losses		(853)	(78.125)
Cash and cash equivalents, end of year	3.I, 43	**30.625.269**	**22.805.898**

Transform operating model.



We are leveraging on digitalisation to transform our operating model. We are ahead of schedule, with an improved cost reduction. The optimisation of the cost base will remain important to ensure our Group's efficiency and effectiveness.

1) ESTABILISHMENT AND ACTIVITY OF THE BANKING GROUP

Banking Group (hereinafter: the "Group") is comprised of the parent entity UniCredit Bank Srbija a.d. Beograd (hereinafter: the "Parent Entity" or the "Bank") and its subsidiaries UniCredit Leasing Srbija d.o.o. Beograd and UniCredit Partner d.o.o. Beograd. In January 2016 the Bank became the sole (100%) owner of each of the aforesaid subsidiaries.

(a) Estabilishment and Activity of the Bank

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 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.

The Bank is registered in the Republic of Serbia for performing credit and deposit operations in the country and abroad, payment services 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.

On December 31, 2018, the Bank consisted of a Head Office in Belgrade and 72 branch offices in different cities throughout the Republic of Serbia (December 31, 2017: 71 branch offices).

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

(b) Establishment and Activity of the Subsidiary UniCredit Leasing Srbija d.o.o. Beograd

The Subsidiary UniCredit Leasing Srbija d.o.o. Beograd (hereinafter: "Leasing") was established under Decision of the Commercial Court in Belgrade registry card no. 1-92733-00 dated May 18, 2004 under the name of HVB Leasing d.o.o. Beograd. The founder of Leasing was Bank Austria Creditanstalt Leasing GmbH, Vienna. On April 11, 2007, Leasing changed its name into UniCredit Leasing d.o.o. Beograd. Change of founder was registered with of the Serbian Business Registers Agency under no. 4109/2009 dated February 10, 2009 with UniCredit Global Leasing S.p.A, Milan as the new founder. In January 2016, in accordance with the Agreement on Sale and Purchase of Equity Interest and upon obtaining the National Bank of Serbia's approval, the Bank became the sole (100%) owner of Leasing. Change in ownership was registered with the Serbian Business Registers Agency on January 26, 2016.

The Leasing Company is principally involved in finance lease activities.

As of December 31, 2018 Leasing had 29 employees (December 31, 2017: 30 employees).

(c) Establishment and Activity of the Subsidiary UniCredit Partner d.o.o. Beograd (Continued)

The Subsidiary UniCredit Partner d.o.o. Beograd (hereinafter: "Partner") was founded on May 3, 2006 under the name of HVB Partner d.o.o. za zastupanje u osiguranju Beograd. Partner's founder was BA-CA Leasing Versicherungs Service GmbH, Vienna, Austria. Change of the founder to a new founder Allegro Leasing Gesellschaft m.b.H. was registered under Decision of the Serbian Business Registers Agency no. BDŽU 30358/2013/01-01 dated April 9, 2013. The Company's foundation was registered with the Serbian Business Registers Agency under Decision no. BD 3370/2007 on March 13, 2007. On June 2008, Partner changed its name to UniCredit Partner d.o.o. za zastupanje u osiguranju.In January 2016, in accordance with the Agreement on Sale and Purchase of Equity Interest and upon obtaining the National Bank of Serbia's approval, the Bank became the sole (100%) owner of Partner. Change in ownership was registered with the Serbian Business Registers Agency on January 12, 2016.

Partner is registered to perform the activities of an agent and intermediary in insurance. On April 16, 2007 Partner executed the Agency Agreement with the Wiener Staedtische osiguranje a.d. Beograd, (headquartered at no. 1, Trešnjinog Cveta St., Belgrade) as the main insurer. Based on the written approval obtained from the main insurer and other insurance companies, Partner acts as an agent of the following insurers: Generali oisguranje a.d. Beograd, DDOR Novi Sad a.d., Novi Sad, Dunav osiguranje a.d., Beograd, AS osiguranje a.d., Beograd, AMS osiguranje a.d., Beograd, Triglav osiguranje a.d., Beograd, UNIQA osiguranje a.d., Beograd and Insuarance company taken over by UNIQA osiguranje "Basler osiguranje" a.d., Beograd

As of December 31, 2018 Partner had 2 employees (December 31, 2017: 2 employees).

2) BASIS OF PREPARATION AND PRESENTATION OF THE CONSOLIDATED FINANCIAL STATEMENTS AND ACCOUNTING CONVENTION

(a) Basis of Preparation and Presentation of the Consolidated 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). The Group 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 consolidated 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).

Consolidated financial statements have been prepared on the basis of the principle of historical (historical) value, 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 the 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 consolidated financial statements, the Group adhered to the accounting policies described in Note 3.

The Group's consolidated 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 entered into force 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 Group 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 Real Estate" - Transfer of Investment Property,

- Amendments to IFRS 2 "Share Payments" - Classification and Measurement of Share-based Payment Transactions,
- Amendments to IFRS 1 and IAS 28 due to "Improvements to IFRSs (cycle 2014-2016)"

Below are detailed explanations of the effect of the application of IFRS 9 and IFRS 15 to the consolidated financial statements of the Group.

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 Group 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:

- *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 Group 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 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.

- *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 Group 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 in relation to IAS 39, since it is no longer necessary for a credit event to occur before recognition of credit losses.

- *Hedge Accounting*
  IFRS 9 introduced new rules for hedge accounting in relation to hedge relationship and testing its effectiveness. As permitted by the IFRS 9, the Group 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).

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 Group 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 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 CONSOLIDATED FINANCIAL STATEMENTS December 31, 2018

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

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 the existing standards that have been issued but are not yet effective

On the date of the approval of these consolidated financial statements, the following new standards, amendments to the 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 Group'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 new standards, the amendment of existing standards and new interpretations will have no material impact on the financial statements of the Group in the period of initial application, except for IFRS 16. The expected effects of the first application of IFRS 16 to the Group's financial statements are set out below in more detail.

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 Group 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 Group 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 Group 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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS December 31, 2018

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

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 Group decided not to change the comparative data, and in the 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 -0.28%.

(d) Comparative Information

Comparative data in these consolidated financial statements are those from the Group's consolidated financial statements for the year 2017 compiled in accordance with IAS 39 (while the consolidated financial statements for 2018 were prepared in accordance with IFRS 9).

(e) Use of Estimates

Preparation of the consolidated financial statements in accordance with IFRS requires the 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 Group's consolidated financial statements have been prepared in accordance with the International Financial Reporting Standards ("IFRS") issued by the International Accounting Standards Board.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS December 31, 2018

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

(g) Transitional disclosure

Below are the effects of application of IFRS 9 to the Group's consolidated 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:

(Thousands of RSD)

		New classification and measurement of financial instruments			Effect		
	December 31 2017	At fair value through profit&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	11.885.064	-	-	11.885.064	(2.040)	-	11.883.024
Loans and receivables from clients	240.608.342	-	-	240.608.342	(115.645)	-	240.492.697
Change in fair value of hedged items	192.251	192.251	-	-	-	-	192.251
Receivables under hedging derivatives	9.195	9.195	-	-	-	-	9.195
Intangible assets*	1.165.916	-	-	-	-	-	1.165.916
Property, plant and equipment*	1.554.223	-	-	-	-	-	1.554.223
Investment property*	1.364	-	-	-	-	-	1.364
Deferred tax assets*	172.085	-	-	-	-	-	172.085
Other assets	1.000.303	-	-	1.000.303	(1.220)	(4.992)	994.091
Total assets	**370.780.331**	**2.482.495**	**82.171.636**	**283.232.612**	**(117.340)**	**(4.992)**	**370.657.999**
Liabilities under derivatives	207.003	207.003	-	-	-	-	207.003
Deposits and other liabilities to banks, other financial organisations and central bank	106.676.158	-	-	106.676.158	-	-	106.676.158
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	1.076.838	-	-	1.076.838	(6.428)	-	1.070.410
Current tax liabilities*	205.253	-	-	-	-	-	205.253
Other obligations	2.644.579	-	-	2.644.579	-	-	2.644.579
Capital							
Share capital*	24.169.776	-	-	-	-	-	24.169.776
Profit*	7.437.207	-	-	-	(430.094)[1)]	(4.992)[2)]	7.002.121
Reserve*	38.537.400	-	-	-	319.182	-	38.856.582
Total liabilities	**370.780.331**	**655.797**	**-**	**299.774.898**	**(117.340)**	**(4.992)**	**370.657.999**

* 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 435,086 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 430,094 thousand;
2. The effect on the reclassification and measurement of other equity investments amounts to RSD 4,992 thousand. Namely, the Group has no change in the method of classification and measurement of financial instruments except other equity investments that the Group measures at fair value through other comprehensive income. However, as the Group 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 retined earnings, so, cumulatively, there is no effect.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS December 31, 2018

2) BASIS OF PREPARATION AND PRESENTATION OF THE CONSOLIDATED FINANCIAL STATEMENTS AND ACCOUNTING CONVENTION (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:

(Thousands of RSD)

		New classification and measurement of financial instruments			Effect		
	December 31 2017	At fair value through profit&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	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
Loan and receivables from banks and oher financial organizations	8.701	-	-	8.701	2.040	-	10.741
Loans and receivables from clients	9.576.411	-	-	9.576.411	115.645	-	9.692.056
Other assets	32.412	-	-	32.412	1.220	-	33.632
Total assets	**9.619.368**	**-**	**-**	**9.619.368**	**436.522**	**-**	**10.055.890**
Provisions for losses on off-balance sheet items	324.841	-	-	-	(6.428)[2)]	-	318.413
Total effect of the first application of IFRS 9	**-**	**-**	**-**	**-**	**430.094**	**-**	**-**

The Group recognized the effects of credit loss measurement in accordance with IFRS 9 in the total amount of RSD 430,094 thousand, which were recorded:

1. against the retained earnings amount of RSD 117,340 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 CONSOLIDATED FINANCIAL STATEMENTS December 31, 2018

3) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting policies of Group 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 Group's consolidated financial statements include the consolidated statement of financial position as at December 31, 2018 and the related consolidated income statement, statement of other comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes. The Group's consolidated financial statements as of and for the year ended December 31, 2018 include the financial statements of the Parent Entity (the Bank) and the financial statements of the following entities:

	% Equity Interest	
Subsidiary:	2018.	2017.
UniCredit Leasing d.o.o, Beograd	100%	100%
UniCredit Partner d.o.o, Beograd	100%	100%

The Bank is the sole owner of the above listed subsidiaries. All the material transaction amounts and balances arising from the intragroup business relations were eliminated upon consolidation.

