HALKBANK A.D., BEOGRAD

Financial Statements
Year Ended December 31, 2018 and
Independent Auditor's Report

Translation of the Auditors' Report issued in the Serbian language

CONTENTS

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Translation of the Auditors' Report issued in the Serbian language

INDEPENDENT AUDITORS' REPORT

To the Shareholders and Management of Halkbank A.D., Beograd

We have audited the accompanying financial statements of Halkbank A.D., Beograd (hereinafter: the "Bank") enclosed on pages 2 to 102, which comprise the statement of the financial position as of December 31, 2018 and the related income statement, statement of other comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Unconsolidated Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of Halkbank A.D., Beograd as at December 31, 2018, and its financial performance and cash flows for the year then ended in accordance with the International Financial Reporting Standards.

Report on Other Legal and Regulatory Requirements

Management is responsible for preparation of the annual business report in accordance with the requirements of the Law on Accounting of the Republic of Serbia. In accordance with the Law on Audit of the Republic of Serbia and Decision on Amendments and Supplements to the Decision on External Audit of Banks, it is our responsibility to express an opinion on the compliance of the Bank's annual business report for the year 2018 with the financial statements for the same financial year. In our opinion, the financial information disclosed in the Bank's annual business report for 2018 is consistent with its audited financial statements for the year ended December 31, 2018.

Belgrade, March 22, 2019

Deloitte d.o.o. BEOGRAD IV

Nataša Milojević

Nataša Milojević
Certified Auditor

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

	Note	December 31, 2018	December 31, 2017
ASSETS			
Cash and balances held with the central bank	3.10, 14	7,643,117	4,839,851
Receivables under derivative financial instruments	15	6,278	470
Securities	3.9, 16	6,713,867	4,857,030
Loans and receivables due from banks and other financial institutions	3.9, 17	2,281,251	1,524,613
Loans and receivables due from customers	3.9, 18	38,765,127	28,894,906
Intangible assets	3.7, 19a	273,138	98,947
Property, plant and equipment	3.5, 19b, 19c	851,041	817,842
Investment property	3.6, 19d	123,883	127,727
Deferred tax assets	3.12, 13c	62,393	62,393
Other assets	20	184,995	225,398
TOTAL ASSETS		**56,905,090**	**41,449,177**
LIABILITIES AND EQUITY			
Deposits and other liabilities due to banks, other financial institutions and the central bank	3.9, 21	6,180,692	6,277,751
Deposits and other liabilities due to customers	3.9, 22	39,165,999	28,762,098
Provisions	2.7, 23	97,677	39,343
Other liabilities	24	309,037	250,278
TOTAL LIABILITIES		**45,753,405**	**35,329,470**
EQUITY			
Share Capital	3.13, 25	8,972,603	4,248,483
Profit	25	414,098	194,631
Reserves	3.13, 25	1,764,984	1,676,593
TOTAL EQUITY	25	**11,151,685**	**6,119,707**
TOTAL LIABILITIES AND EQUITY		**56,905,090**	**41,449,177**

Notes on the following pages form an integral part of these financial statements.

These financial statements were adopted by the Executive Board of Halkbank a.d., Beograd on February 27, 2019.

AKCIONARSKO DRUŠTVO HALKBANK BEOGRAD

Vesna Petrović	Radojica Popović	Kenan Bozkurt
Head of the Financial Management and Planning Division	Member of the Executive Board	Chairman of the Executive Board

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

	Note	2018	2017
Interest income	3.1, 4a	2,068,379	1,754,993
Interest expenses	3.1, 4b	(315,868)	(265,688)
Net interest income		**1,752,511**	**1,489,305**
Fee and commission income	3.2, 5a	843,582	710,404
Fee and commission expenses	3.2, 5b	(145,030)	(106,059)
Net fee and commission income		**698,552**	**604,345**
Net gains on changes in the fair value of financial instruments	6	4,042	5,933
Net gains on derecognition of the financial assets measured at fair value	7	7,910	4,347
Net foreign exchange gains and positive currency clause effects	3.4, 8	1,914	25,238
Net losses from impairment of financial assets not measured at fair value through profit or loss (FVtPL)	10a	(75,127)	(269,765)
Other operating income	9	5,102	6,274
TOTAL OPERATING INCOME, NET		**2,394,904**	**1,865,677**
Salaries, salary compensations and other personal expenses	11	(802,875)	(648,765)
Depreciation and amortization charge	3.5, 3.6, 3.7	(150,143)	(151,567)
Other income	12	11,278	14,842
Other expenses	12	(1,091,439)	(885,556)
PROFIT BEFORE TAXES		**361,725**	**194,631**
Current income tax expense	3.12, 13	-	-
Deferred tax gains/(losses)	3.12, 13	-	-
PROFIT FOR THE YEAR	25	**361,725**	**194,631**

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

	2018	2017
PROFIT FOR THE YEAR	**361,725**	**194,631**
Components of other comprehensive income that cannot be reclassified to the profit or loss:		
Increase in revaluation reserves arising from intangible assets and property, plant and equipment	2,567	-
Actuarial losses	(829)	(990)
Components of other comprehensive income that can be reclassified to the profit or loss:		
Positive effects of changes in fair value of debt instruments measured at fair value through other comprehensive income (FVtOCI)	98,018	45,452
Negative effects of changes in fair value of debt instruments measured at fair value through other comprehensive income (FVtOCI)	(11,365)	(2,975)
Total positive other comprehensive income for the year	**88,391**	**41,487**
TOTAL POSITIVE COMPREHENSIVE INCOME FOR THE YEAR	**450,116**	**236,118**

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AKCIONARSKO DRUŠTVO HALKBANK BEOGRAD

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

	Share capital	Share premium	Reserves from profit and other reserves	Revaluation reserves	Retained earnings	Accumulated losses	Total equity
Opening balance at January 1, 2017	2,421,160	1,827,323	1,174,274	322,675	138,153	-	5,883,585
Actuarial losses, net	-	-	-	(990)	-	-	(990)
Profit for the year	-	-	-	-	194,631	-	194,631
Profit distribution	-	-	138,153	-	(138,153)	-	-
Other			4				4
Other comprehensive income	-	-	-	-	-	-	-
Positive effects of changes in fair value of debt instruments measured at fair value through other comprehensive income (FVtOCI)	-	-	-	42,477	-	-	42,477
Balance at December 31, 2017	2,421,160	1,827,323	1,312,431	364,162	194,631	-	6,119,707
Opening balance at January 1, 2018	2,421,160	1,827,323	1,312,431	364,162	194,631	-	6,119,707
Effects of IFRS 9 first-time adoption recorded against prior years' retained earnings	-	-	-	-	(142,258)	-	(142,258)
Opening balance at January 1, 2018, restated	2,421,160	1,827,323	1,312,431	364,162	52,373	-	5,977,499
Actuarial losses, net	-	-	-	(829)	-	-	(829)
Gains on the changes in the fair value of property, plant and equipment				2,567			2,567
Profit for the year	-	-	-	-	361,725	-	361,725
Share capital increase	3,839,120	-	-	-	-	-	3,839,120
Share issue premium increase	-	885,000	-	-	-	-	885,000
Other comprehensive income							
Positive effects of changes in fair value of debt instruments measured at fair value through other comprehensive income (FVtOCI)	-	-	-	86,653	-	-	86,653
Balance at December 31, 2018	6,260,280	2,712,323	1,312,431	452,553	414,098	-	11,151,685

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

	2018	2017
Cash inflows from operating activities	**2,881,745**	**2,334,414**
Interest receipts	2,018,094	1,615,643
Fee and commission receipts	858,916	712,474
Receipts of other operating income	3,849	5,538
Dividend receipts and profit sharing	886	759
Cash outflows from operating activities	**(2,296,456)**	**(1,907,513)**
Interest payments	(291,577)	(245,085)
Fee and commission payments	(141,536)	(121,289)
Payments to, and on behalf of employees	(751,379)	(651,930)
Taxes, contributions and other duties paid	(185,280)	(142,180)
Payments for other operating expenses	(926,684)	(747,029)
Net cash inflows from operating activities prior to increases/decreases in financial assets and financial liabilities	**585,289**	**426,901**
Decrease in financial assets and increase in financial liabilities	**8,786,035**	**6,135,293**
Increase in deposits and other liabilities due to banks, other financial institutions, the central bank and customers	8,786,035	6,135,293
Increase in financial assets and decrease in financial liabilities	**(11,471,006)**	**(6,333,081)**
Increase in loans and receivables due from banks, other financial institutions, the central bank and customers	(11,471,006)	(6,332,272)
Increase in receivables from securities and other financial assets not held for investments	-	(809)
Net cash (used in)/generated by operating activities	**(2,099,682)**	**229,113**
Cash inflows from investing activities	**1,583,070**	**3,539,514**
Proceeds from investing in investment securities	1,568,355	3,510,981
Proceeds from the sales of intangible assets, property, plant and equipment	14,715	28,533
Cash outflows from investing activities	**(3,636,183)**	**(3,775,070)**
Cash used for investing in investments securities	(3,357,329)	(3,619,533)
Cash used for the purchases of intangible assets, property, plant and equipment	(278,854)	(155,537)
Net cash used in investing activities	**(2,053,113)**	**(235,556)**
Cash inflows from financing activities	**7,879,373**	**2,427,371**
Capital increase	4,724,120	-
Inflows from the borrowings	3,155,253	2,427,371
Cash outflows from financing activities	**(1,888,821)**	**(1,909,824)**
Cash used in the repayment of borrowings	(1,888,821)	(1,909,824)
Net cash generated by financing activities	**5,990,552**	**517,547**
TOTAL CASH INFLOWS	**21,130,223**	**14,436,592**
TOTAL CASH OUTFLOWS	**(19,292,466)**	**(13,925,488)**
NET CASH INCREASE	**1,837,757**	**511,104**
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	**3,302,734**	**2,883,213**
FOREIGN EXCHANGE GAINS	112,670	88,644
FOREIGN EXCHANGE LOSSES	(108,006)	(180,227)
CASH AND CASH EQUIVALENTS, END OF YEAR	**5,145,155**	**3,302,734**

Notes on the following pages form an integral part of these financial statements.

These financial statements were adopted by the Executive Board of Halkbank a.d., Beograd on February 27, 2019.

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AKCIONARSKO DRUŠTVO HALKBANK BEOGRAD

Translation of the Auditors' Report issued in the Serbian language

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

1. BANK'S ESTABLISHMENT AND ACTIVITY

1.1. Establishment

Halkbank a.d., Beograd, formerly known as Čačanska banka, has been operating since July 1, 1956, and during its operations and development it has changed its legally registered name and organizational form several times.

In May 2015, Turkiye Halk Bankasi AS became the majority owner of Čačanska banka. The change of ownership caused the change to the Bank's name and headquarters. The new name of the Bank is Halkbank a.d., Beograd (hereinafter: the "Bank").