(b) Going concern principle

Consolidated financial statements have been prepared in accordance with the "going concern" principle of continuity of business, which implies that the Group will continue to operate 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 Group'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 consolidated 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 Expenses

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 classified as available-for-sale or held to maturity under IAS 39, are also recorded 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 Group 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 Group receives a fee from a client that offsets similar charges paid by the Group, only the net amount is included in the amortized cost of the asset. If transaction costs are not material in relation to the fair value of a particular financial asset at initial recognition, they can be recorded as cost/income of a period.

Fees that are integral part of the effective interest rate of a financial instrument include:

a) "origination fee" – fees charged by the Group 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 of guarantees, collateral and other security arrangements, negotiating instrument conditions, preparing and processing documents, and closing the transaction,

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS December 31, 2018

3) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

b) "commitment fee" – fee received for issuing 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 valued at amortized cost.

The Group 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 Group 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 Group 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 Group 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 expense included in the profit and loss account include:

- Interest on financial assets and financial liabilities that are measured at amortized cost calculated using the effective interest rate;
- 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; and
- Coupon interest on Coupon Securities for trading purposes.

Interest income and expense for all trading assets and liabilities (other than interest on coupon securities) are deemed secondary to the trading activities of the Group 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 Expense

Fee and commission income and expense, which are an integral part of the effective interest rate of a financial asset or liability, are included in the calculation of the effective interest rate and are therefore reported within interest income and expenses.

Fees that are not ntegral part of the effective interest rate of a financial instrument and are accounted for in accordance with IFRS 15 include:

a) fees charged for loan servicing ("monitoring" ili "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 expense generally relates to fees based on transactions and services performed and is recorded at the moment of receiving the service.

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

Net gains/losses on the 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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS December 31, 2018

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS December 31, 2018

3) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(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 Group 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 tax

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 reimbursed or the liability settled in accordance with the appropriate tax regime.

iii. Other taxes and contributions

In accordance with the current regulations in the Republic of Serbia, the Group pays for various taxes, contributions and public fees such as: property tax, contributions to the earnings borne by the employer and other public duties. These expenditures are included in the "Other Expenses" position in the Income Statement.

(k) Financial assets and liabilities

i. Recognition and initial evaluation

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

A financial asset or liability is measured at fair value plus transaction costs that are directly attributable to their 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 Group classified 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 Group 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 fulfill 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).

Business model

The business model reflects the way in which the Group manages its financial assets in order to generate cash flows. This implies an assessment of whether the Group'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 Group does not expect frequent changes in business models.

SPPI criteria

If a business model is to hold asset to collect cash flows or to both collect cash flows and sell financial assets, the Group 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 asset 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 asset 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 Group, upon initial recognition, designates at fair value through profit or loss, independently of

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS December 31, 2018

3) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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.

Equity instruments

Equity instruments are instruments that fulfill 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 Group'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 that can be directly attributed to their acquisition, unless the Group assesses in certain 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 the 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 "Other operating income" position in the income statement when the Group'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 gain 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 Group 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 for 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 amount of the change in the fair value of a financial liability that relate to changes in the Group'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 Group derecognize a financial asset when it is:
- the contractual rights to the cash flows from the given financial asset expire;
- when the Group transfers the financial asset to a transaction in which the principal is transferred substantially all risks and uses of ownership of the asset or in which it neither transfers nor retains the risks and benefits arising from the ownership but does not retain control over the financial asset;
- significantly modified contractual terms of a financial asset (see Note 3(k)(iv)).

On derecognition of a financial asset, the difference between the carrying amount of the asset (or the carrying amount allocated to the part 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 Group 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 third parties with a concurrent total rate of return swap on transferred assets, the transaction is accounted for as an insured financial transaction similar to repurchase transactions since the Group retains all or substantially all the risks and rewards of ownership of such an asset.

In transactions in which the Group neither retains nor transfers substantially all the risk and rewards of ownership of a financial asset and it retains control over the asset, the Group continues

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS December 31, 2018

3) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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 Group derecognizes a financial liability when the 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 Group 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, the Group under significant modification of cash flows considers: contract changes due to commercial reasons that are in line with market conditions, changes in currency or debtors, 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 the purposes of ECL measurement, unless it is an asset represented by the 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 Group 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 measured using the original interest rate and the effects were recorded as expenses/income on the basis of impairment.

v. Offsetting

Financial assets and liabilities are offset and the net amount presented in the statement of financial position only when the Group 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 Group'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 Group 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 Group 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 Group, incorporates all factors that market participants would consider significant in setting a price, and is consistent with accepted economic methodologies for pricing financial instruments.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2018

3) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Inputs to valuation techniques reasonably represent market expectations and measures of the risk-return factors inherent in the financial instrument. The Group 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 Group 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 Group 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 Group 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.

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 Group 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 Group uses future information and macroeconomic factors, i.e. the Group 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.

Basic principles and rules of the Group in calculating of provisions under IFRS 9

The Group 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 Group 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.

In the impairment process, the Group 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 Group 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 Group 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 Group on terms that the Group 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 Group 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 Group 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)

ix. Write-off

The accounting policies related to the write-off of loans and receivables were 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 Group 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 Group would still be entitled even after the conducted write-off without debt acquittal, where the Group has decided to cease further calculation and recording of interest as from the moment of such write-off. In these cases, the Group 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 Group 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 Group 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 Group 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.

(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 Group designates certain derivatives held for risk management as hedging instruments in qualifying hedging relationships. On initial designation of the hedge, the Group 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 Group 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

3) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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 Group'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 Group 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 Group 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.

(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 Group 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 Group 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 Group 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 Group.

Securities at fair value through profit or loss include securities held by the Group for the purpose of trading in the near future or upon initial recognition are designated by the Group 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 Group 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.

3) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(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.

ii. Subsequent Expenditure

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

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 Group 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.

Depreciation rates applied in the current and comparative periods are as follows:

Description	Estimated useful life (in 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%

The depreciation method, useful life and residual value are estimated at the end of each reporting period and are adjusted when necessary.

(r) Intangible assets

Intangible assets include software, licenses and other intangible assets.

Intangible assets purchased by the Group 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.

(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 Group. Leasing is classified as operating in case when the benefits and risks arising from the ownership of the lease are not transferred to the Group.

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.

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December 31, 2018

3) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

ii. Financial leasing - Group as the Lessee

Leasing in which the Group 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 - Group as the Lessor

The Group recognizes financial assets leased in its statement of financial position in the amount equal to the net investment in the lease. The Group 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 Group'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.

(u) Deposits, received loans and subordinated liabilities

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

The Group classifies equity instruments as liabilities or equity instruments in accordance with the substance of the contractual provisions of a particular instrument.

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) Provision

A provision is recognized if, as a result of a past event, the Group 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 guarantees are contracts whereby the Group is obliged to perform the indicated payment in the form of a payment to the loss holder that it has suffered because the declared debtor has not made a timely payment or performance in accordance with the terms of the debt instrument.

Liabilities arising from a financial guarantee are initially recognized at fair value and the initial fair value is amortized over the term of the financial guarantee, in accordance with the terms of the contract. The liability under the financial guarantee is subsequently recorded at amortized cost or at the present value of the best estimate of all future payments (where the payment is likely to be guaranteed), whichever is greater. Financial guarantees are shown under potential liabilities.

3) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(y) Employee benefits

In accordance with regulatory requirements of the Republic of Serbia, the Group 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 Group 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 Group 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, Group 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 Group accrued expenses for unused annual leaves (vacations).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS December 31, 2018

4) FINANCIAL RISK MANAGEMENT

(a) Introduction and overview

In its operations, the Group is particularly exposed to the following risks:

- Credid 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,
- Reputation risk,
- Interest rate risk in the banking book[4],
- Risk of the information system.

[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, the IDRC (incremental default risk charge), an additional component of the capital calculated on the positions of the trading book, arising from the risk of the default status of the issuer of the securities.
[3] Includes internal and external fraud, employee relationships, and workplace safety systems, clients, products and business processes, material damage, business interruptions and errors in the Group's systems, as well as execution of transactions and delivery and process management in the Group.
[4] Includes interest gap, option risk, base risk.

The Group has established a process for collecting data, measuring and managing the individual risks that they form and are involved in the Group's risk profile. This process is ensured by a comprehensive annual risk assessment process.
Liquidity risk is the possibility of adverse effects on the Group's financial result and capital as a result of the Group's inability to meet its obligations as a result of the withdrawal of existing sources of financing and / or the inability to provide new sources of financing or difficulties in converting assets into liquid assets due to market disturbances.
Interest rate risk is the risk of possible negative effects on the financial result and the Group's equity based on positions in the banking book due to changes in interest rates. In the context of interest rate risk management, the Group 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 Group'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 Group caused by human error, inadequate internal procedures and processes, inadequate management of the information system and other systems in the Group, as well as by unpredictable external events.

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 Group and Bank are 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 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. The ratio of the parent and dependent legal entities is strictly defined in accordance with the regulatory provisions covering the areas of transactions with related parties and taking into account the legal credit limits prescribed by the National Bank of Serbia. 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 Group 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.
It is important to note that the risk management function is integrated where UniCredit Leasing d.o.o. entrusted the tasks of identifying, measuring, assessing and managing risks to the risk management function of the Bank, in accordance with the Law on Financial Leasing. 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 equity due to non-performance of the borrower's obligations towards the Group or potential decrease in the credit quality of the client.

Credit process in the Group 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 Group 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 Group'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.

In order to define consistent guidelines for credit activity and general risk management framework, the Group 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 Group 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 Group also takes into account the analysis of the risk of money laundering and terrorist financing in deciding on the takeover of credit risk.

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 Group manages the credit risk, sets the limits and controls it in all segments of the business activity and in all relevant types of placements to legal entities and individuals. Timely identification, measurement, control and credit risk management at the portfolio level is provided by the Credit Risk Reporting System (hereinafter: RMIS). By reporting at the level of the total portfolio and at the individual client level, RMIS provides complete, accurate and timely information on the status, quality and movement of the loan portfolio.