During 2018, there were further significant changes in the structure of the share capital of Halkbank a.d., Beograd. In 2018, Turkiye Halkbankasi AS became it sole (100%) owner after purchase of the remaining shares held by the minority (non-controlling) shareholders.

In 2018, the Bank increased its issued (share) capital through new share issues (31st and 32nd share issues).

- The first capital increase was conducted on February 20, 2018 through a new issue of 236,412 ordinary (common stock) shares with the par value of RSD 10,000 per share. Thereby the Bank's share capital was increased from RSD 4,248,483 thousand to RSD 6,612,603 thousand. The selling price amounted to RSD 10,000 per share, i.e., the capital was paid in without a share issue premium.

- Another capital increase was conducted on August 1, 2018 through a new share issue totaling RSD 2,360,000 thousand. The Bank issued 147,500 ordinary shares with the par value of RSD 10,000 per share. The total par value of the shares issued amounted to RSD 1,475,000 thousand. The ordinary shares issued were sold at the price of RSD 16,000 per share, which price was defined under the Decision on the Price for the 32nd Ordinary Share Issue Price enacted by the Bank's Shareholder Assembly. The difference between the share issue selling price and the par value of shares represent the share issue premium.

Through the above described two share issued, the Bank increased its share capital from RSD 4,248,483 thousand to RSD 8,972,603 thousand during 2018.

The Bank was registered with the Serbian Business Registers Agency under number BD 54244 as of September 13, 2005.

1.2. Activities

The Bank is registered in the Republic of Serbia for payment, credit and deposit activities in the country and abroad and it operates in accordance with the effective Law on Banks.

The Bank's head office is in Belgrade, at the address of no. 9e, Milutina Milankovica Street, as registered with the Business Registers Agency under number BD 82129/2016 on October 19, 2016.

As of December 31, 2018, the Bank's network consisted of 24 branches (2017: 23 branches, as follows: Belgrade (8 branches), Čačak (2 branches), Jagodina, Gornji Milanovac, Kraljevo, Užice, Kragujevac, Kruševac, Aranđelovac, Valjevo, Šabac, Niš, Novi Sad, Pančevo, Novi Pazar, and Subotica. The Bank also had 9 sub-branches (2017: 9 sub-branches) in Paraćin, Požega, Topola, Ivanjica, Vrnjačka Banja, Leskovac, Mladenovac, Čačak and Tutin and 4 counters.

In 2018 the Bank opened a new branch in Belgrade, at no. 108, Bulevar Kralja Aleksandra Street.

As of December 31, 2018, the Bank had 487 employees (December 31, 2017: 435 employees). The Bank's tax identification number is 100895809.

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

2.1. Basis of Preparation and Presentation of the 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). As a large legal entity and in accordance with the Law on Accounting, the Bank is required to apply International Financial Reporting Standards ("IFRS"), which as per the aforementioned law comprise the following: the Framework for the Preparation and Presentation of Financial Statements (the "Framework"), International Accounting Standards ("IAS"), International Financial Reporting Standards ("IFRS"), as well as the related interpretations issued by the International Financial Reporting Interpretations Committee ("IFRIC") and additional amendments to the standards and related interpretations issued by the International Accounting Standards Board ("IASB"), the translations of which to the Serbian language were approved and published by the competent Ministry of Finance. In addition, in accordance with the Amendments and Supplements to the Law on Banks (Official Gazette of the Republic of Serbia no. 14/2015), upon preparation of the annual financial statements, banks in the Republic of Serbia are obligated to apply the International Financial Reporting Standards, subsequent revisions and amendments thereto and related interpretations as from their issue date by the competent authorities.

The accompanying financial statements are presented in the format prescribed by the Decision on Forms and Content of Items in the Financial Statement Forms to Be Completed by Banks (Official Gazette of RS nos. 101/2017, 38/2018 and 103/2018).

The accompanying financial statements are stand-alone financial statements of the Bank. The Bank is not a parent entity, i.e., it has no subsidiaries or associates so that it does not prepare consolidated financial statements. The Bank's sole shareholder is Turkiye Halkbankasi AS.

The accompanying financial statements pertain to the reporting period ended December 31, 2018. These financial statements were approved and adopted by the Bank's Executive Board on February 27, 2018.

These financial statements were prepared at historical cost principle, except for the measurement of the following significant balance sheet items:

- financial instruments measured at fair value through other comprehensive income (FVtOCI); and
- derivative financial instruments stated at fair value.

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 leasing transactions, which are in the scope of IAS 17, and measurements that have some similarities to fair value but are not fair value, such as the net realizable value in IAS 2 or value in use in IAS 36.

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

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

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

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

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

2.2. Standards, Amendments to the Existing Standards and Interpretations Effective for the Current Reporting Period

The following new amendments to the existing standards issued by the International Accounting Standards Board (IASB) have been effective over the current reporting period:

- IFRS 9 “Financial Instruments” (effective for annual periods beginning on or after January 1, 2018);
- IFRS 15 “Revenue from Contracts with Customers” (effective for annual periods beginning on or after January 1, 2018);
- Amendments to IFRS 2 “Share-based Payment” - Classification and Measurement of Share-based Payment Transactions (effective for annual periods beginning on or after January 1, 2018);
- Amendments to IFRS 4 “Insurance Contracts” - Applying IFRS 9 “Financial Instruments” with IFRS 4 “Insurance Contracts” (effective for annual periods beginning on or after January 1, 2018 or when IFRS 9 “Financial Instruments” is applied first time);
- Amendments to IAS 40 “Investment Property” - Transfers of Investment Property (effective for annual periods beginning on or after January 1, 2018);
- Amendments to IFRS 1 and IAS 28 due to “Improvements to IFRSs (cycle 2014-2016)” resulting from the annual improvement project of IFRS (IFRS 1, IFRS 12 and IAS 28) primarily with a view to removing inconsistencies and clarifying wording (amendments to IFRS 1 and IAS 28 are to be applied for annual periods beginning on or after January 1, 2018); and
- IFRIC 22 “Foreign Currency Transactions and Advance Consideration” (effective for annual periods beginning on or after January 1, 2018).

Implementation of these amendments to the existing standards has not led to any material changes in the Bank’s financial statements other than the adoption of IFRS 9, which is explained in more detail further in these financial statements.

2.3. New Standards, Amendments to the Existing Standards and Interpretations in Issue not yet Adopted

At the date of approval of these financial statements the following new standards, amendments to the existing standards and new interpretations were in issue but 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 3 “Business Combinations” - Definition of a Business (effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 January 2020 and to asset acquisitions that occur on or after the beginning of that period);
- Amendments to IFRS 9 “Financial Instruments” - Prepayment Features with Negative Compensation (effective for annual periods beginning on or after January 1, 2019);
- Amendments to IFRS 10 “Consolidated Financial Statements” and IAS 28 “Investments in Associates and Joint Ventures” - Sale or Contribution of Assets between an Investor and its Associate or Joint Venture and further amendments (effective date deferred indefinitely until the research project on the equity method has been concluded;
- Amendments to IAS 1 “Presentation of Financial Statements” and IAS 8 “Accounting Policies, Changes in Accounting Estimates and Errors” - Definition of Material (effective for annual periods beginning on or after 1 January 2020);
- 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)” resulting from the annual improvement project of IFRS (IFRS 3, IFRS 11, IAS 12 and IAS 23) primarily with a view to removing inconsistencies and clarifying wording (amendments should be effective for annual periods beginning on or after January 1, 2019);
- Amendments to References to the Conceptual Framework in IFRS Standards (effective for annual periods beginning on or after 1 January 2020); and
- IFRIC 23 “Uncertainty over Income Tax Treatments” (effective for annual periods beginning on or after January 1, 2019).

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

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

2.3. New Standards, Amendments to the Existing Standards and Interpretations in Issue not yet Adopted (Continued)

The Bank's management has elected not to adopt these new standards, amendments to existing standards and new interpretations in advance of their effective dates. The management anticipates that the adoption of these standards, amendments to existing standards and new interpretations will have no material impact on the unconsolidated financial statements of the Bank in the period of initial application, except for the first-time adoption of IFRS 16. The Bank determined the effects of the first-time adoption of IFRS 16 at the beginning of 2019. The rate used for discounting the leased assets as of December 31, 2018 equaled 1.37% per annum, representing the average interest rate applicable to the Bank's borrowed funds.

The effects of the first-time adoption of IFRS 16, i.e., right-of-uses assets as of January 1, 2019, are presented in the table below:

	January 1, 2019
Right-of-assets	
- within a year:	
Property	1,444
- from 1 to 5 years:	
Property	416,421
Automobile	58,452
- over 5 years:	
Property	170,376
Total	**646,693**

2.4. Comparative Information

Comparative information in the accompanying financial statements comprise the data from the Bank's financial statements for 2017. The Bank's accounting policies and estimates relating to the recognition and measurement of the assets and liabilities used upon preparation of the accompanying financial statements are consistent with the accounting policies and estimates used in preparation of the Bank's financial statements for FY 2017, except for the changes in the accounting policies resulting from the adoption of IFRS 9. The Bank applied the allowed exemption option not to adjust the comparative figures for prior years in respect of the changes relating to the classification and measurement of the financial assets and financial liabilities and impairment of financial assets. Differences between the carrying values of the financial assets and liabilities after IFRS 9 adoption and those from the period prior to IFRS 9 adoption were recognized within equity, under the line item of retained earnings as of January 1, 2018 as the opening balance adjustment. Consequently, the presented comparative figures for 2017 do not reflect the requirements of IFRS 9 and are not comparable with the figures presented for 2018 (Notes 2.6 and 28.1).

2.5. Statement of Compliance

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

2.6. First-Time Adoption of IFRS 9

In accordance with IFRS 9, effective as of January 1, 2018, after the reporting date the Bank has changed its accounting policies on recognition, classification and measurement of its financial assets and labilities as well as those on impairment of the financial assets.

As permitted by the Standard, the Bank has not applied the provisions of IFRS 9 to the prior reporting periods; accordingly, the comparative data for 2017 remained presented in accordance with IAS 39 and are therefore not comparable with the data presented for 2018. The effects of adjustment of the carrying value of the Bank's financial assets and liabilities as of the Standard's first-time adoption date were recognized within the retained earnings as the 2018 opening balance adjustment (Note 10b). Breakdown of the effects of IFRS 9 first-time adoption is presented in Note 28.1.

The key requirements of IFRS 9 are as follows:

- *Classification and Measurement of the Financial Instruments*

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

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

2.6. First-Time Adoption of IFRS 9 (Continued)

Classification and measurement of the financial assets, except for equity instruments and derivatives, are driven by the business model the Bank uses for management of the financial assets and the characteristics of the cash flows of the assets (SPPI criterion). The Standard introduces three basic categories of financial assets: financial assets measured at amortized cost (AC), financial assets measured at fair value through other comprehensive income (FVtOCI) and financial assets measured at fair value through profit or loss (FVtPL), to replace the previous categories of financial assets under IAS 39 (loans and receivables, financial assets held to maturity, financial assets available for sale and financial assets at fair value through profit or loss). Moreover, under IFRS 9, if an equity instrument is not held for trading, the Bank may make an irrevocable election, upon initial recognition, to measure such an instrument at FVtOCI, with only dividend income recognized within the profit or loss (income) statement.