RMIS must fulfill the following four 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. Continuous monitoring of credit risk,
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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS December 31, 2018

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS December 31, 2018

4) FINANCIAL RISK MANAGEMENT (Continued)

4) FINANCIAL RISK MANAGEMENT (Continued)

Classification and relevant internal acts of the Group.

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 Group at default (EaD);
- Probability of default (PD); and
- Loss given default (LGD).

The Group 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. PD credit risk parameters for leasing are determined on the basis of the master scale applicable to leasing companies within the UniCredit Group. The Group internally assesses other credit risk parameters, while Leasing parameters are defined by UniCredit Group.
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 Group'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 (past-due days for Leasing clients are provided from the internal database), as important client's credit risk parameters.

Limits

The Group 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	Responsible org. a part of	Periodics	Report user				
			CRO Sector	Credit Committee	Manage-ment Board	Audit Committee	Supervisory Board
CRO report / SB presentation	CFO / Strategic Risk Management Department	Quarterly (or more often)	+	-	+*	+*	+
Credit Risk Dashboard	Credit Risk Control Department	Monthly ***	+	-	-	-	-
Credit Portfolio Report	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.

The Credit Risk Dashboard Platform is updated monthly by the Strategic Risk Management Department and Control 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.

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 Group 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.

Credit risk exposure

The following table shows the Group's maximum exposure to credit risk by type of financial instruments:

(Thousands of RSD)

	Cash and assets 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 33)		Off-balance items	
	2018.	2017.	2018.	2017.	2018.	2017.	2018.	2017.	2018.	2017.	2018.	2017.
Individually impaired												
Corporate clients, rating 10	-	-	-	-	-	-	1.698.104	1.883.111	4.699	14.724	2.984	3.084
Corporate clients, rating 9	-	-	-	-	-	-	47.011	168.857	-	-	-	-
Corporate clients, restructured loans*	-	-	-	-	-	7	5.343.819	10.592.819	6.407	30.170	138.752	213.576
Retail clients, > 90 days past due	-	-	-	-	-	-	2.086.079	1.400.737	5.496	3.076	1.642	724
Gross loans	-	-	-	-	-	7	9.175.013	14.045.524	16.602	47.970	143.378	217.384
Impairment allowance	-	-	-	-		7	5.135.647	8.218.862	13.952	31.869	89.729	126.577
Carrying value	-	-	-	-	-	-	4.039.366	5.826.662	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	21.026.800	11.892.400	175.453.791	154.746.484	111.073	71.320	148.856.844	134.431.232
Corporate clients, rating 7	-	-	-	-	10.911	1.358	2.363.723	5.263.396	622	2.438	829.633	3.675.251
Corporate clients, rating 8	-	-	9.140	9.355	172	-	2.051.216	460.951	386	499	465.448	41.710
Retail clients, < 90 days past due	-	-	-	-	-	-	84.440.705	75.667.609	1.653	388	1.580.678	1.575.544
Gross loans	23.788.821	38.226	100.433.746	2.199.756	21.037.883	11.893.758	264.309.435	236.138.440	113.734	74.645	151.732.604	139.723.737
Impairment allowance	211	196	5	1.648	18.187	8.694	1.942.351	1.357.549	794	543	152.438	198.264
Carrying value	23.788.610	38.030	100.433.741	2.198.108	21.019.696	11.885.064	262.367.084	234.780.891	112.940	74.102	151.580.165	139.525.473
Carrying value of rated assets	23.788.610	38.030	100.433.741	2.198.108	21.019.696	11.885.064	266.406.450	240.607.553	115.590	90.203	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	1.030.303	910.100	-	-
Total carrying value	**53.405.309**	**29.661.017**	**101.927.293**	**84.345.367**	**21.019.696**	**11.885.064**	**266.406.450**	**240.608.342**	**1.145.893**	**1.000.303**	**151.633.815**	**139.616.280**

* The category "Legal entities - restructured placements" includes clients with an internal rating 8- whose impairment allowance was made on a group-level and not individually.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS December 31, 2018

4) FINANCIAL RISK MANAGEMENT (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 Group 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 Group 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 rules for ranking clients are established at the level of UniCredit Group and as such are unique for all members of the UniCredit Group. The Group's rating system has been developed and has been in use since 2004 at the group level for clients that belong to the business segment of the business. For clients from the segment of individuals and entrepreneurs, the rating system has been developed internally and has been in use since 2010. The Group uses the rating of the UniCredit Group for multinational companies, banks, insurance companies and exposures to countries. Master Rating Scale is used as a unique method of assigning ratings to ensure that clients with the same rating have the same credit characteristics and the same likelihood that they will not fulfill their obligations, in part or in full, for a 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 in line 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 Group 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.

Impairment Allowance and Provisioning Methodology

In accordance with the current Rule on IFRS Loan Loss Provisioning, the Group 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 Group 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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS December 31, 2018

4) FINANCIAL RISK MANAGEMENT (Continued)

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 Group specifically treats clients in a default status whose exposure is considered significant and such loans or clients are individually assessed by the Group 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 Group 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 Group 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.

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 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 Group'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 Group 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.

4) FINANCIAL RISK MANAGEMENT (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.

(Thousands of RSD)

	Securities (Note 24)		Loans and receivables from banks and other financial organizations (Note 25)		Loans and receivables from clients (Note 26)		Other assets (Note 33)		Off-balance sheet items	
	Gross	Net	Gross	Net	Gross	Net	Gross	Net	Gross	Net
December 31, 2018										
Corporate clients, rating 10	-	-	-	-	1.698.104	315.081	4.699	568	2.984	-
Corporate clients, rating 9	-	-	-	-	47.011	21.050	-	-	-	-
Corporate clients, restructured loans	-	-	-	-	5.343.819	2.539.277	6.407	1.515	138.752	52.540
Retail clients, > 90 days past due	-	-	-	-	2.086.079	1.163.958	5.496	567	1.642	1.109
Total	**-**	**-**	**-**	**-**	**9.175.013**	**4.039.366**	**16.602**	**2.650**	**143.378**	**53.649**
December 31, 2017										
Corporate clients, rating 10	-	-	-	-	1.883.111	566.793	14.724	3.262	3.084	85
Corporate clients, rating 9	-	-	-	-	168.857	89.237	-	-	-	-
Corporate clients, restructured loans	-	-	7	-	10.592.819	4.209.604	30.170	12.700	213.576	90.139
Retail clients, > 90 days past due	-	-	-	-	1.400.737	961.028	3.076	139	724	583
Total	**-**	**-**	**7**	**-**	**14.045.524**	**5.826.662**	**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:

(Thousands of RSD)

	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	12.030.587	525.540	251.400	32.616	**12.840.143**
Impairment allowance	(177.190)	(70.392)	(38.546)	(32.616)	**(318.744)**
Net carrying value	**11.853.397**	**455.148**	**212.854**	**-**	**12.521.399**

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 Group 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, as parent legal entity, 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 Group uses relevant policies and procedures for collateral management. The most significant collaterals accepted and used by the Group 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 Group's relevant internal regulations defining the process of credit risk mitigation.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2018

4) FINANCIAL RISK MANAGEMENT (Continued)

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

(Thousands of RSD)

	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**

(c) Market Risks

Market risks represent the possibility of adverse effects on the financial result and the Group'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 Group'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 Group and in accordance with the risk-taking capacities.

Some of the basic indicators for monitoring the Group'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 Group'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:

(Thousands of RSD)

	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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS December 31, 2018

4) FINANCIAL RISK MANAGEMENT (Continued)

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	(17.291)	(11.739)
EUR	5.704	2.503
USD	(287)	(200)
GBP	-	-
CHF	(458)	(441)
Other currencies	-	-
Total effect*	**23.740**	**14.883**

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

(i) Currency Risk

Foreign currency risk is the risk of potential negative effects on the Group'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 Group's capital, calculated in accordance with NBS Decision on Capital Adequacy of Banks. The Group 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 Group is exposed to the effects of exchange rate fluctuations of the most important foreign currencies on its financial position and cash flows. Group 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 Group, in the aggregate, and for the Markets and ALM departments individually.

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

The Group's foreign exchange risk management at the operational level is the responsibility of the Operations Department in the Financial Markets.

Foreign exchange risk ratio:	2018.	2017.
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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS December 31, 2018

4) FINANCIAL RISK MANAGEMENT (Continued)

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

(Thousands of RSD)

	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	15.464.049	15.669	213.736	5.004.189	21.019.696
Loans and receivables from clients	444.835	201.478.240	4.414.382	-	60.068.993	266.406.450
Change in fair value of hedged items	-	1	222.772	-	-	222.773
Receivables under hedging derivatives	-	2	-	-	-	2
Intangible assets	-	-	-	-	1.627.558	1.627.558
Property, plant and equipment	-	-	-	-	1.599.656	1.599.656
Investment property	-	-	-	-	1.331	1.331
Deferred tax assets	-	-	-	-	240.617	240.617
Other assets	1.597	44.932	105	3	1.099.256	1.145.893
Total assets	**3.027.049**	**253.100.538**	**4.826.152**	**282.136**	**187.043.526**	**448.279.401**
Liabilities under derivatives	-	651.294	-	-	72.338	723.632
Deposits and other liabilities to banks, other financial organisations and central bank	450.417	131.345.981	479.611	1.993	10.601.334	142.879.336
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	-	-	-	-	1.136.326	1.136.326
Current tax liabilities	-	-	-	-	451.881	451.881
Deferred tax liabilities	-	-	-	-	412	412
Other liabilities	108.529	1.118.774	911	9.658	1.624.436	2.862.308
Equity	-	-	-	-	78.805.890	78.805.890
Total liabilities and equity	**16.117.067**	**234.414.128**	**2.578.706**	**1.736.781**	**193.432.719**	**448.279.401**
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**	**1.111.587**	**919**	**65.664**	**(1.264.908)**	**(80.692)**

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

4) FINANCIAL RISK MANAGEMENT (Continued)

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

(Thousands of RSD)

	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	9.864.028	20.209	233.452	2.841	11.885.064
Loans and receivables from clients	4.303.490	169.617.420	4.855.601	-	61.831.831	240.608.342
Change in fair value of hedged items	-	141	192.110	-	-	192.251
Receivables under hedging derivatives	-	9.195	-	-	-	9.195
Intangible assets	-	-	-	-	1.165.916	1.165.916
Property, plant and equipment	-	-	-	-	1.554.223	1.554.223
Investment property	-	-	-	-	1.364	1.364
Deferred tax assets	-	-	-	-	172.085	172.085
Other assets	601	46.494	4	330	952.874	1.000.303
Total assets	**8.206.055**	**210.359.335**	**5.165.855**	**360.027**	**146.689.059**	**370.780.331**
Liabilities under derivatives	-	152.548	-	-	54.455	207.003
Deposits and other liabilities to banks, other financial organisations and central bank	3.397.484	94.404.115	771.632	457	8.102.470	106.676.158
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	-	-	-	-	1.076.838	1.076.838
Deferred tax liabilities	-	-	-	-	205.253	205.253
Other liabilities	194.790	1.106.983	1.852	4.235	1.336.719	2.644.579
Equity	-	-	-	-	70.144.383	70.144.383
Total liabilities and equity	**18.713.247**	**191.930.801**	**5.213.253**	**1.164.896**	**153.758.134**	**370.780.331**
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)**	**152.732**	**13.373**	**31.954**	**(227.179)**	**(33.042)**

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

(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 Group'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 Group's Management Board is responsible for decision making on operational risk. It is responsibility of the Department to calculate the capital requirements for operational

4) FINANCIAL RISK MANAGEMENT (Continued)

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 Group is to maintain adequate liquidity and financing position in order to enable the bank to fulfill its payment obligations not only in regular business, but also in stressful circumstances.