In respect of the classification and measurement of the financial assets, IFRS 9 retains the basic requirements of IAS 39. However, with regard to the measurement of financial liabilities initially designated as liabilities at fair value through profit or loss, IFRS 9 requires that the amount of the change in the fair value of the financial liability resulting from the increase/decrease in the credit risk be presented within the other comprehensive income unless such presentation of the effects of credit risk changes would create or significantly increase a measurement or recognition inconsistency (‘accounting mismatch’), within the income statement. Changes in the fair value of liabilities arising from the credit risk are not subsequently reclassified to the profit or loss. Under IAS 39, the entire amount of the change in the fair value of the liability designated as measured at fair value through profit or loss used to be presented within the profit or loss.

- *Impairment of Financial Instruments*

In respect of impairment of financial assets, IFRS 9 requires the use of the model of expected credit losses (ECL) as opposed to the model of incurred credit loss under IAS 39. IFRS 9 requires that the Bank determine ECL for loans and other debt instruments held other than instruments measured at FVtPL, as well as for the financial guarantees and irrevocable commitments per undrawn loans. Credit losses are recognized sooner under IFRS 9 than under IAS 39, since it is no longer necessary that a loss event occurs before recognition of the credit losses.

- *Hedge Accounting*

IFRS 9 introduced new rules applicable to the hedge accounting in respect of defining the hedging relationship and testing its effectiveness. The Bank does not apply hedge accounting.

The accounting policies relating to the classification, measurement and impairment of the financial instruments in accordance with IFRS 9 are presented hereunder:

(a) Classification and Measurement of the Financial Assets and Liabilities

In accordance with IFRS 9, all financial instruments are classified into the following three categories – instruments carried at amortized cost (AC), instruments carried at fair value through profit or loss (FVtPL) and instruments carried at fair value through other comprehensive income (FVtOCI).

Fulfillment of the classification criteria is analyzed by means of SPPI test, which assesses the characteristics of the contractual cash flows of the assets.

SPPI Criterion

If a financial asset is held within the business model whose objective is to collect the asset’s contractual cash flows or within the model whose objective is achieved by collecting the contractual cash flows and/or sale of the assets, the Bank assesses whether the financial asset’s contractual cash flows represent solely payments of principal and interest on the principal amount outstanding (the SPPI test). For the purpose of this assessment, the principal is defined as the consideration for the time value of money, accepted credit risk level of the borrower, and other basic risks of crediting, including an adequate margin. If the contractual terms of the financial instruments include exposures to risks that are not in line with the basic credit arrangement, such financial asset is classified and measured at FVtPL.

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

2.6. First-Time Adoption of IFRS 9 (Continued)

(a) Classification and Measurement of the Financial Assets and Liabilities (Continued)

According to the afore described criteria, debt instruments are classified into the following financial asset categories:

1) <u>Financial assets measured at amortized cost (AC)</u>
A financial asset held within a business model whose purpose is to collect the contractual cash flows, the contractual cash flows represent solely payments of interest (SPPI), and the Bank did not irrevocably elected to measure and carry such an asset at FVtPL, is measured at amortized cost (AC). Amortized cost of such financial assets is subsequently adjusted for assessed impairment, as explained in Note 28.1. Interest income from these assets is recognized using the effective interest method and presented under the line item of interest income within the income statement (profit or loss statement). All the loans the Bank extended to customers meet the criteria for measurement at amortized cost (AC).

2) <u>Financial assets measured at fair value through other comprehensive income (FVtOCI)</u>
A financial asset held within a business model whose purpose is to collect the contractual cash flows or sell the assets , the contractual cash flows represent solely payments of interest (SPPI), and the Bank did not irrevocably elected to measure and carry such an asset at FVtPL, is measured at fair value through other comprehensive income (FVtOCI). Effects of changes in the fair value of such instruments upon their subsequent measurements are presented within the statement of other comprehensive income. As for the financial assets measured at AC, determined impairment of these financial instruments, interest income and foreign exchange losses/gains per such instruments are recognized within the income statement. Upon derecognition, cumulative gains or losses previously recorded within other comprehensive income are reclassified to the profit or loss statement and presented under the line item of the net gains/losses on derecognition of financial statements at fair value. Interest income from these assets is recognized using the effective interest method and presented under the line item of interest income within the income statement (profit or loss statement). All the securities in the Bank's portfolio other than shares are measured at FVtOCI.

3) <u>Financial assets measured at fair value through profit or loss (FVtPL)</u>
A financial asset that does not meet the criteria for classification and measurement at either AC or FVtOCI is measured at fair value through profit or loss (FVtPL). Effects of the changes in the fair value of these instruments upon subsequent measurement are recorded within the income (profit or loss) statement under the line item of the net gains/losses on changes in the fair value of financial instruments. Interest income on coupon financial assets held for trading are recognized using the effective interest method and presented under the line item of interest income within the income statement (profit or loss statement). The shares held by the Bank in its portfolio as of December 31, 2018 as well as derivatives are measured at FVtPL.

Summary of the measurement of the Bank's financial assets in line with IFRS 9 is provided below:
- The following Bank's assets are measured at AC:
  - Cash and balances held with the central bank;
  - Loans and re□eivables due from banks and other finan□ial institutions;
  - Loans and receivables due from customers; and
  - Other assets.
- The following Bank's assets are measured at FVtOCI:
  - Securities measured at FVtOCI, comprising:
    - Bonds issued by the Republic of Serbia (both in local and foreign currencies); and
    - Bonds issued by the local governance units (municipalities).
- The following Bank's assets are measured at FVtPL:
  - Receivables under derivative financial instruments;
  - Securities measured at FVtPL, comprising:
    - Bank shares; and
    - Corporate shares.

Financial assets may be reclassified only if the business model they are held within is changed. Financial assets are reclassified prospectively, i.e., as form the reclassification date onward, from the first day of the reporting period beginning after the business model change. The Bank's strategy does not envisage frequent changes to the business models or reclassifications of the financial assets held within the business models.

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

2.6. First-Time Adoption of IFRS 9 (Continued)

(a) Classification and Measurement of the Financial Assets and Liabilities (Continued)

In addition, there were no changes in the manner of classification and measurement of the Bank's financial liabilities under IFRS 9 compared to IAS 39. The changes introduced by IFRS 9 in respect of the classification of the financial liabilities are not applicable to the Bank's liabilities.

Derecognition and Modification of the Financial Assets

In some circumstances, renegotiation or modification of the contractual cash flows of a financial asset may lead to derecognition of the existing financial asset in accordance with IFRS 9. When modification of financial assets results in derecognition of the existing assets and subsequent recognition of modified assets, the modified assets will be deemed a "new" financial asset for the purposes of IFRS 9.

In such instances, the Bank performs both qualitative and quantitative assessments to determine whether there is a significant difference between the cash flows of the original financial asset and the cash flows of the modified asset. If there is a significant difference, the contractual rights to the original financial assets will be deemed expired and the new asset, issued under new terms is to be recognized. A significant difference between the cash flows of the two assets means a change in the present value of the cash flows of above 10% (the so-called quantitative test).

A financial asset may modified or replaced as part of a transaction with the same counterparty. For example, when the Bank's customer (borrower) is experiencing financial difficulties, restructuring of some or all of the borrower's liabilities may be negotiated in order to enable adequate debt repayment capacity, in part or in full. Such circumstances are commonly referred to as "forbearance" in the banking practice.

Modifications resulting in derecognition of the existing assets and initial recognition of the new assets, driven by deteriorated credit rating and repayment capacity of the borrowers, give rise to initial recognition of the financial assets defined by IFRS 9 as purchased or originated credit-impaired assets ("POCI assets"), i.e., assets impaired at the time of initial recognition.

In instances of significant modification of a financial instrument, IFRS 9 prescribes derecognition of the original financial asset and recognition of the new asset at fair value as of the recognition date. Derecognition of the gives rise to a permanent gain or loss, which must be recognized within profit or loss, in the amount equal to the difference between the amortized cost of the original financial assets and the fair value of the new financial assets net of the expected credit losses recognized as the impairment allowance of the financial assets.

(b) Impairment of the Financial Instruments under IFRS 9

Expected Credit Losses (ECL)

IFRS 9 introduces a concept of expected credit losses (ECL) the Bank is to identify and recognize for all financial assets within the scope of the standard. The Bank calculates and recognizes impairment allowance in accordance with its methodology for financial instruments recognized at AC and all the financial assets measured at FVtOCI.

Impairment allowance for financial assets at FVtOCI and at AC is included in expenses within the income statement. However, the accumulated impairment allowance in the financial statements is not deducted from the fair value of assets but from the cumulative change in the fair value recorded within the other comprehensive income.

The calculated expected credit losses represent probability-weighted estimates of credit losses (the present value of all the differences between the contractual cash flows and the cash flows he Bank expects to receive) during the expected life of a financial instrument. Therefore, for financial assets, the credit loss is the present value of the difference between:

- the contractual cash flows belonging to the Bank under the relevant contract and
- the cash flows the Bank expects to receive,

while for commitments per undrawn loans, credit loss is the present value of the difference between:

- the contractual cash flows belonging to the Bank if the user draws down the loan funds and
- the cash flows the Bank expects to receive if the loan is drawn down.

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

2.6. First-Time Adoption of IFRS 9 (Continued)

(b) Impairment of the Financial Instruments under IFRS 9 (Continued)

Expected Credit Losses (ECL) (Continued)

The Bank classifies all financial assets measured at AC into the following three stages depending on the risk level, i.e., the expected credit loss, as follows:

- Stage 1 includes all new financial assets upon initial recognition except for purchased or originated credit-impaired (POCI) assets, and instruments without a significant increase in credit risk since initial recognition and low-risk financial assets;
- Stage 2 includes financial assets with a significant increase in credit risk since initial recognition, but without objective evidence of impairment based on the credit losses; and
- Stage 3 includes financial assets with objective evidence of impairment at the reporting date, including all POCI assets as impaired upon initial recognition.

Accordingly, at each reporting date, the Bank calculates impairment allowance in the amount of lifetime expected credit losses if the credit risk of an instrument has increased significantly since initial recognition or there is identified objective evidence of impairment (assets in Stage 2 and Stage 3), or in the amount equal to 12-month expected credit losses for all financial instruments without a significant increase in credit risk since initial recognition (assets in Stage 1). Lifetime ECL calculated in this manner represent losses recognized by the Bank for the purposes of imapirment allowance of assets in Stage 2, while the12-month ECL portion calculated in this way represents expected credit losses recognized for financial assets in Stage 1.

2.7. Key Accounting Estimates and Judgments

Preparation and presentation of the financial statements requires the Bank's management to make the best estimates and reasonable assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements, as well as income and expenses for the reporting period. The actual values of the 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 ensuing periods.

The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are addressed below.