The liquidity risk that the Group meets in everyday business may have different forms:

- Intraday liquidity - the liquidity risk during the day occurs when the Group 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 Group 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 Group.
- 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 Group 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 Group addresses each of the above mentioned sources of liquidity risk through the appropriate system of limits.

On a yearly basis, during the process of determining the limits, the Group determines the material significance of the participation of dependent legal entities and in accordance with this, reporting is carried out according to the stated sources of liquidity risk. For 2018, the participation of dependent legal entities was not materially significant. Regardless of the materiality criteria, certain indicators of the Group's exposure are monitored only on a consolidated basis.

The limit system used in daily liquidity risk management ensures that the Group maintains a liquidity and funding position that is strong enough to bear the potential effects of unfavorable 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 Group 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 Group'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) - consolidated
- Net Stable Funding Ratio (NSFR)

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

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

In accordance with the Decision on Liquidity Management of the Bank, the liquidity ratio and rigid/cash liquidity ratio are calculated only for the Bank. The Bank is obliged to maintain the relationship between the collection of first-class liquid assets and second-class liquid assets, on the one hand, and collect the Bank's obligation to see and without the agreed maturity and obligations with the agreed maturity, on the other hand, by:

- 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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS December 31, 2018

4) FINANCIAL RISK MANAGEMENT (Continued)

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:

Liquidity ratio (I grade)	2018.	2017.
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

Rigid/cash liquidity ratio:	2018.	2017.
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

Liquidity Coverage Ratio (LCR)

This indicator represents the ratio of the Group'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 Group and consolidated at the Group level 2 times a year. The bank is obliged to keep the indicator of liquid assets coverage, collectively in all currencies, at a level not lower than 100%.

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

(Thousands of RSD)

As at December 31st	2018.	2017.
Protective layer of liquidity	125.544.487	86.227.529
Net outflows of liquid assets	84.046.596	46.315.576
Liquid assets coverage indicator	149%	186%

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 Group'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 unfavorable 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 Group has adopted the Contingency Liquidity Plan in case of occurrence of unforeseen circumstances which are precisely defined:

- Procedures for early detection of Group'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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS December 31, 2018

4) FINANCIAL RISK MANAGEMENT (Continued)

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

(Thousands of RSD)

	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	20.170.440	2.838	604.435	241.983	-	**21.019.696**
Loans and receivables from clients	3.612.637	5.612.090	45.024.732	101.780.367	110.376.624	**266.406.450**
Receivables under hedging derivatives	-	-	-	2	-	**2**
Other assets	1.145.893	-	-	-	-	**1.145.893**
Total assets	**80.665.117**	**16.009.389**	**52.090.095**	**181.530.381**	**114.292.484**	**444.587.466**
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	41.061.486	8.081.627	22.808.570	58.251.282	12.676.371	**142.879.336**
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	451.881	-	-	-	-	**451.881**
Other liabilities	2.862.308	-	-	-	-	**2.862.308**
Total liabilities	**227.410.012**	**21.061.990**	**36.754.691**	**68.349.387**	**14.760.693**	**368.336.773**
Net liquidity gap as at December 31, 2018	**(146.744.895)**	**(5.052.601)**	**15.335.404**	**113.180.994**	**99.531.791**	**76.250.693**

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 of the Group. Such customer behavior, 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 Group 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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS December 31, 2018

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS December 31, 2018

4) FINANCIAL RISK MANAGEMENT (Continued)

4) FINANCIAL RISK MANAGEMENT (Continued)

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

(Thousands of RSD)

	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	10.052.136	2.669	1.782.508	47.751	-	**11.885.064**
Loans and receivables from clients	9.868.280	4.926.577	35.862.363	87.925.175	102.025.947	**240.608.342**
Receivables under hedging derivatives	-	-	-	9.195	-	**9.195**
Other assets	1.000.303	-	-	-	-	**1.000.303**
Total assets	**50.630.428**	**13.986.755**	**41.246.369**	**151.611.192**	**110.219.748**	**367.694.492**
Liabilities						
Liabilities under derivatives	54.456	-	-	98.690	53.857	**207.003**
Deposits and other liabilities to banks, other financial organisations and central bank	27.348.342	3.638.920	23.692.931	40.248.894	11.747.071	**106.676.158**
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	205.253	-	-	-	-	**205.253**
Other liabilities	2.644.579	-	-	-	-	**2.644.579**
Total liabilities	**176.771.124**	**17.672.350**	**40.708.477**	**50.854.464**	**13.552.695**	**299.559.110**
Net liquidity gap as at December 31, 2017	**(126.140.696)**	**(3.685.595)**	**537.892**	**100.756.728**	**96.667.053**	**68.135.382**

(f) Group Compliance Risks

Group Compliance risk represents possibility of adverse effect on the Group's financial performance and capital due to the failure of the Group 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. In the Bank, as a parent legal entity, a special organizational unit was set up whose competence covers compliance review, while in UniCredit Leasing is established organizational unit within the jurisdiction of which is legal affairs and control of business compliance

The primary task of the Compliance Department is to identify and asses the Group'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 Group's compliance function supports other organizational units of the Group in defining procedures, introducing new products or modifying the existing ones, in implementation of the laws and bylaws, rules, standards and 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 Group's compliance function.

Within the Compliance Department 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 Group's financial performance, capital or reputation due to the use of the Group for money laundering and/or terrorist financing.

The risk of money laundering and terrorist financing arises in particular as a result of failure to align the Group's operations with the law, regulations and internal acts of the Group regulating the prevention of money laundering and terrorist financing, or as a result of the mutual non-compliance of its internal acts regulating these issues. Identification, measurement and assessment of the risk of money laundering and financing of terrorism and management of such risk was arranged by the Group with appropriate policies and procedures.

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 Group'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 Group operates in or the Group's failure to respond property to such changes.

Each and every employee within the Group'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 Group'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 Group operates in. The system of reporting to the Group'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 and Group's management in order to enable prompt responses to the changes in the business environment.

The Group'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 Group 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 Group's financial performance and equity.

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

Business risk may result from extremely unfavorable developments in the market environment, changes in competition or behavior 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 (eg 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 Group.

(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 Group 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 Group 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 Group's equity based on positions in the banking book due to changes in interest rates.

The Group'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

4) FINANCIAL RISK MANAGEMENT (Continued)

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 price re-determination,
- 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).

The Group 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 Department of the Group is to establish procedures for the Group 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 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 Group, 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:

(Thousands of RSD)

	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

* The mentioned indicator within the RAF is only monitored for the Bank.

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4) FINANCIAL RISK MANAGEMENT (Continued)

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

(Thousands of RSD)

	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	21.019.696	20.165.382	1.417	819.163	28.632	-	5.102
Loans and receivables from clients	266.406.450	3.759.029	5.948.073	239.601.767	10.543.269	5.801.083	753.229
Receivables under hedging derivatives	2	-	-	-	-	-	2
Other assets	1.145.893	-	-	-	-	-	1.145.893
Total assets	**444.587.466**	**46.651.603**	**16.341.509**	**328.174.460**	**10.571.901**	**5.801.083**	**37.046.910**
Liabilities under derivatives	723.632	-	-	-	-	-	723.632
Deposits and other liabilities to banks, other financial organisations and central bank	142.879.336	40.582.109	27.621.262	25.693.377	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	451.881	-	-	-	-	-	451.881
Other liabilities	2.862.308	-	-	-	-	-	2.862.308
Total liabilities	**368.336.773**	**100.805.398**	**48.208.426**	**41.078.636**	**54.816.644**	**1.471.084**	**121.956.585**
Net interest rate risk sensitivity exposure at December 31, 2018	**76.250.693**	**(54.153.795)**	**(31.866.917)**	**287.095.824**	**(44.244.743)**	**4.329.999**	**(84.909.675)**

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

(Thousands of RSD)

	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
Gotovina i sredstva kod centralne banke	29.661.017	15.965.402	-	-	-	-	13.695.615
Potraživanja po osnovu derivata	185.204						185.204
Hartije od vrednosti	84.345.367	2.144.526	8.827.206	3.567.870	61.670.297	8.135.468	-
Krediti i potraživanja od banaka i drugih finansijskih organizacija	11.885.064	10.046.633	9.479	1.797.825	29.227	-	1.900
Krediti i potraživanja od komitenata	240.608.342	9.015.958	4.918.909	199.799.710	21.499.531	4.521.160	853.074
Potraživanja po osnovu derivata namenjenih zaštiti od rizika	9.195	-	-	-	-	-	9.195
Ostala sredstva	1.000.303	-	-	-	-	-	1.000.303
Ukupna aktiva	**367.694.492**	**37.172.519**	**13.755.594**	**205.165.405**	**83.199.055**	**12.656.628**	**15.745.291**
Obaveze po osnovu derivata	207.003	-	-	-	-	-	207.003
Depoziti i ostale finansijske obaveze prema bankama, drugim finansijskim organizacijama i centralnoj banci	106.676.158	26.102.605	4.372.532	70.365.199	5.320.867	-	514.954
Depoziti i ostale finansijske obaveze prema drugim komitentima	186.658.833	75.244.759	72.897.649	20.078.300	4.350.796	-	14.087.329
Obaveze po osnovu derivata namenjenih zaštiti od rizika	448.794	-	-	-	-	-	448.794
Subordinirane obaveze	2.718.490	-	2.718.490	-	-	-	-
Tekuće poreske obaveze	205.253	-	-	-	-	-	205.253
Ostale obaveze	2.644.579	-	-	-	-	-	2.644.579
Ukupna pasiva	**299.559.110**	**101.347.364**	**79.988.671**	**90.443.499**	**9.671.663**	**-**	**18.107.912**
Neto izloženost riziku od promene kamatnih stopa na dan 31.decembra 2017. godine	**68.135.382**	**(64.174.845)**	**(66.233.077)**	**114.721.906**	**73.527.392**	**12.656.628**	**(2.362.621)**