Impairment of Financial Assets

<u>*Policies Applicable as from January 1, 2018*</u>
The Bank recognizes ECL provisions for financial assets measured at AC or for debt instruments measured at FVtOCI and for credit commitments and guarantees issued.

Assumptions and estimates used by the Bank as inputs to the model for ECL measurement and assessment of a significant increase in credit risk are disclosed in Note 28.1.

<u>*Policies Applicable until January 1, 2018*</u>
In accordance with its internal bylaws, the Bank assesses, at the end of each reporting period, whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is impaired, and impairment losses are incurred, if and only if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a “loss event“) and that loss event has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated. Concerning the loss assessment due to loan impairment, the Bank reviews its loan portfolio at least on a quarterly basis, in order to assess impairment.

In determining whether an impairment loss should be recorded in the income statement, the Bank makes judgments as to whether there is any reliable evidence indicating that there is a measurable decrease in estimated future cash flows from a loan portfolio before the decrease can be identified for individual loans in that portfolio.

The evidence could include available data indicating adverse changes in respect of the customer's ability to settle its liabilities toward the Bank in a timely manner.

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

2.7. Key Accounting Estimates and Judgments (Continued)

Impairment of Financial Assets (Continued)

Policies Applicable until January 1, 2018 (Continued)
The Bank's management makes estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those of the portfolio, at the time of projecting its future cash flows. The methodology and assumptions used for estimating both the amount and timing of the future cash flows are reviewed on a regular basis in order to reduce any differences between the estimated and actual losses (Notes 10b, 17 and 18).

Useful Lives of Intangible Assets, Property, Plant and Equipment

The determination of the useful lives of intangible assets, property and equipment is based on historical experience with similar assets as well as on any anticipated technological development and changes influenced by wide range of economic or industry factors. Adequacy of the estimated useful lives is reviewed annually, or whenever there is an indication of significant changes in the underlying assumptions (Note19).

Impairment of Non-Financial Assets

As of the reporting date, the Bank's management reviews the carrying amounts of the Bank's intangible assets and property, plant and equipment presented in the financial statements. 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 the impairment loss. If the recoverable amount of an asset is estimated to be less than its carrying value, the carrying amount of the asset is reduced to its recoverable amount (Note 19).

Provisions, Contingent Liabilities and Contingent Assets

Provisions are recognized if, as a result of a past event, the Bank has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. In order to be maintained, the best possible estimates are considered, determined and, if necessary, adjusted at each reporting date.

When the outflow of the economic benefits is no longer probable in order to settle legal or constructive liabilities, provisions are reversed through profit and loss. Provisions are monitored per type and they can be used only for the expenses they were initially recognized for. Provisions are not recognized for future operating losses.

Contingent liabilities are not recognized in the financial statements. Contingent liabilities are disclosed in the notes to the financial statements, unless the probability of an outflow of resources containing economic benefits is very remote (Note 23).

Contingent assets are not recognized in the financial statements. Contingent assets are disclosed in the notes to the financial statements, when an inflow of economic benefits is probable.

Provisions for Litigations

The Bank is involved in a number of legal proceedings arising from daily operations that relate to commercial, contractual and labor disputes, which are resolved and considered in the course of regular business activities. The Bank regularly estimates the probability of negative outcomes of these matters, as well as the amounts of probable or reasonably estimated losses.

Reasonable estimates include judgments made by management, after considering information including notifications, settlements, estimates performed by the Legal Department, available facts, identification of other potentially responsible parties and their ability to contribute as well as prior experience.

A provision for litigation is recognized when it is probable that an obligation exists and a related outflow of resources will occur (probability of a negative outcome higher than 50%), for which a reliable estimation can be made. Accordingly, when there is an expectation that the outcome of the dispute may be negative for the Bank, a provision is made in the amount of the estimated expenditure required to settle the obligation as of the statement date. Provisions are estimated on a quarterly basis. The required provision may change in the future due to occurrence of new events or obtaining additional information.

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

2.7. Key Accounting Estimates and Judgments (Continued)

Deferred Tax Assets

Deferred tax assets are recognized for unused tax losses to the extent that it is probable that expected future taxable profit will be available, against which the unused tax losses can be utilized. The Bank's management necessarily makes significant estimates in order to determine the amount of deferred tax assets that can be recognized, based on the period of occurrence and the amount of future taxable profit. Additional information in this respect is disclosed in Note 3.12.

Retirement and Other Post-Employment Benefits

The costs of defined employee benefits payable upon termination of employment, i.e., retirement in accordance with the fulfilled legal requirements, are determined based on the actuarial valuation. The actuarial valuation includes the average salary paid in the Republic of Serbia, an assessment of the discount rate, future movements in salaries, mortality rates and employee turnover. As these plans are long-term, significant uncertainties influence the outcome of the estimations. Additional information in this respect is disclosed in Note 3.14.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

3.1. Interest Income and Expenses

The Bank presents within the income statement income (revenues) and expenses grouped according to their natures and discloses the amounts of the major types of income and expenses. Presentation in the income statement and disclosures in the notes to the financial statements cover all the income and expense items in accordance with the prescribed content and forms for preparation of the financial statements.

For all interest-bearing financial instruments, interest income and expenses are recognized within the income statement using the effective interest rate method.

The Bank ceases to recognize income from accrued regular interest in the following cases:

- when a decision has been made on instigation of a bankruptcy procedure over the borrower;
- when a decision on instigation of court proceedings for collection of receivables from the borrower has been made;
- when decision on derecognition of income from accrued interest has been made by the Bank's competent board or when other circumstances, which aggravate the collection of receivables, have been identified;
- when the borrower, a legal entity or an entrepreneur, is over 150 days past due in liability settlement.

When the Bank ceases to recognize income from the accrued regular interest, the suspended (broken-period) interest is calculated and recorded within the off-balance sheet items for the purposes of balance reconciliations with the borrowers. After identification of objective evidence of impairment and the recognition of the impairment, interest income on the receivables in Stage 3 calculated by applying the effective interest rate to the net basis (unwinding).

Loan origination fees per loans with pre-defined repayment schedules are recognized within the interest income in the profit or loss statement and are amortized using the effective interest method. Loan origination fees per loans without pre-defined repayment schedules (framework loans, current account overdrafts, credit cards and the like), guarantees and other types of sureties are amortized on as straight-line basis and presented within the fee and commission income.

3.2. Fee and Commission Income and Expenses

Fees and commissions originating from banking services are generally recognized as per the matching principle, on an accrual basis, at the time of occurrence or maturity for collection, except for loan origination fees, which ae presented within the interest income using the effective interest method (Note 3.1).

Fee and commission expenses mostly relate to fees for transactions of domestic and international payment operations and other services and are recorded upon service rendering.

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

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.3. Dividend Income

Dividend income from investments in equity instruments is recognized as income when the shareholder's right to receive payment is established, i.e., at the moment when the dividend is received.

3.4. Foreign Exchange Translation

Transactions denominated in foreign currencies are translated into dinars at the official middle exchange rate of the National Bank of Serbia effective as at the transaction date.

Assets and liabilities denominated in foreign currencies at the reporting date are translated into dinars at the official middle exchange rate of the National Bank of Serbia effective as at the reporting date.

Net foreign exchange effects arising upon performance of transactions in foreign currencies and upon translation of the assets and liabilities denominated in foreign currencies are recognized as foreign exchange gains or losses, in accordance with IAS 21 – "The Effects of Changes in Foreign Exchange Rates". Gains and losses arising in instances of annuities (installments) linked to a RSD/ foreign currency exchange rate are calculated at the reporting date and presented as positive or negative currency clause effects under MSFI 9.

Commitments and contingent liabilities denominated in foreign currencies are translated into dinars at the official middle exchange rate of the National Bank of Serbia effective as at the reporting date.

3.5. Property, Plant and Equipment

Building property is initially measured at cost or at purchase price. Cost includes expenditure that is directly attributable to the acquisition of assets.

Subsequent costs are included in the asset's carrying amount or are recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Bank and the cost of the item can be measured reliably. All other repairs and maintenance costs are recognized as expenses in the income statement of the financial period in which they are incurred.

Valuation of buildings after the initial recognition is performed using the revaluation model stipulated by IAS 16 – "Property, Plant and Equipment", buildings are stated at revalued amounts less any subsequent accumulated depreciation and subsequent accumulated impairment losses.

Assessment of revalued amounts and useful life of buildings is carried out at least once every three years by an independent certified appraiser (expert valuer in civil engineering).

Assessment of the building property market value/impairment was performed by an independent certified appraiser as of November 30, 2018.

Plant and equipment are initially measured at cost, less accumulated depreciation and subsequently at cost less accumulated depreciation and impairment losses, if any.

Depreciation is calculated on a straight-line basis to the cost or revalued amount of each part of an item of property, plant and equipment and investment property in order to fully write off the cost of assets over their estimated useful lives in accordance with the Bank's Rulebook on Amortization of Intangible Assets and Depreciation of Property, Equipment and Investment Property.

At each year-end, the Bank internally reviews the carrying amounts of its buildings in order to determine if there are indications that there have been any impairment losses. If there are such indications, the Bank assesses the recoverable amounts of such assets in order to determine impairment loss amounts, if any.

The following depreciation rates were used in 2018 and were not changed compared to the rates used in 2017:

Buildings	2.50%
Investment property	2.50%
Leasehold improvements	16.67% - 20.00%
Computer equipment	20.00%
Furniture and other equipment	16.67% - 20.00%

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.6. Investment Property

Investment property is property held by the Bank for the purpose of lease and it is accounted for in accordance with IAS 40 – "Investment Property".

Investment property is initially measured at cost or purchase price. After initial recognition, the Bank measures its investment property at cost less the accumulated depreciation.

Depreciation of investment property is calculated using the straight-line method over an estimated life of investment property, in accordance with the Bank's internal bylaws. Depreciation of investment property is carried out over the period of 40 years, using a depreciation rate of 2.5%.

At each year-end, the Bank internally reviews the carrying amounts of its investment properties in order to determine if there are indications that there have been any impairment losses. If there are such indications, the Bank assesses the recoverable amounts of such assets in order to determine impairment loss amounts, if any.

3.7. Intangible Assets

Intangible assets are measured at cost less accumulated amortization upon initial recognition and are subsequently stated at cost less accumulated amortization and accumulated impairment losses. Intangible assets comprise licenses, patents and software.

Amortization is calculated using the straight-line method to the cost of intangible assets over the agreed period of use of such assets or their estimated useful lives unless a period of use is agreed. Most commonly, those are periods from 3 to 5 years.

3.8. Leases

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards associated with ownership of that asset. In other cases, the Bank has operating lease arrangements.

The Bank appears as both the lessor and lessee (only in operating leases).

When the Bank is an operating lease lessor, the leased asset continues to be recognized in the Bank's books and depreciation is calculated during its estimated useful life.

Income from the leased asset is recognized as other income on a straight-line basis over the period of the lease.

When the Bank appears as a lessee, the Bank does not recognize the asset leased as an asset but recognizes the lease payments within other expenses, using a straight-line basis over the period of the lease.

3.9. Financial Instruments

A financial instrument is each contract based on which a financial asset of one entity and a financial liability or an equity instrument of another entity arise.

The Bank recognizes its financial assets and financial liabilities in the statement of financial position in accordance with IFRS 7 "Financial Instruments: Disclosures" and IFRS 9 "Financial Instruments".

The Bank recognizes a financial asset or a financial liability from the moment it becomes a party to the contractual terms of an instrument.

Financial instruments are classified into:

a) Financial assets
- Equity instruments
- Debt instruments
- Derivate

b) Financial liabilities.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.9. Financial Instruments (Continued)

3.9.1 Financial Assets

Policies Applicable as from January 1, 2018

3.9.1.1 Equity Instruments

Financial equity instruments refer to the equity investments (interests) represent long-term financial investments in equity of other entities (banks, insurance companies, shareholding and limited liability companies) that have not been acquired for sale in the near term, as well as securities, i.e., shares of other entities acquired for sale in the near term.

The accounting treatment of the equity investments depends on the influence the investor has over the investee. The following three cases are possible:

- The investor has control over the investee (investments in subsidiaries) and the parent-subsidiary relationship is formed if the equity investment exceeds 50% or other criteria are met as defined by IAS 27;
- The investor exercises a significant influence over the investee (investments in associates) and the parent-associate relationship is formed if the equity investment exceeds 20% or other criteria are met as defined by IAS 28; and
- The investor exercises no significant influence over the investee (other investments) if the equity investment is below 20%.

The Bank is not a parent entity, i.e., it has neither subsidiaries nor associates and does not prepare consolidated financial statements.

Equity investments the Bank holds in other entities and shares are stated at fair value and the changes in fair value thereof are recorded in the profit or loss statement (FVtPL) under IFRS 9.

3.9.1.2 Debt Instruments

The Bank classifies debt instruments as financial assets subsequently measured at amortized cost (AC), at fair value through other comprehensive income (FVtOCI) and fair value through profit or loss (FVtPL) based on:

- the business model for management of the financial assets, and
- characteristics of the contractual cash flows of the financial assets.

Debt instruments are classified upon initial recognition, i.e., when the Bank becomes a party to the contractual terms of the instrument.

Debt instruments are initially measured at fair value increased by transaction costs directly attributable to the acquisition or issuance of the financial asset, except for the financial assets at FVtPL.

The transaction cost or fair value of the consideration given or received in exchange for a financial instrument is usually the best evidence of the fair value of the financial instrument upon initial recognition.

Debt instruments measured at amortized cost (AC)

Debt instruments are measured at AC if the following two criteria are met:

- the asset is held within a business model whose objective is to hold assets in order to collect contractual cash flows (HTC model); and
- the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest (SPPI) on the principal amount outstanding.

The Bank’s business model for classification and measurement of the Bank’s loans and receivables and letters of credit and guarantees except for debt securities is AC measurement mode (the hold-to-collect model and cash flows that are solely payments of principal and interest – HTC and SPPI). Only if the SPPI test reveals that contractual terms exist due to which the assets have failed the SPPI test and cannot therefore be measured at AC, does the Bank use the fair value through profit or loss measurement model (FVtPL). Debt securities may be measured and held within the amortized cost model, FVtOCI model and FVtPL model, depending on each individual case and intention of the management.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.9. Financial Instruments (Continued)

3.9.1 Financial Assets (Continued)

Policies Applicable as from January 1, 2018 (Continued)

3.9.1.2 Debt Instruments (Continued)

Debt instruments measured at amortized cost (AC) (continued)

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Amortized cost is the amount at which a financial asset is measured upon initial recognitions increased or decreased by accumulated amortization using the effective interest method on all the differences between the initial amount and amount upon maturity, less any payments and adjustments for expected credit losses. All loans and receivables originated by the Bank are recognized in the statement of financial position in the amount of gross amortized cost less the individual allowances for impairment. Gross amortized costs represent total receivables from the Bank's customers (including principal outstanding, nominal interest, penalty interest, receivables for fees and other receivables) adjusted by the amount of unamortized fees.

The initial effective interest rate for IFRS 9 purposes represents the rate that precisely discounts the estimated future cash inflows or outflows during the expected life of a financial asset or a liability to the gross carrying value thereof. For IFRS 9 purposes, the effective interest rate is calculated so that it can he used in the process of determining the amortized cost and interest income during the life of a financial instrument. In using the effective interest method, the Bank identifies fees that are part of the effective interest rate of the financial asset in accordance with its Impairment Allowance Methodology under IFRS 9.

The Bank calculates and recognizes impairment allowance in accordance with its Impairment Allowance Methodology under IFRS 9 for all financial instruments measured at AC and at FVtOCI.

IFRS 9 introduces a concept of expected credit losses (ECL), entailing probability-weighted estimates of the lifetime ECL if the credit risk of the financial instruments has significantly increased since initial recognition or there is objective evidence of its impairment identified (Stage 2 and Stage 3 assets) or of the 12-month ECL the Bank is to identify and recognize for all financial for all financial instruments where the credit risk has not s significantly increased since initial recognition (Stage 1 assets).

In its internal bylaws the Bank has defined parameters the identification of which is indicative of the significant increase in credit risk of Stage 2 customers and the default status for Stage 3 customers.

Debt instruments measured at fair value through other comprehensive income (FVtOCI)

Financial assets are measured at FVtOCI if the following two criteria are met:

- the objective of the business model within which the Bank holds the assets is achieved by collection of the contractual cash flows and by sale of the assets; and
- the contractual terms of the assets give rise to the cash flows at specific future dates that represent solely payments of the principal and interest on the principal amount outstanding.

Debt instruments measured at FVtOCI are assets that the Bank intends to hold for an indefinite period yet they may be sold for liquidity maintenance purposes or due to changes in the interest rates, foreign exchange rates or market prices.

Upon initial recognition of such assets, the Bank measures them at fair value increased by transaction costs.

Following their initial recognition, these financial assets are measured at fair value with gains or losses on the changes in their fair value and impairment losses (impairment allowances) recognized under revaluation reserves within equity. Impairment allowance of the financial assets measured at FVtOCI is calculated in the same manner as the imapirment allowance of financial assets measured at AC, However, the accumulated impairment allowance in the financial statements is not deducted from the fair value of assets but from the cumulative change in the fair value recorded within the other comprehensive income. Foreign exchange gains or losses, i.e., gains or losses on the changes in the value of the financial asset arising from the movements in the foreign exchange rates (if the asset is denominated in a foreign currency or linked to a currency clause) are not recognized within equity. At the sale date, the carrying amount of the asset and revaluation reserves from the asset will be derecognized and the excess or shortage of the sale proceeds will be recognized as the gain or loss on the sale of the asset.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.9. Financial Instruments (Continued)

3.9.1 Financial Assets (Continued)

Policies Applicable as from January 1, 2018 (Continued)

3.9.1.2 Debt Instruments (Continued)

Debt instruments measured at fair value through profit or loss (FVtPL)

The Bank measures debt instruments at FVtPL if they are not measured at AC or at FVtOCI.

A financial asset at FVtPL is an asset acquired primarily for sale or repurchase in the near future, with the aim to earn a profit from short-term price fluctuations and/or dealer's margin, or such an asset is a derivative instrument.

A derivative is a financial instrument or another contract whose value is changing (as a result of changes in the defined/agreed interest rate or the price of the financial instrument or its stock exchange price or foreign exchange rate or price growth index or another variable), which requires no initial net investment or an initial net investment which is lower than that for other agreement types that are expected to show similar responses to the changes in market conditions, and which will be settled at a future date.

The initial positive or negative difference in the fair value of a derivative is recorded on-balance sheet as an asset or a liability. Effects of the changes in the fair value of a derivative are subsequently recorded within the income statement. The positive fair value of the derivative is recognized as an asset and the negative fair value of the derivative as a liability. The derivative is derecognized at the moment when the contractual rights and obligations (exchange of cash flows) arising from the derivative expire, i.e., at the termination date.

As of the termination date the carrying amount of an asset is derecognized and all the gains or losses (within the income or expenses) on the changes in the fair value of the asset are cancelled, with the ultimate effects of gain or loss from the derivative recorded within realized exchange gains or losses. In the event that there is an active market for derivatives in the country of the Bank's domicile, the ultimate effect of the sale of a derivative instrument is recorded in the profit or loss statement as a gain or loss on the sale of derivatives. The only derivative transactions the Bank performs are currency swaps.

Fair value option

Even if a financial asset meets the criteria for classification and measurement at AC or FVtOCI, it may be measured at FVtPL if doing so would eliminate or significantly reduce a measurement or recognition inconsistency ('accounting mismatch') that would otherwise arise from measuring assets or liabilities or recognizing the gains and losses on them on different bases. The Bank did not use the FVtPL option.

Financial assets – derecognition and reclassification

The Bank derecognizes a financial asset when the Bank has transferred the asset to another party, and determined that it has transferred all the risks and rewards associated with the asset. If so, the asset will be derecognized from the Bank's books. If the Bank has retained substantially all the risks and rewards of ownership over the asset, the asset cannot be derecognized.

If the Bank has neither transferred nor retained substantially all the risks and rewards of ownership over the asset, the Bank must assess whether it has given up control over the asset or not. If the Bank has no control over the asset, it may derecognize it. However, if the control over the asset is retained by the Bank, the Bank will continue to recognize the asset to extent of its continuing involvement in the asset.

Financial liabilities – measurement and derecognition

A financial liability is any contractual obligation of the Bank to give cash or another financial asset to the counterparty. Upon initial recognition, a financial liability is measured at cost, representing the fair value of the consideration received.

Financial liabilities held for trading are measured at FVtPL, while all other financial liabilities are measured at AC unless the fair value option is elected. The Bank does not use the fair value measurement option.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.9. Financial Instruments (Continued)

3.9.1 Financial Assets (Continued)

Policies Applicable as from January 1, 2018 (Continued)

3.9.1.2 Debt Instruments (Continued)

Financial liabilities – measurement and derecognition (Continued)

A financial liability is derecognized when the contractual obligation underlying the liability is discharged or cancelled or has expired. A gain or loss on cancellation/derecognition of the financial liability is recognized within the profit or loss statement.

Policies Applicable until January 1, 2018

Financial Instruments

All financial instruments are initially recognized at fair value increased by transaction costs directly attributable to the acquisition or issue of a financial asset or liability, except for financial assets and financial liabilities at fair value through profit or loss.

Financial assets and financial liabilities are recorded in Bank's statement of financial position at the date upon which the Bank becomes a party to the contractual provisions of a specific financial instrument. All purchases and sales of financial assets are recognized on the settlement date, which is the date the asset is delivered to the counterparty.