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4) FINANCIAL RISK MANAGEMENT (Continued)

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 Group 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 Group's operations.
In order to control, i.e. mitigate this type of risk, as well as to improve the management of such risk, the Group 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 Group 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 Group monitors its capital adequacy ratio on a quarterly basis using the standardized approach.
The Group is required to calculate the following capital adequacy ratios:

1. the Common Equity Tier 1 capital ratio (CET 1 ratio) represents 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 Group 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 Group is required to maintain at all times its capital in the amount necessary for coverage of all risks the Group 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 Group to achieve and maintain capital adequacy ratios higher than the prescribed ones. In 2018 NBS did not impose on the Group capital adequacy ratios higher than the prescribed ones.

The Group'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 Group'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 Group 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.

The Group 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 Group's future profitability in line with the effective regulations;
- defined benefit pension fund assets on the Group's statement of the financial position;
- the Group's direct, indirect and synthetic holdings of its own Common Equity Tier 1 instruments, including those that the Group is under an actual or contingent obligation to repurchase by virtue of a constructive obligation;
- the Group'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 Group, designed to artificially inflate the bank's capital;
- the Group's applicable direct, indirect and synthetic holdings of Common Equity Tier 1 instruments of FSI entities where the Group holds no significant investments in accordance with Articles 19 and 20 of the Decision;
- the Group's applicable direct, indirect and synthetic holdings of Common Equity Tier 1 instruments of FSI entities where the Group holds significant investments in accordance with Sections 19 of the Decision;
- the amount for which the Group's Additional Tier 1 capital deductible items exceed the Group's additional Tier 1 capital;
- the amount of exposures qualifying for application of a risk weight of 1.25%, where the Group 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 Group 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 Group's balance sheet assets and off-balance sheet items.

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

As of December 31, 2018 the Group 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 Group's future profitability, arising from the temporary differences since their aggregate amount was below the defined limit.

The Group'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 Group had no additional Tier 1 capital.

The Group'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 Group had no additional Tier 2 capital.

4) FINANCIAL RISK MANAGEMENT (Continued)

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

(Thousands of RSD)

	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 years profit eligible for inclusion in CET 1 Capital	821.285	655.690
Revaluation reserves and other unrealized gains	2.517.878	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)	(1.627.558)	(1.165.916)
(-) 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	(377.682)	(231.860)
(-) Amount of the required reserve for estimated losses on the Bank's balance sheet assets and off-balance sheet items	(9.958.131)	(13.237.592)
Total Common Equity Tier 1 capital - CET1	**57.464.942**	**48.727.498**
Additional Tier 1 capital - AT1	**-**	**-**
Total core Tier 1 capital - T1 (CET1 + AT1)	**57.464.942**	**48.727.498**
Supplementary capital - T2		
Paid amount of subordinated liabilities	-	538.731
Total supplementary capital - T2	**-**	**538.731**
Total Regulatory Capital (T1 + T2)	**57.464.942**	**49.266.229**

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2018

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 Group'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 Group, which assigns PD to individual rating categories;
- The Group'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 modeling 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 Group 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 Group 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, ie 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 Group 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 can not be directly linked to those claims, but for which experience can be estimated to exist in the loan portfolio. In this assessment, the Group 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.

(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:

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS December 31, 2018

5) USE OF ESTIMATES AND JUDGMENTS (Continued)

(i) Measurement of Financial Instruments

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

The Group 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 Group 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 Group 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.

(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 Group 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 subportfolio 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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS December 31, 2018

5) USE OF ESTIMATES AND JUDGMENTS (Continued)

At each reporting date, the Group's management reviews the carrying amounts of the 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 Group'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 Group is involved in a number of lawsuits and labor disputes. Provisions are recognized when the Group has a present obligation (legal or constructive) as a result of past events, it is probable that the Group 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 Group'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.

(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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS December 31, 2018

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:

(Thousands of RSD)

	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 and 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	34	-	723.632	-	723.632
Liabilities under hedging derivatives	37	-	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.

(Thousands of RSD)

	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 and 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	34	-	207.003	-	207.003
Liabilities under hedging derivatives	37	-	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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS December 31, 2018

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:

(Thousands of RSD)

	Note	Level 1	Level 2	Level 3	Total Fair Value	Carrying Value
2018.						
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	20.208.028	21.013.035	21.019.696
Loans and receivables from clients	26	-	95.601.414	175.417.141	271.018.555	266.406.450
Other assets	33	-	-	1.145.893	1.145.893	1.145.893
		-	**96.406.421**	**250.213.294**	**346.619.715**	**342.014.271**
Deposits and other liabilities due to banks, other financial institutions and the central bank	35	-	100.523.415	42.009.610	142.533.025	142.879.336
Deposits and other financial liabilities to clients	36	-	52.824.689	168.812.410	221.637.099	220.931.036
Current tax liabilities	21.4	-	-	451.881	451.881	451.881
Deferred tax liabilities	32	-	-	412	412	412
Other liabilities	40	-	-	2.862.308	2.862.308	2.862.308
		-	**153.348.104**	**214.136.621**	**367.484.725**	**367.124.973**

(Thousands of RSD)

	Note	Level 1	Level 2	Level 3	Total Fair Value	Carrying Value
2017.						
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	2.636.678	11.885.064	11.885.064
Loans and receivables from clients	26	-	80.231.248	177.322.790	257.554.038	240.608.342
Other assets	33	-	1.000.303	-	1.000.303	1.000.303
		-	**90.479.937**	**209.702.265**	**300.182.202**	**283.232.612**
Deposits and other liabilities due to banks, other financial institutions and the central bank	35	-	85.780.106	22.341.839	108.121.945	106.676.158
Deposits and other financial liabilities to clients	36	-	34.783.435	152.525.877	187.309.312	186.658.833
Subordinated liabilities	38	-	2.718.490	-	2.718.490	2.718.490
Current tax liabilities	21.4	-	205.253	-	205.253	205.253
Other liabilities	40	-	2.644.579	-	2.644.579	2.644.579
		-	**126.131.863**	**174.867.716**	**300.999.579**	**298.903.313**

*Classification of securities in accordance with IAS 39.

Valuation techniques and models the Group 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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS December 31, 2018

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

(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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS December 31, 2018

7) NET INTEREST INCOME

Net interest income includes:

(Thousands of RSD)

	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 and 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	127.636	141.147
Loans and receivables from clients	11.676.312	10.561.733
Derivatives and assets held for risk hedging purposes	284.378	313.677
Total interest income	16.504.300	15.145.641
Interest expenses		
Liabilities under derivatives	188.959	114.804
Liabilities under hedging derivatives	75.676	80.105
Deposits and other liabilities due to banks, other financial organizations and the central bank	1.018.224	1.167.001
Deposits and other financial liabilities to clients	1.114.553	1.284.698
Subordinated liabilities	167.191	135.462
Total interest expenses	2.564.603	2.782.070
Net interest income	**13.939.697**	**12.363.571**

*Clasification 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 973,286 thousand in 2018 (2017: RSD 686,034 thousand).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS December 31, 2018

8) NET FEE AND COMMISSION INCOME

Net fee and commission income includes:

(Thousands of RSD)

	2018.	2017.
Fee and commission income		
Payment transfer activities	1.263.282	1.166.390
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	1.284.092	1.186.667
Fees per deposits	408.551	369.753
Loan origination and processing fees	454.875	360.645
Other fees and commissions	374.349	309.422
Total fee and commission income	4.863.881	4.362.623
Fee and commission expenses		
Payment transfer activities	179.102	163.834
Fees arising on guarantees, sureties and letters of credit	8.467	11.688
Fees arising from card operations	973.502	1.027.211
Other fees and commissions	139.500	153.102
Total fee and commission expenses	**1.300.571**	**1.355.835**
Net fee and commission income	**3.563.310**	**3.006.788**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS December 31, 2018

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

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

(Thousands of RSD)

	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**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS December 31, 2018

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:

(Thousands of RSD)

	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**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS December 31, 2018

11) NET LOSSES ON HEDGING

Net losses on hedging include:

(Thousands of RSD)

	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 the value of hedging derivatives	(45.954)	56.564
Net losses on hedging	**(10.705)**	**(33.865)**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS December 31, 2018

12) NET EXCHANGE RATE GAINS FROM AGREED CURRENCY CLAUSE

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

(Thousands of RSD)

	2018.	2017.
Foreign exchange gains and positive currency clause effects	46.825.873	62.456.406
Foreign exchange losses and negative currency clause effects	(45.419.444)	(61.098.619)
Net foreign exchange gains and positive currency clause effects	**1.406.429**	**1.357.787**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS December 31, 2018

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:

(Thousands of RSD)

	2018.	2017.
Loans and receivables from clients		
Individual impairment allowance charge, net	1.982.656	2.227.326
Collective impairment allowance charge, net	1.074.130	572.284
	3.056.786	2.799.610
Net impairment of securities measured at fair value through other comprehensive income	309.024	-
Contingent liabilities		
Individual impairment allowance (reversal)/charge, net (Note 39)	(36.848)	27.069
Collective impairment allowance (reversal)/charge, net (Note 39)	(39.398)	537
	(76.246)	27.606
Losses arising from the modification of financial instruments	(46)	-
Direct write-off	1.179	1.757
Collection of receivables previously written off	(410.846)	(202.208)
Total	**2.879.851**	**2.626.765**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS December 31, 2018

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:

(Thousands of RSD)