Derecognition of Financial Assets and Financial Liabilities

Financial Assets

A financial asset (or, where applicable, part of a financial asset or part of a group of similar financial assets) is derecognized when:

- the rights to receive cash flows from the asset have expired; or
- the Bank has transferred its rights to receive cash flows from the asset or has assumed an obligation to pay the received cash flows in full without material delay to a third party under a pass-through arrangement; and
- either the Bank has transferred substantially all the risks and benefits of the asset, or has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

When the Bank has transferred its rights to receive cash flows from an asset or has entered into a pass-through arrangement, and has neither transferred nor retained substantially all the risks and rewards of the asset, nor transferred control of the asset, the asset is recognized to the extent of the Bank's continuing involvement in the asset. Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Bank could be required to repay.

Financial Liabilities

A financial liability is derecognized when the obligation underlying the liability is discharged or cancelled or has expired. Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognized in the profit or loss.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.9. Financial Instruments (Continued)

3.9.1 Financial Assets (Continued)

Policies Applicable until January 1, 2018 (Continued)

Loans and Receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market.

All loans and receivables originated by the Bank are recognized in the statement of financial position in the amount of gross amortized cost less the individual allowances for impairment. Gross amortized costs represent total receivables from the Bank's customers (including principal outstanding, nominal interest, penalty interest, receivables for fees and other receivables) adjusted by the amount of unamortized fees.

Individual allowances for impairment and provisions represent decreased value of assets (collectable amounts) below the carrying amounts, caused by increase in the credit risk of such assets, leading to negative changes in expected cash flows from such assets.

By recording individual allowance for impairment as an expense, the Bank indirectly decreases the value of loans and receivables when there is objective evidence of uncertainty of collection, as a result of one or more events (loss event) that occurred after the initial recognition of an investment, and such a loss event affects the estimated future cash flows.

Loss events may be identified at the moment when:
- the borrower is over 90 days past due or
- another loss event has occurred.

RSD loans and receivables with contracted currency clause are revalued in accordance with the particular contract executed for each loan. The difference between the nominal value of the outstanding principal and the revalued amount is recorded within the underlying financial instrument.

The Bank performs accounting write-off of balance sheet assets of low recoverability and general release of debt as follows:

- Accounting write-off of balance sheet assets of low recoverability entails transfer of the balance sheet assets to the off-balance sheet items, where the balance sheet assets represent non-performing loans and other doubtful receivables. The accounting write-off does not entail the Bank’s waiver of its legal and contractual rights and collection of these receivables, but merely an accounting procedure of write-off from the balance sheet assets, with the continued recording of such loans and receivables within the Bank’s off-balance sheet items and continued collection activities undertaken by the Bank. The Bank performs the accounting write-off balance sheet assets of low recoverability when the calculates impairment of such loans and receivables calculated and credited by the Bank to impairment allowance equals 100% of the gross carrying amount of such loans and receivables, i.e., if they are fully impaired. Accounting write-off is carried out at least quarterly.

- General release of debt may be performed in the event that the Bank permanently waives collection of and releases receivables due from a debtor based on the settlement (agreement) with the debtor/co-debtors, final court ruling, writ of execution (court ruling or decision), decision of the Bank’s competent body or based on assignment of debts causing termination of rights to further collection. In such instances, all the Banks’ receivables are derecognized from the Bank’s on-balance and off-balance item records. Before general debt release, the Bank may but need not perform write-off of such loans and receivables.

Financial Assets Held to Maturity

Held-to-maturity assets are non-derivative financial assets with fixed or determinable payments and fixed maturity that the Bank has intention to hold to maturity (except for assets classified as loans and receivables).

Financial assets held to maturity include Treasury bills of the Republic of Serbia and government bonds of the Republic of Serbia quoted on an active market. Shares cannot be classified in this category since these financial assets have no maturity date.

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

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.9. Financial Instruments (Continued)

3.9.1 Financial Assets (Continued)

Policies Applicable until January 1, 2018 (Continued)

Financial Assets Held to Maturity (Continued)

Upon initial recognition, financial assets held to maturity are measured at amortized cost using the effective interest method. Transaction costs that may be attributable to the purchase of the financial asset are included in amortized cost by applying the effective interest method, i.e., they are amortized through the income statement over the instrument's life. The effective interest method entails calculation of amortized cost by applying the market effective interest rate and distribution of interest income over the relevant period.

Subsequent measurement of changes in the amortized cost of these assets is performed each day when interest for such assets is due, as determined by the relevant contract, as well as on the last day of each month during the year.

Gains and losses from the changes in value of financial assets arising from changes in RSD exchange rate (if the asset is denominated in a foreign currency or in RSD with a currency clause index) are also recognized in the income statement, as income and expenses.

Financial Assets at Fair Value through Profit or Loss Held for Trading

Financial assets at fair value through profit or loss represent assets that are classified as held for trading, which means that they were acquired for sale or repurchase in the near future, with the aim to earn a profit from short-term price fluctuations and/or dealer's margin.

Financial assets at fair value through profit or loss held for trading consist of bank and corporate shares continuously traded in the Belgrade Stock Exchange. Securities held for trading are measured at fair value at the reporting date, while the recognized gains or losses arising from the changes in the fair value of the financial assets are included in the net profit or loss. Fair value is the market value of a financial asset determined as of the reporting date on the stock exchange where the asset is traded.

Financial assets at fair value through profit or loss held for trading include derivatives as well. A derivative is a financial instrument or any other agreement with the following three characteristics:

- its value changes (as a result of changes in the defined/agreed interest rate or the price of the financial instrument or its stock exchange price or foreign exchange rate or price growth index or another variable);
- it does not require any initial net investment or it requires an initial net investment which is lower than that for other agreement types that are expected to show similar responses to the changes in market conditions; and
- it will be settled in the future.

Initial recognition of derivatives is carried out at the moment when the derivative agreement is concluded, when the notional amount of the derivative is record within off-balance sheet items. The initial positive or negative difference in the fair value of a derivative is recorded on-balance sheet as an asset or a liability. The positive fair value of the derivative is recognized as an asset and the negative fair value of the derivative as a liability. The derivative is derecognized at the moment when the contractual rights and obligations (exchange of cash flows) arising from the derivative expire, i.e., at the termination date. As of the termination date the carrying amount of an asset is derecognized.

Financial Assets Available for Sale

Financial assets available for sale are non-derivative financial assets designated as available for sale or assets not classified as loans and receivables, held-to-maturity assets and financial assets at fair value through profit or loss.

Assets available-for-sale are acquired to be sold within non-specified future period in order to realize a profit.

Upon initial recognition, financial assets available for sale are measured at fair value increased for transaction costs. These costs are initially capitalized rather than recognized as an expense in the income statement and they increase the carrying amount of the asset.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.9. Financial Instruments (Continued)

3.9.1 Financial Assets (Continued)

Policies Applicable until January 1, 2018 (Continued)

Financial Assets Available for Sale (Continued)

After initial recognition, the Bank measures available-for-sale financial assets at their fair value, recognizing gains and losses from changes in the fair value in revaluation reserves within equity. Within equity, gains and losses from the change in the value of a financial asset are not recognized if arising from RSD exchange rate fluctuations (if the asset is denominated in a foreign currency or subject to a foreign currency clause).

Subsequent valuation is recorded on a quarterly basis. On the sale date, the amount acquired through the sale of the asset closes the carrying amount of the asset and the revaluation reserve for that asset, and the difference is recognized as a gain or loss on sale/disposal.

Impairment of Financial Instruments

In accordance with IAS 39, a financial asset or a group of financial assets are impaired or impairment loss is reversed, only and only if, there is objective evidence of the uncertainty, due to one or more events, which have arisen after initial recognition of financial assets, and if such loss events have an impact on the estimated future cash flows from a financial asset or group of financial assets that can be measured reliably. Possible or expected future trends, which can cause losses in future, do not provide objective evidence of uncertainty.

3.10. Cash and Balances Held with the Central Bank

Cash and balances held with the central bank are comprised of cash in RSD and in foreign currencies, i.e., cash held on the Bank's gyro and current accounts, cash on hand and other cash in RSD and foreign currencies, gold and other precious metals and liquid surpluses deposited with the National Bank of Serbia.

For purposes of the cash flow statement, cash includes cash on hand in local and foreign currencies, balances on accounts held with other banks, as well as available funds held with the National Bank of Serbia.

3.11. Managed Funds

The funds that the Bank manages on behalf of and for the account of third parties for fees are disclosed within off-balance sheet items.

3.12. Taxes and Contributions

Current Income Taxes

Income tax is recognized and calculated in accordance with IAS 12 – "Income Taxes" and the effective Law on Corporate Income Tax.

Income tax represents the amount calculated by applying the statutory income tax rate of 15% to the profit before taxes, after deducting the effects of permanent differences that adjust the prescribed tax rate to the effective tax rate. The final amount of income tax liability is calculated by applying the prescribed tax rate to the taxable income determined in the tax statement and reported in the annual tax return.

The Law on Corporate Income Tax of the Republic of Serbia does not allow any tax losses of the current period to be used to recover taxes paid in previous periods. However, any current year losses disclosed in the tax statements up to 2009 may be used to reduce the taxable profits for future periods, but only for a period of up to ten years. The losses in the tax statements for 2010 and thereafter may be used for reduction of the taxable profits for the ensuing periods, yet no longer than five years.

In addition, the Bank may recognize the loss incurred on the negative opening balance adjustment as of January 1, 2018 due to IFRS 9 first-time adoption as expenses within the tax statement in equal amounts over 5 tax periods form the period in which the adjustment was made. Such tax losses, up to the amount of anticipated future taxable profit against which the tax losses can be offset, are recognized in the statement of the financial position as deferred tax assets.

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

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.12. Taxes and Contributions (Continued)

Deferred Taxes

Deferred taxes are provided for using the balance sheet liability method on all temporary differences at the reporting date between the taxation-purpose amounts of assets and liabilities and their carrying amounts for financial reporting purposes. Tax rate enacted at the reporting date is used to determine the deferred tax amount.

Deferred tax liabilities are recognized for all taxable temporary differences, except where the deferred tax liability arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and in respect of taxable temporary differences associated with investments in subsidiaries, associates and joint ventures, where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not be reversed in the foreseeable future.

Deferred tax assets are recognized for all deductible temporary differences, unused portions tax credit and tax loss carryforwards to the extent that it is probable that taxable profits will be available against which the deductible temporary differences, and the unused tax credits and tax losses carried forward can be utilized, except where the deferred tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit, nor taxable profit or loss; and in respect of deductible temporary differences associated with investments in subsidiaries, associates and joint ventures, when deferred tax assets are recognized only to the extent that it is probable that the temporary differences will be reversed in the foreseeable future and that sufficient taxable profit will be available against which the temporary differences can be utilized.

The carrying amount of deferred tax assets is reviewed at each reporting date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or portion of the deferred tax assets to be utilized. Deferred tax assets and liabilities are calculated at tax rates that are expected to be effective in the year when the asset is realized or the liability is settled, based on tax rates and tax regulations enacted or substantively enacted at the reporting date.