	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**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS December 31, 2018

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:

(Thousands of RSD)

	2018.	2017.
Gains on the sale of investments	-	120.379
Total	**-**	**120.379**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS December 31, 2018

16) OTHER OPERATING INCOME

Other operating income includes:

(Thousands of RSD)

	2018.	2017.
Dividend income	-	120
Other operating income	10.773	12.519
Total other operating income	**10.773**	**12.639**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS December 31, 2018

17) STAFF COSTS

Staff costs comprise:

(Thousands of RSD)

	2018.	2017.
Net salaries	1.875.433	1.685.117
Payroll taxes and contributions	686.328	630.236
Net provisioning for retirement benefits and unused annual leaves (vacations)	16.257	5.613
Other staff costs	516.567	573.789
Total	**3.094.585**	**2.894.755**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS December 31, 2018

18) DEPRECIATION AND AMORTIZATION CHARGE

Depreciation and amortization charge includes:

(Thousands of RSD)

	2018.	2017.
Amortization of intangible assets (Note 29.2, 29.3)	316.609	273.687
Depreciation of investment property (Note 31)	33	33
Depreciation of property and equipment (Notes 30.2, 30.3)	267.267	265.183
Total	**583.909**	**538.903**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS December 31, 2018

19) OTHER INCOME

Other income include:

(Thousands of RSD)

	2018.	2017.
Reversal of unrealized provisions for litigation (Note 39)	35.750	23.044
Reversal of unrealized provisions for other liabilities (Note 39)	-	4.895
Other operating income	60.141	81.723
Total	**95.891**	**109.662**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS December 31, 2018

20) OTHER EXPENSES

Other expenses include:

(Thousands of RSD)

	2018.	2017.
Business premises costs	116.313	91.578
Office supplies	42.938	39.827
Rental costs	725.072	673.730
Information system maintenance	753.842	513.390
Property and equipment maintenance	67.523	55.846
Marketing, advertising, entertainment and donations	254.300	305.170
Lawyer fees, other consultant services and auditing fees	197.192	199.302
Telecommunications and postage services	136.263	139.682
Insurance premiums	843.444	775.287
Insurance of property and security services	93.958	85.509
Professional training costs	22.593	21.005
Servicing	115.355	92.448
Transportation services	16.468	17.780
Employee commuting allowances	40.643	38.836
Accommodation and meal allowance – business travel costs	34.337	31.102
Other taxes and contributions	499.917	469.872
Provisions for litigations and other provisions (Note 39)	194.953	127.009
Losses on disposal of property, equipment and intangible assets	40.447	17.349
Other costs	438.091	409.600
Total	**4.633.649**	**4.104.322**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS December 31, 2018

21) INCOME TAXES

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

(Thousands of RSD)

	2018.	2017.
Current income tax expense	(924.987)	(521.163)
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	(7.435)	(20.528)
Total	**(855.847)**	**(513.098)**

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

(Thousands of RSD)

	2018.	2017.
Profit before taxes	10.230.502	7.294.615
Effective income tax at the legally prescribed		
tax rate of 15%	1.534.575	1.094.192
Tax effects of permanent differences:		
Tax effects of expenses not recognized for tax purposes	21.506	43.266
Tax effects of income adjustment	(640.858)	(632.306)
Tax effects of temporary differences:		
Difference between depreciation/amortization calculated for tax and financial reporting purposes	(15.573)	(6.976)
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	(13.140)	-
Current income tax expense	**924.987**	**521.163**
Effective tax rate	9,04%	7,14%

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

(Thousands of RSD)

	2018.			2017.		
	Before taxes	Tax expense	After taxes	Before taxes	Tax expense	After taxes
Actuarial gains/(losses)	3.355	(1.020)	2.335	(1.967)	(1.478)	(3.445)
Balance at December 31	**3.355**	**(1.020)**	**2.335**	**(1.967)**	**(1.478)**	**(3.445)**

21.4 The calculated current income tax payable for the year 2018 amounted to RSD 924,987 thousand, of which RSD 473,106 thousand was settled through several tax advance payments. The outstanding current tax liabilities as of December 31, 2018 hence amounted to RSD 451,881 thousand.

22) CASH AND ASSETS HELD WITH THE CENTRAL BANK

22.1. Cash and assets held with the central bank include:

(Thousands of RSD)

	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**

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 Group'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 Group 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 Group 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:

(Thousands of RSD)

	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)**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2018

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

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

(Thousands of RSD)

	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**

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:

(Thousands of RSD)

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)**

23) RECEIVABLES UNDER DERIVATIVES

Receivables under derivatives include:

(Thousands of RSD)

	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**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2018

24) SECURITIES

24.1. Securities include:

(Thousands of RSD)

	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:

(Thousands of RSD)

	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 for a year	-	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:

(Thousands of RSD)

	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**

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:

(Thousands of RSD)

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)**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS December 31, 2018

24) SECURITIES (Continued)

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

(Thousands of RSD)

	2018.		2017.	
	IFRS 9 measurement	Total	IAS 39 measurement	Total
Receivables per discounted bills of exchange	Amortized cost	36.923	Amortizovana vrednost	77.886
Treasury bills of Republic of Serbia	FV through other comprehensive income	93.445.489	Po FV kroz ostali rezultat	70.123.561
	FV through profit or loss	1.493.552	Po FV kroz bilans uspeha	2.095.845
Local municipality bonds	FV through other comprehensive income	44.035	Po FV kroz ostali rezultat	58.851
Treasury bills of Republic of Serbia and Local municipality bonds - hedged items	FV through other comprehensive income	6.907.294	Po FV kroz ostali rezultat	11.989.224
Balance at December 31		**101.927.293**		**84.345.367**

Receivables for discounted bills of exchange as of exchange on 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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS December 31, 2018

25) LOANS AND RECEIVABLES FROM BANKS AND OTHER FINANCIAL ORGANISATIONS

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

(Thousands of RSD)

	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	687
Total short-term loans	591.697	687
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
Financial lease receivables in RSD	45.585	59.589
Total	21.037.883	11.893.765
Impairment allowance	(18.187)	(8.701)
Balance at December 31	**21.019.696**	**11.885.064**

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:

(Thousands of RSD)

	Individual level		Group level	
	2018.	2017.	2018.	2017.
Balance at January 1	-	(3)	(8.701)	(32.112)
Effect of first application of IFRS 9 (Note 2g (ii))	-	-	(2.040)	-
Initial balance after first application of IFRS 9	-	(3)	(10.741)	(32.112)
Impairment loss:				
(Charge for the year) / reversal				
Foreign exchange effects	-	3	(7.529)	22.974
Write-off without debt acquittal	-	-	69	437
		-	14	-
Total impairment allowance	**-**	**3**	**(7.446)**	**23.411**
Balance at December 31	**-**	**-**	**(18.187)**	**(8.701)**

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:

(Thousands of RSD)

	Gross carrying amount	Impairment loss	Net carrying amount
Stage 1	20.986.446	(16.686)	20.969.760
Stage 2	51.437	(1.501)	49.936
Stage 3	-	-	-
POCI	-	-	-
Balance at December 31	**21.037.883**	**(18.187)**	**21.019.696**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS December 31, 2018

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:

(Thousands of RSD)

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	(8.692)	(2.038)	(10.730)	(718)	(5.238)	-	-	-	(16.686)
Stage 2	(2)	(2)	(4)	-	(1.566)	-	-	69	(1.501)
Stage 3	(7)	-	(7)	-	(7)	-	14	-	-
POCI	-	-	-	-	-	-	-	-	-
TOTAL	**(8.701)**	**(2.040)**	**(10.741)**	**(718)**	**(6.811)**	**-**	**14**	**69**	**(18.187)**

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

(Thousands of RSD)

	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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS December 31, 2018

26) LOANS AND RECEIVABLES FROM CLIENTS

26.1. Loans and receivables due from clients include:

(Thousands of RSD)

	2018.	2017.
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**
Financial lease receivables in RSD	10.924.648	8.257.936
Other RSD placements	1.973.176	5.892.542
Total	273.484.448	250.184.753
Impairment allowance	(7.077.998)	(9.576.411)
Balance at December 31	**266.406.450**	**240.608.342**

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

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

(Thousands of RSD)

	Individual-level		Group-level	
	2018.	2017.	2018.	2017.
Balance at January 1	(7.560.287)	(15.120.903)	(2.016.124)	(1.354.475)
Effect of first application of IFRS 9 (Note 2g (ii))	-	-	(115.645)	-
Initial balance after first application of IFRS 9	(7.560.287)	(15.120.903)	(2.131.769)	(1.354.475)
Impairment loss:				
(Charge for the year) / reversal	(1.980.430)	(2.272.680)	(1.008.571)	(563.075)
Foreign exchange effects	24.396	661.660	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	246.249	-	-
Write-off without debt acquittal*	549.760	7.299.669	-	-
Total impairment allowance	3.622.203	7.560.616	(1.008.145)	(661.649)
Balance at December 31	**(3.938.084)**	**(7.560.287)**	**(3.139.914)**	**(2.016.124)**

*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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS December 31, 2018

26) LOANS AND RECEIVABLES FROM CLIENTS (Continued)

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:

(Thousands of RSD)

	Gross carrying amount	Impairment loss	Net carrying amount
Stage 1	240.941.477	(931.367)	240.010.096
Stage 2	23.367.960	(1.010.985)	22.356.975
Stage 3	9.175.011	(5.135.646)	4.039.379
POCI	-	-	-
Balance at December 31	**273.484.448**	**(7.077.998)**	**266.406.450**

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:

(Thousands of RSD)

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	(1.109.946)	319.018	(790.928)	(468.447)	327.389	-	-	619	(931.367)
Stage 2	(247.602)	(236.661)	(484.263)	(350.501)	(176.029)	-	-	(192)	(1.010.985)
Stage 3	(8.218.863)	(198.002)	(8.416.865)	(158.172)	(2.163.241)	-	549.796	5.052.836	(5.135.646)
POCI	-	-	-	-	-	-	-	-	-
TOTAL	**(9.576.411)**	**(115.645)**	**(9.692.056)**	**(977.120)**	**(2.011.881)**	**-**	**549.796**	**5.053.263***	**(7.077.998)**

*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 bellow:

(Thousands of RSD)

	2018.			2017.		
	Gross Amount	Impairment Allowance	Carrying Amount	Gross Amount	Impairment Allowance	Carrying Amount
Public sector	5.729.226	(9.069)	5.720.157	11.667.494	(30.021)	11.637.473
Corporate customers	174.556.139	(4.834.453)	169.721.686	157.364.612	(8.477.777)	148.886.835
Retail customers	93.199.083	(2.234.476)	90.964.607	81.152.647	(1.068.613)	80.084.034
Balance at December 31	**273.484.448**	**(7.077.998)**	**266.406.450**	**250.184.753**	**(9.576.411)**	**240.608.342**

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 Group'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. The Group offers housing loans with a fixed, variable and combined interest rate. The possibility of pre-authorization makes the loan approval process simpler, faster and more transparent for clients.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS December 31, 2018

26) LOANS AND RECEIVABLES FROM CLIENTS (Continued)

In May 2018, Group 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.

Finance lease receivables relate to receivables from legal entities were granted to legal entities for the purchase of vehicles and equipment at an interest rate ranging from 1.3% to 5.99% and a funding period of 2 to 5 years. Funds for financial leasing were placed with retail clients for the purchase of cars at an average interest rate of 2.5% and repayment period from 4 to 7 years.

As a hedge against interest rate risk, Group 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.

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

(Thousands of RSD)

	2018.	2017.
Corporate customers		
- Energy	4.328.784	2.305.917
- Agriculture	6.232.613	6.692.229
- Construction industry	15.196.083	8.289.481
- Mining and industry	54.675.907	55.399.678
- Trade	42.779.339	40.129.255
- Services	22.728.856	23.015.638
- Transportation and logistics	19.628.550	16.939.365
- Other	8.986.007	4.593.049
	174.556.139	157.364.612
Public sector	5.729.226	11.667.494
Retail customers		
- Private individuals	88.144.263	77.477.184
- Entrepreneurs	5.054.820	3.675.463
	93.199.083	81.152.647
Total	**273.484.448**	**250.184.753**
Impairment allowance	(7.077.998)	(9.576.411)
Balance at December 31	**266.406.450**	**240.608.342**

The Group' 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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS December 31, 2018

27) CHANGE IN FAIR VALUE OF HEDGED ITEMS

Change in fair value of hedged items include:

(Thousands of RSD)

	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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS December 31, 2018

28) RECEIVABLES UNDER HEDGING DERIVATIVES

Receivables under hedging derivatives comprise:

(Thousands of RSD)

	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 of hedging derivatives referred to the micro fair value hedging (Note 26.6).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS December 31, 2018

29) INTANGIBLE ASSETS

29.1. Intangible assets, net:

(Thousands of RSD)

	2018.	2017.
Intangible assets	1.238.891	1.004.775
Investments in progress	388.667	161.141
Balance at December 31	**1.627.558**	**1.165.916**

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

(Thousands of RSD)

	Intangible Assets	Investment in Progress	Total
Cost			
Balance at January 1, 2018	3.343.731	161.141	3.504.872
Additions	566.838	240.980	807.818
Disposal and retirement	(25.320)	(13.454)	(38.774)
Balance at December 31, 2018	3.885.249	388.667	4.273.916
Accumulated amortization and impairment losses			
Balance at January 1, 2018	2.338.956	-	2.338.956
Amortization charge for the year	316.609	-	316.609
Disposal and retirement	(9.207)	-	(9.207)
Balance at December 31, 2018	2.646.358	-	2.646.358
Net book value at December 31, 2018	**1.238.891**	**388.667**	**1.627.558**
Net book value at January 1, 2018	**1.004.775**	**161.141**	**1.165.916**

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

(Thousands of RSD)

	Intangible Assets	Investment in Progress	Total
Cost			
Balance at January 1, 2017	2.993.722	195.869	3.189.591
Additions	552.995	(23.379)	529.616
Disposal and retirement	(202.986)	(11.349)	(214.335)
Balance at December 31, 2017	3.343.731	161.141	3.504.872
Accumulated amortization and impairment losses			
Balance at January 1, 2017	2.268.255	-	2.268.255
Amortization charge for the year	273.687	-	273.687
Disposal and retirement	(202.986)	-	(202.986)
Balance at December 31, 2017	2.338.956	-	2.338.956
Net book value at December 31, 2017	**1.004.775**	**161.141**	**1.165.916**
Net book value at January 1, 2017	**725.467**	**195.869**	**921.336**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS December 31, 2018

30) PROPERTY, PLANT AND EQUIPMENT

30.1. Property, plant and equipment comprise:

(Thousands of RSD)

	2018.	2017.
Buildings	551.776	566.288
Equipment and other assets	749.853	731.592
Leasehold improvements	175.376	200.575
Investments in progress	122.651	55.768
Balance at December 31	**1.599.656**	**1.554.223**

30.2. Movements on the account of property and equipment in 2018 are presented below:

(Thousands of RSD)

	Buildings	Equipment and other assets	Leasehold improvements	Investments in progress	Total
Cost					
Balance at January 1, 2018	671.034	1.675.818	483.059	55.768	2.885.679
Additions	-	8.782	-	319.101	327.883
Transfer from investments in progress	-	237.731	14.487	(252.218)	-
Disposal and retirement	-	(107.150)	(7.111)	-	(114.261)
Other	-	(83)	-	-	(83)
Balance at December 31, 2018	671.034	1.815.098	490.435	122.651	3.099.218
Accumulated depreciation and impairment losses					
Balance at January 1, 2018	104.746	944.226	282.484	-	1.331.456
Depreciation charge for the year	14.512	213.070	39.685	-	267.267
Impairment losses	-	-	-	-	-
Disposal and retirement	-	(92.161)	(7.110)	-	(99.271)
Other	-	110	-	-	110
Balance at December 31, 2018	119.258	1.065.245	315.059	-	1.499.562
Net book value at December 31, 2018	**551.776**	**749.853**	**175.376**	**122.651**	**1.599.656**
Net book value at January 1, 2018	**566.288**	**731.592**	**200.575**	**55.768**	**1.554.223**

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

(Thousands of RSD)

	Buildings	Equipment and other assets	Leasehold improvements	Investments in progress	Total
Cost					
Balance at January 1, 2017	671.034	1.840.068	481.302	46.916	3.039.320
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	1.675.818	483.059	55.768	2.885.679
Accumulated depreciation and impairment losses					
Balance at January 1, 2017	90.320	1.108.519	259.284	-	1.458.123
Depreciation charge for the year	14.502	203.389	47.292	-	265.183
Impairment losses	-	-	-	-	-
Disposal and retirement	(76)	(360.452)	(24.092)	-	(384.620)
Other	-	(7.230)	-	-	(7.230)
Balance at December 31, 2017	104.746	944.226	282.484	-	1.331.456
Net book value at December 31, 2017	**566.288**	**731.592**	**200.575**	**55.768**	**1.554.223**
Net book value at January 1, 2017	**580.714**	**731.549**	**222.018**	**46.916**	**1.581.197**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS December 31, 2018

31) INVESTMENT PROPERTY

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

(Thousands of RSD)

	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**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS December 31, 2018

32) DEFERRED TAX ASSETS AND LIABILITIES

32.1. Deferred tax assets and liabilities relate to:

(Thousands of RSD)

	2018.			2017.		
	Assets	Liabilities	Net	Assets	Liabilities	Net
Difference in net carrying amount of tangible assets for tax and financial reporting purposes	20.121	-	20.121	27.556	-	27.556
Deferred tax assets in respect of unrecognized current year expenses	165.847	-	165.847	143.921	-	143.921
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	-	(412)	(412)	608	-	608
Total	**240.617**	**(412)**	**240.205**	**172.085**	**-**	**172.085**

32.2. Movements on temporary differences during 2018 are presented as follows:

(Thousands of RSD)

	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	27.556	(7.435)	-	20.121
Deferred tax assets in respect of expenses not recognized in the current year	143.921	21.926	-	165.847
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	-	(1.020)	(412)
Total	**172.085**	**69.140**	**(1.020)**	**240.205**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS December 31, 2018

33) OTHER ASSETS

33.1. Other assets relate to:

(Thousands of RSD)

	2018.	2017.
Other assets in RSD:		
Fee and commission receivables calculated per other assets	62.748	65.081
Advances paid, deposits and retainers	146.240	18.013
Receivables per actual costs incurred	428.324	344.889
Receivables from the RS Health Insurance Fund	52.024	65.501
Other receivables from operations	346.937	397.319
Assets acquired through collection of receivables	5.517	5.517
Claims on prepaid taxes and contributions	10	165
Other investments	-	4.992
Inventories of leasing	19.457	-
Accrued other income receivables	16.736	27.341
Deferred other expenses	77.438	90.130
Total	**1.155.431**	**1.018.948**
Other assets in foreign currencies:		
Fee and commission receivables calculated per other assets	685	320
Other receivables from operations	4.201	12.008
Accrued other income receivables	322	1.439
Total	**5.208**	**13.767**
Total	**1.160.639**	**1.032.715**
Impairment allowance	**(14.746)**	**(32.412)**
Balance at December 31	**1.145.893**	**1.000.303**

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

(Thousands of RSD)

	Individual level		Group level	
	2018.	2017.	2018.	2017.
Balance at January 1	(252)	(343.254)	(32.160)	(559)
Effect of first application of IFRS 9 (Note 2g(ii))	-	-	(1.220)	-
Initial balance after first application of IFRS 9	(252)	(343.254)	(33.380)	(559)
Impairment loss:				
(Charge for the year)/reversal	(2.023)	45.351	(58.092)	(31.601)
Foreign exchange effects	9	561	3	-
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)	343.002	19.418	(31.601)
Balance at December 31	**(784)**	**(252)**	**(13.962)**	**(32.160)**

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

(Thousands of RSD)

	Gross carrying amount	Impairment loss	Net carrying amount
Stage 1	1.091.440	(127)	1.091.313
Stage 2	52.597	(664)	51.933
Stage 3	16.602	(13.955)	2.647
POCI	-	-	-
Balance at December 31	**1.160.639**	**(14.746)**	**1.145.893**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS December 31, 2018

33) OTHER ASSETS (Continued)

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

(Thousands of RSD)

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)	(1.157)	(33.028)	(8.525)	(51.400)	-	78.989	9	(13.955)
POCI	-	-	-	-	-	-	-	-	-
TOTAL	**(32.412)**	**(1.220)**	**(33.632)**	**(8.759)**	**(51.356)**	**-**	**78.989**	**12**	**(14.746)**

33.5. 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)).