Indirect Taxes and Contributions

Indirect taxes and contributions include property tax, value added tax, payroll taxes and contributions charged to the employer, as well as other taxes and contributions payable in accordance with the tax regulations of the Republic of Serbia and local municipal tax regulations. These taxes and contributions are presented within other operating expenses.

3.13. Equity and Reserves

Equity represents the Bank's assets in excess of all its liabilities. Equity is not assessed and measured separately. Equity consists of the Bank's issued (share) capital, reserves and retained earnings. The Bank is required to maintain at all times its regulatory capital in the amount sufficient to cover all the risks that may arise in the course of the Bank's business (capital requirements), as explained in greater detail in Note 28.2.

3.14. Employee Benefits

Long-Term Employee Benefits – Retirement Benefits

The Bank does not have its own pension funds or share-based payment options and consequently had no liabilities recognized in this respect as of December 31, 2018.

As of December 31, 2018, the Bank made provisions for retirement benefits and unused annual leaves based on the assessment carried out by a certified actuary.

Provisions were made based of the following assumptions:

Average salary for November 2018 paid in Republic of Serbia	69,012.00
Discount rate	3.25%
Salary growth rate	4.00%
Employee turnover rate	5.50%

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

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.14. Employee Benefits (Continued)

Short-Term Employee Benefits – Taxes and Contributions for Social Security

Pursuant to the regulations effective in the Republic of Serbia, the Bank has an obligation to pay personal income tax contributions to various state social security funds. This obligation involves the payment of the tax and contributions on behalf of the employee, by the employer, in amounts calculated by applying the specific, legally prescribed rates. The Bank is also legally obligated to withhold the tax amount and contributions from gross salaries to employees, and to transfer the withheld portions on their behalf directly to the appropriate government funds. These taxes and contributions payable on behalf of the employee and employer are charged to expenses in the period in which they arise.

Short-Term Compensated Absences

Accumulating compensated absences (annual vacation leaves) may be carried forward and used in future periods if the current period's entitlement is not used in full. Expenses for compensated absences are recognized at the amount the Bank expects to pay as a result of the unused entitlement that has accumulated at the reporting date. In the case of non-accumulating compensated absences, an obligation or expense is recognized when the absences occur.

3.15. Going Concern

The Bank's financial statements have been prepared on a going concern basis, assuming that the Bank will continue to operate in the foreseeable future.

4. INTEREST INCOME AND EXPENSES

a) Interest Income

	Year Ended December 31, 2018	2017
RSD loans measured at AC, due from:		
Banks	532	413
Public companies	1,308	1,942
Corporate customers	737,973	644,093
Entrepreneurs	138,733	125,085
Public sector	13,294	31,726
Individuals	771,847	600,597
Other customers	47,119	69,254
	1,710,806	1,473,110
Foreign currency loans measured at AC, due from:		
Corporate customers	26,249	38,593
Entrepreneurs	17	99
Individuals	90	114
Other customers	26,787	103
	53,143	38,909
RSD deposits measured at AC, due from:		
Banks	30,952	27,985
	30,952	27,985
Foreign currency deposits measured AC, due from:		
Banks	299	99
Non-residents	3,826	1,478
	4,125	1,577
Securities measured at FVtOCI:		
In RSD	255,845	198,265
In foreign currencies	12,636	14,731
	266,481	212,996
Other receivables measured at AC:		
In RSD	455	416
In foreign currencies	417	-
	872	416
TOTAL	**2,068,379**	**1,754,993**

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

4. INTEREST INCOME AND EXPENSES (Continued)

a) Interest Income (Continued)

Total interest income recognized on impaired loans for the year ended December 31, 2018 totaled RSD 116,634 thousand (2017: RSD 166,645 thousand).

b) Interest Expenses

	Year Ended December 31, 2018	2017
RSD borrowings measured at AC, due to:		
Banks	3,601	1,784
	3,601	1,784
Foreign currency borrowings measured at AC, due to:		
Public sector	38,527	49,082
Banks	59,988	37,289
	98,515	86,371
RSD deposits measured at AC, due to:		
Banks	35,367	17,603
Public companies	3,504	1,976
Corporate customers	27,448	26,903
Entrepreneurs	421	59
Public sector	18,405	8,672
Individuals	31,210	26,313
Other customers	14,229	17,265
	130,584	98,791
Foreign currency deposits measured AC, due to:		
Banks	1,279	439
Corporate customers	18,755	19,948
Entrepreneurs	9	6
Individuals	54,139	55,097
Other customers	8,986	3,252
	83,168	78,742
TOTAL:	**315,868**	**265,688**

5. FEE AND COMMISSION INCOME AND EXPENSES

a) Fee and Commission Income

	Year Ended December 31, 2018	2017
Fee and commission income in RSD:		
Banks and other financial institutions	71,980	36,805
Public companies	994	929
Corporate customers	450,198	378,328
Entrepreneurs	104,707	91,584
Public sector	167	184
Individuals	174,243	155,987
Non-residents	2,070	2,431
Other customers	13,597	22,590
	817,956	688,838
Fee and commission income in foreign currencies:		
Foreign banks	20,127	16,009
Western Union	1,784	2,388
Individuals	2,366	2,046
Corporate customers	18	47
Entrepreneurs	1,331	1,076
	25,626	21,566
TOTAL	**843,582**	**710,404**

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

5. FEE AND COMMISSION INCOME AND EXPENSES (Continued)

b) Fee and Commission Expenses

	Year Ended December 31, 2018	2017
Fee and commission expenses in RSD		
Banks and other financial institutions	29,093	24,853
Corporate customers	45,705	38,448
Entrepreneurs	43	-
Public sector	438	318
Other customers	15,992	13,915
	91,271	77,534
Fee and commission expenses in foreign currencies:		
Banks and other financial institutions	34,244	20,401
Corporate customers	1,861	-
Public sector	445	-
Non-residents	17,209	8,124
	53,759	28,525
TOTAL	**145,030**	**106,059**

6. NET GAINS ON CHANGES IN THE FAIR VALUE OF FINANCIAL INSTRUMENTS

	Year Ended December 31, 2018	2017
Losses on the changes in the fair value of financial assets measured at FVtPL	(1,039)	-
Gains on the changes in the fair value of financial assets measured at FVtPL	-	1,468
Gains on the changes in the fair value of financial liabilities measured at FVtPL	-	3,995
Losses on the changes in the fair value of financial liabilities measured at FVtPL	(727)	-
Gains on the changes in the fair value of other derivatives	5,808	470
TOTAL	**4,042**	**5,933**

7. NET GAINS ON DERECOGNITION OF THE FINANCIAL ASSETS MEASURED AT FAIR VALUE

	Year Ended December 31, 2018	2017
Gains on derecognition of financial assets measured at FVtOCI	7,910	4,270
Losses on derecognition of financial assets measured at FVtOCI	-	77
TOTAL	**7,910**	**4,347**

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

8. NET FOREIGN EXCHANGE GAINS AND POSITIVE CURRENCY CLAUSE EFFECTS

	Year Ended December 31, 2018	2017
Foreign exchange gains	1,475,369	2,658,370
Positive currency clause effects	636,368	924,699
TOTAL:	2,111,737	3,583,069
Foreign exchange gains	(1,426,594)	(1,875,220)
Positive currency clause effects	(683,229)	(1,682,611)
TOTAL:	(2,109,823)	(3,557,831)
Net foreign exchange gains	**1,914**	**25,238**

The share of foreign currency items in the total Bank's balance sheet assets was 56.56% (2017: 61.49%), while the share of foreign currency items in the total balance sheet liabilities was 53.92% (2017: 61.12%).

9. OTHER OPERATING INCOME

	Year Ended December 31, 2018	2017
Other income from operations	4,216	5,515
Dividend income and profit sharing	886	759
TOTAL	**5,102**	**6,274**

10. NET LOSSES FROM IMPAIRMENT OF FINANCIAL ASSETS NOT MEASURED AT FAIR VALUE THROUGH PROFIT OR LOSS

a) Credited/(Charged) to the Profit or Loss

	Year Ended December 31, 2018	2017
Impairment allowance of financial assets measured at AC	(831,502)	(877,297)
Reversal of impairment allowance of financial assets measured at AC (Note 10b)	721,004	543,481
Net losses	(110,498)	(333,816)
Provisions for off-balance sheet items (Note 23)	(4,476)	(4,625)
Reversal of provisions for off-balance sheet items (Note 23)	5,019	9,139
Net gains	543	4,514
Impairment allowance of financial assets measured at FVtOCI	(7,342)	-
Reversal of impairment allowance of financial assets measured at FVtOCI	5,158	-
Net losses	(2,184)	-
Write-off of irrecoverable receivables	(2,612)	(1,608)
Recovery of receivables previously written off	39,624	61,145
Net gains	37,012	59,537
TOTAL	**(75,127)**	**(269,765)**

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

10. NET LOSSES FROM IMPAIRMENT OF FINANCIAL ASSETS NOT MEASURED AT FAIR VALUE THROUGH PROFIT OR LOSS (Continued)

b) Movements on impairment allowance accounts

	Cash and balances with the central bank (Note 14)	Loans and receivables due from banks (Note 17)	Loans and receivables due from customers (Note 18)	Securities (Note 16)	Other assets (Note 20)	Total
Balance at January 1, 2018	**-**	**79**	**2,678,820**	**166**	**12,978**	**2,692,043**
Effects of IFRS 9 first-time adoption	543	300	124,073	12,083	5,459	**142,458**
Effects of IFRS 9 first-time adoption recorded within equity (FVtOCI)	-	-	-	(11,994)		**(11,994)**
Impairment losses on balance sheet items	350	1,585	770,275	-	99	**772,309**
Reversal of impairment of balance sheet items (Note 10a)	-	(42)	(714,858)	(255)	(5,849)	**(721,004)**
Foreign exchange effects	1	-	(22)	-	-	**(21)**
Impairment allowance translation due to currency clause		-	(5,120)	-	1	**(5,119)**
Accounting write-off, aligned with NBS	-	-	(1,324,444)	-	-	**(1,324,444)**
Definite write-off	-	-	(98,906)	-	-	**(98,906)**
Balance at December 31, 2018	**894**	**1,922**	**1,429,818**	**-**	**12,688**	**1,445,322**

	Cash and balances with the central bank (Note 14)	Loans and receivables due from banks (Note 17)	Loans and receivables due from customers (Note 18)	Securities (Note 16)	Other assets (Note 20)	Total
Balance at January 1, 2017	**-**	**19,746**	**2,777,210**	**225**	**19,177**	**2,816,358**
Impairment losses on balance sheet items	-	61	788,134	5	5,437	793,637
Reversal of impairment of balance sheet items (Note 10a)	-	-	(540,154)	(64)	(3,264)	(543,482)
Foreign exchange effects	-	(606)	(5,217)	-	3	(5,820)
Impairment allowance translation due to currency clause	-	-	(42,914)	-	-	(42,914)
Accounting write-off, aligned with NBS	-	(19,122)	(201,070)	-	(6,391)	(226,583)
Definite write-off	-	-	(61,501)	-	-	(61,501)
Cancelation of fx differences (in line with the Law on Bankruptcy)	-	-	(35,668)	-	(1,984)	(37,652)
Balance at December 31, 2017	**-**	**79**	**2,678,820**	**166**	**12,978**	**2,692,043**

Total impairment allowance of other assets presented in Note 20 totaling RSD 39,041 thousand (2017: RSD 39,233 thousand) includes impairment allowance of other both financial and non-financial assets, while Note 10b) presents only impairment allowance of other assets in the amount RSD12,688 thousand (2017: RSD 12,978 thousand).