(Thousands of RSD)

	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 canceled, in 2018, the Bank made a write-off of participation in the legal entity FAP Korporacija ad, Priboj.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS December 31, 2018

34) LIABILITIES UNDER DERIVATIVES

Liabilities under derivatives include:

(Thousands of RSD)

	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**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS December 31, 2018

35) DEPOSITS AND OTHER LIABILITIES TO BANKS, OTHER FINANCIAL ORGANISATIONS AND CENTRAL BANK

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

(Thousands of RSD)

	2018.	2017.
Demand deposits:		
- in RSD	3.999.660	4.446.328
- in foreign currencies	240.670	959.936
Total demand deposits	**4.240.330**	**5.406.264**
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	4.225.820	2.534.084
- in foreign currencies	19.135.850	15.937.684
Total short-term deposits	**23.361.670**	**18.471.768**
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	25.985.910	27.641.588
Total long-term borrowings:	**26.586.937**	**27.641.588**
Other financial liabilities:		
- in foreign currencies	231.586	106.451
Total other financial liabilities:	**231.586**	**106.451**
Balance at December 31	**142.879.336**	**106.676.158**

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%.

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

(Thousands of RSD)

	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	1.074.893	2.315.214
UniCredit S.P.A. Milano	10.725.509	7.230.579
Balance at December 31	**26.586.937**	**27.641.588**

The above listed long-term borrowings were approved to the Group for periods from 2 to 12 years at nominal interest rates ranging from 0.96% to 4.23% per annum.

36) DEPOSITS AND OTHER FINANCIAL LIABILITIES TO CLIENTS

36.1. Deposits and other financial liabilities to clients comprise:

(Thousands of RSD)

	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**

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

(Thousands of RSD)

	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 36.3)	2.559.134	5.845.446
Balance at December 31	**220.931.036**	**186.658.833**

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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2018

36) DEPOSITS AND OTHER FINANCIAL LIABILITIES TO CLIENTS (Continued)

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

(Thousands of RSD)

	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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS December 31, 2018

37) LIABILITIES UNDER HEDGING DERIVATIVES

Liabilities under hedging derivatives include:

(Thousands of RSD)

	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 loans 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).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS December 31, 2018

38) SUBORDINATED LIABILITIES

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

(Thousands of RSD)

	2018.	2017.
UniCredit Bank Austria AG, Vienna	-	2.718.490
Balance at December 31	**-**	**2.718.490**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS December 31, 2018

39) PROVISIONS

39.1. Provisions relate to:

(Thousands of RSD)

	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	65.544	59.878
Provisions for potential litigation losses	484.625	348.129
Provisions for other liabilities	343.990	343.990
Balance at December 31	**1.136.326**	**1.076.838**

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

(Thousands of RSD)

	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	59.878	348.129	343.990	1.076.838
Effects of the first application of IFRS 9	-	(6.428)	-	-	-	(6.428)
Initial balance after first application of IFRS 9	126.577	191.836	59.878	348.129	343.990	1.070.410
Charge for the year:						
- in the income statement	68.696	220.081	13.847	194.952	-	497.576
- in the statement of other comprehensive income	-	-	(6.800)	-	-	(6.800)
	68.696	220.081	7.047	194.952	-	490.776
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**	**65.544**	**484.625**	**343.990**	**1.136.326**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS December 31, 2018

40) OTHER LIABILITIES

Other liabilities include:

(Thousands of RSD)

	2018.	2017.
Advances received, deposits and retainers:		
- in RSD	73.821	39.748
- in foreign currencies	4.928	3.669
Trade payables:		
- in RSD	304.907	229.898
- in foreign currencies	194.724	294.110
Other liabilities:		
- in RSD	528.034	497.427
- 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	293.496	217.653
- in foreign currencies	86.117	56.364
Accrued other expenses:		
- in RSD	551.689	398.877
- in foreign currencies	36.677	35.124
Liabilities per managed funds	31.185	19.288
Taxes and contributions payable	61.919	57.862
Balance at December 31	**2.862.308**	**2.644.579**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS December 31, 2018

41) RECONCILIATION OF OUTSTANDING BALANCES OF RECEIVABLES AND LIABILITIES WITH CREDITORS AND DEBTORS

In accordance with the Law on Accounting, the Group 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 totaled RSD 29,175 thousand, gross, while non-responded balance confirmation requests amounted to RSD 10,000,257 thousand. Out of the total amount of liabilities for balance reconciliation, unreconciled balances totaled RSD 6,114 thousand, while non-responded balance confirmation requests amounted to RSD 85,565,198 thousand. As for off-balance sheet items, the unreconciled balances amounted to RSD 397,908 thousand and confirmation requests totaling RSD 41,301,870 thousand were not responded to.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS December 31, 2018

42) EQUITY

42.1. Equity is comprised of:

(Thousands of RSD)

	2018.	2017.
Issued capital – share capital	23.607.620	23.607.620
Share premium	562.156	562.156
Retained earnings	10.198.862	7.437.207
Reserves	44.437.252	38.537.400
Balance at December 31	**78.805.890**	**70.144.383**

As of December 31, 2018 the Group's share capital totaled 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 Group are ordinary shares.

Ordinary shareholders are entitled to dividend payment pursuant to the relevant decision on profit distribution enacted by the Group's Supervisory Board and to one vote per share the Shareholder General meeting.

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.

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

(Thousands of RSD)

	2018.	2017.
Actuarial gains per defined employee benefits	5.780	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	**657.756**	**(247.039)**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS December 31, 2018

43) CASH AND CASH EQUIVALENTS

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

(Thousands of RSD)

	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**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS December 31, 2018

44) CONTINGENT LIABILITIES AND COMMITMENTS

44.1. Litigation

As of December 31, 2018 there were 1,298 legal suits filed against the Group (including 12 labor lawsuits) with claims totaling RSD 1,316,772 thousand. In 29 of these proceedings plaintiffs are legal entities and in 1,269 proceedings private individuals appear as plaintiffs.

The Bank made provisions of RSD 484,625 thousand in respect of the legal suits filed against it (Note 39). The aforesaid amount of provisions includes those for the labor 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 favorable for the Group, 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.

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

(Thousands of RSD)

	2018.	2017.
Commitments due		
- within a year	536.378	452.590
- from 1 to 5 years	1.669.303	1.682.441
- after 5 years	890.635	1.166.115
Total	**3.096.316**	**3.301.146**

44.3. The Group's contingent liabilities are provided in the table below:

(Thousands of RSD)

	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**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS December 31, 2018

44) CONTINGENT LIABILITIES AND COMMITMENTS (Continued)

44.4. Breakdown of irrevocable commitments is provided below:

(Thousands of RSD)

	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**

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS December 31, 2018

45) RELATED PARTY DISCLOSURES

The Group is under control of UniCredit S.p.A., Milan, domiciled and registered in Italy, which is the sole owner of the Group'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:

(Thousands of RSD)

	STATEMENT OF FINANCIAL POSITION	2018.	2017.
	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.	Group's Management Board	21.277	22.433
2.	UCTAM D.O.O.	119.848	82.004
		141.125	**104.437**
	Other assets		
1.	UniCredit S.P.A. Milano	18.164	12.040
2.	UniCredit S.P.A. Zweigniederlassung, Wien	3.968	11.143
3.	UniCredit Bank Austria AG, Vienna	9.721	2.766
4.	UniCredit Bank AG, Munich	1.025	2.518
5.	Zagrebačka banka d.d.	474	316
6.	UniCredit Bank BIH	265	287
7.	UniCredit Banka Slovenia, Ljubljana	4	4
8.	UniCredit Bank ZAO Moscow	6	6
9.	UniCredit Bank Hungary Z.r.t., Hungary	53.738	28.538
10.	UniCredit Rent d.o.o.	213	275
11.	UniCredit Bank AG, London	-	1.025
12.	UniCredit Tiriac Bank SA, Romania	1.693	1.483
13.	UCTAM D.O.O.	5	80
		89.276	**60.481**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS December 31, 2018

45) RELATED PARTY DISCLOSURES (Continued)

(Thousands of RSD)

		2018.	2017.
Deposits and other liabilities to banks, other financial institutions and the central bank			
1.	UniCredit Bank Austria AG, Vienna	7.333.672	17.956.684
2.	UniCredit Bank AD Banja Luka	5.579	241.132
3.	Zagrebačka banka d.d.	94.734	53.062
4.	UniCredit Bank AG, London	-	36
5.	UniCredit Banka Slovenija, Ljubljana	40.876	4.639
6.	UniCredit Bank AG, Munich	25.978	6.091
7.	UniCredit Bank Hungary Z.r.t., Hungary	3.743	2.790
8.	UniCredit Bulbank, Sofia	2	2
9.	UniCredit S.P.A. Milano	106.464.144	54.150.636
10.	UniCredit Bank Czech Republic and Slovakia a.s.	9.445	42.071
		113.978.173	**72.457.143**
Deposits and other financial liabilities to clients			
1.	Group's Management Board	38.885	27.501
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
		315.864	**674.668**
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	79.214	141.118
5.	UniCredit Bulbank, Sofia	4.491	5.552
6.	Yapi ve Kredi Bankasi AS, Turkey	5.410	1.292
7.	UBIS G.m.b.H, Vienna	-	1.412
8.	UniCredit Services S.C.P.A., Czech Republic	-	2.793
		133.548	**256.275**
Liabilities, net as of December 31		**99.451.440**	**67.765.018**

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

(Thousands of RSD)

	2017.	2016.
Income statement		
Interest income	21.440	10.964
Interest expenses	(814.399)	(789.863)
Fee and commission income and other income	181.949	154.720
Fee and commission expenses and other expenses	(682.881)	(533.567)
Expenses, net as of December 31	**(1.293.891)**	**(1.157.746)**

Total gross salaries and other remunerations of the Group's Management Board members in 2018 amounted to RSD 121,554 thousand (2017: RSD 102,210 thousand).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS December 31, 2018

46) 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, Februry 14th 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

Maximise commercial bank value.

We continue to maximise commercial bank value by successfully focusing on our clients, delivering a positive experience through our multichannel strategy and best-in-class products and services. The fully plugged in CIB leverages on the Group's strong commercial banking relationships to support the real economy.