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

10. NET LOSSES FROM IMPAIRMENT OF FINANCIAL ASSETS NOT MEASURED AT FAIR VALUE THROUGH PROFIT OR LOSS (Continued)

For the year ended December 31, 2018, the Bank recognized interest income on impaired loans using the effective interest rate on the amortized cost of loans, i.e., their net values along with adjustment of the income recorded in the income statement and with the calculated impairment allowance of receivables in this respect, and recorded losses on impairment of financial assets measured at amortized cost within the line item of the net gains/losses from impairment of financial assets not measured at fair value through profit or loss.

The impairment allowance made in this respect was recorded in the amount of RSD 59,193 thousand (2017: RSD 83,660 thousand).

Due to the foregoing, losses on impairment assets recorded in the income statement (Note 10a) exceeded by the same amount losses on impairment presented in the table of movements on impairment allowance accounts (Note 10b).

11. SALARIES, SALARY COMPENSATIONS AND OTHER PERSONAL EXPENSES

	Year Ended December 31, 2018	2017
Salaries and salary compensations	533,183	453,879
Taxes on salaries and salary compensations	65,970	57,532
Contributions on salaries and salary compensation	138,702	119,786
Other personal expenses	13,474	17,359
Provisions for retirement and other employee benefits (Note 22)	51,496	5,520
Reversal of provisions for retirement and other employee benefits (Note 22)	-	(5,311)
Considerations payable to temporary and seasonal staff members	50	-
TOTAL	**802,875**	**648,765**

Within the line item of salaries and salary compensations, the amount of RSD 29,963 thousand (2017: RSD 26,986 thousand) refers to the remunerations to the Executive Board members remunerations, while the Board of Directors members' remunerations are presented within the line item of other personal expenses in the amount RSD 11,879 thousand (2017: RSD 12,322 thousand).

12. OTHER INCOME AND EXPENSES

	Year Ended December 31, 2018	2017
Other income		
Gains on the sale of property, plant, equipment and intangible assets	3,009	4,698
Surpluses	283	-
Other income	7,986	10,144
Total	**11,278**	**14,842**
Operating expenses		
Cost of materials	61,363	54,105
Costs of production services	438,215	359,907
Non-material expenses	442,501	334,866
Taxes payable	11,121	15,608
Contributions payable	127,904	109,865
Other expenses	2,659	2,855
Provisions for liabilities	6,752	7,149
Other expenses		
Losses on the retirement and disposal of property, equipment and intangible assets	-	1
Other expenses	924	1,200
Total	**1,091,439**	**885,556**

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

12. OTHER INCOME AND EXPENSES (Continued)

Within the line item of costs of production services, the largest amount relates to rental costs of RSD 237,303 thousand (2017: RSD 193,853 thousand), and within non-material expenses the most significant amount refers to paid insurance premiums of RSD 162,232 thousand (2017: RSD 134,528 thousand), of which the largest portion is the insurance premium paid for retail deposits in the amount of RSD 129,148 thousand (2017: RSD 106,900 thousand) and insurance premium paid for cash loans for pensioners in the amount of RSD 33,084 thousand (2017: RSD 27,628 thousand).

13. INCOME TAXES

a) Income tax components

The Bank's current income tax expense as well as both deferred tax gains and losses (from created and/or decreased deferred tax assets/liabilities) were zero for both 2018 and 2017.

The Bank can create additional deferred tax assets in accordance with the projected profits based on the adopted five-year Bank’s Business Strategy. However, a conservative approach was applied in the calculation of deferred tax assets, i.e., the projections were not changed in 2017 and 2018.

b) Income tax reconciliation with prescribed tax rates

	Year Ended December 31, 2018	2017
Profit before taxes	361,725	194,631
Income tax at the statutory rate of 15%	54,259	29,195
Tax effects of expenses not recognized for tax purposes and other expense adjustments	(2,398)	(1,518)
Tax effects of income from debt securities and other income adjustments	(40,405)	(32,860)
Adjustments in respect of transfer pricing	-	367
Capital gains	103	257
Utilization of capital gains	(103)	(257)
Other	(109)	2,368
Tax losses carried forward	-	2,448
Utilization of tax loss carryforwards	(11,347)	-
Income tax stated in the tax statement	-	-
Effective tax rate	**0%**	**0%**

c) Components of deferred tax assets

	Year Ended December 31, 2018	2017
Tax effects of temporary differences on property, plant and equipment	20,362	13,832
Tax credit per tax losses carried forward	34,413	41,209
Impairment of securities held for trading (at FVtPL)	7,618	7,352
Deferred tax assets	**62,393**	**62,393**

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

13. INCOME TAXES (Continued)

Deferred tax assets:

	Remaining tax credit amount	Non-recognized deferred tax assets	Recognized deferred tax assets	Year of expiry
Tax credit for capital expenditures				
	4,387	(4,387)	-	2020
	8,348	(8,348)	-	2023
	12,735	(12,735)	-	
Tax credit per tax losses carried forward				
	33,575	-	33,575	2019
	29,098	(28,259)	838	2020
	14,115	(14,115)	-	2021
	2,651	(2,651)	-	2022
	17,095	(17,095)	-	2022 (FTA of IFRS 9)
	96,534	(62,120)	34,413	

The Bank is planning to recognize the loss incurred on the negative opening balance adjustment as of January 1, 2018 due to IFRS 9 first-time adoption as expenses within the tax statement in equal amounts over 5 tax periods form the period in which the adjustment was made in the total amount of RSD 142,258 thousand.

14. CASH AND BALANCES HELD WITH THE CENTRAL BANK

	December 31, 2018.	December 31, 2017.
Gyro account	2,264,934	1,512,004
Cash in hand in RSD	696,393	424,457
Liquidity surpluses	1,300,000	-
Receivables for accrued interest, fees and commissions related to cash and balances held with the central bank	2,346	21
Cash in hand in foreign currencies	680,357	562,273
Mandatory foreign currency reserve held with NBS	2,699,981	2,341,096
Less: Imapirment allowance of the cash and balances held with the central bank	(894)	-
TOTAL	**7,643,117**	**4,839,851**

Mandatory RSD reserve represents the minimum average balance of RSD funds that the Bank has to allocate to its gyro account in accordance with the National Bank of Serbia's Decision on Banks' Required Reserves with the National Bank of Serbia (Official Gazette of the Republic of Serbia nos. 72/2003, 55/2004, 85/2005 – the other law, 44/2010, 76/2012, 106/2012, 14/2015, 40/2015 – CC decision, 44/2018, and 76/2018).

In accordance with Article 6 of this Decision, the Bank is obligated to calculate and allocate the RSD mandatory reserve by applying a rate of 5% on the average daily balance of RSD deposits, borrowings and other liabilities with contractual maturity up to two years during one calendar month, while for deposits, borrowings and other liabilities with contractual maturity over two years the allocation rate is 0%. Mandatory reserve is calculated once a month. In 2018, NBS calculated and paid interest on the amount of the calculated mandatory RSD reserve at the rates ranging from the maximum of 1.75% per annum to the current rate of 1.25% per annum.

As of December 31, 2018, RSD mandatory reserve was calculated in the amount of RSD 2,119,765 thousand (2017: RSD 1,623,509 thousand).

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

14. CASH AND BALANCES HELD WITH THE CENTRAL BANK (Continued)

The portion of the calculated foreign currency mandatory reserve allocated in dinars amounts to 38% and refers to deposits, borrowings and other liabilities with contractual maturity of up to two years and 30% refers to deposits, borrowings and other liabilities with contractual maturity of over two years. NBS does not calculate and pay interest on the funds of the foreign currency mandatory reserve.

The mandatory foreign currency reserve represents the minimum average balance of foreign currency assets which the Bank is obligated to allocate to its account held with NBS, in accordance with the Decision on Banks' Required Reserves with the National Bank of Serbia (Official Gazette of the Republic of Serbia nos. 72/2003, 55/2004, 85/2005 – the other law, 44/2010, 76/2012, 106/2012, 14/2015, 40/2015 – CC decision, 44/2018, and 76/2018). The Bank is obligated to calculate and allocate the foreign currency reserve to the amount of the average daily balance of foreign currency deposits, borrowings and other liabilities during one calendar month at a rate of 20% for those with contractual maturity of up to two years, 13% for those with contractual maturity of over two years and 100% for the average balance of the foreign currency clause-indexed RSD liabilities. NBS does not pay any interest on the mandatory foreign currency reserve funds on the Bank's account held with NBS.

As at December 31, 2018, the Bank's mandatory foreign currency reserve amounted to RSD 2,629,655 thousand (2017: RSD 2,341,096 thousand).

The Bank's mandatory foreign currency reserve was comprised of 62% of the foreign currency reserve calculated per the Bank's liabilities with maturities of up to two years and 70% of the foreign currency reserve calculated per the Bank's liabilities with maturities of over two years.

For the purposes of preparation of the cash flow statement, the Bank includes in the cash and cash equivalents cash funds held on the gyro account, cash in hand in both RSD and foreign currencies, and cash funds on the accounts held with foreign banks. The item of cash and balances held with the central bank was reconciled with the items of the statement of cash flows at the end of the reporting period as follows:

	December 31, 2018	December 31, 2017
Cash and balances held with the central bank	7,643,117	4,839,851
Mandatory foreign currency reserve held with NBS	(2,699,981)	(2,341,096)
Foreign currency accounts held with foreign banks	1,503,471	804,000
Liquidity surpluses	(1,300,000)	-
Receivables for accrued interest, fees and commissions related to cash and balances held with the central bank	(2,346)	(21)
Less: Imapirment allowance of the cash and balances held with the central bank	894	-
TOTAL	**5,145,155**	**3,302,734**

15. RECEIVABLES UNDER DERIVATIVE FINANCIAL INSTRUMENTS

	December 31, 2018	December 31, 2017
Receivables under financial derivatives	6,278	470
TOTAL	**6,278**	**470**

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

16. SECURITIES

	December 31, 2018	December 31, 2017
a) Securities measured at FVtPL		
Banks shares	1,239	814
Corporate shares	22,009	23,474
	23,248	**24,288**
b) Securities measured at FVtOCI		
Municipal bonds		
- City of Šabac	23,193	30,839
- Municipality of Stara Pazova	9,095	15,317
Bonds issued by the Republic of Serbia in RSD	6,336,076	4,020,424
Bonds issued by the Republic of Serbia in foreign currencies	322,255	293,436
Less: Imapirment allowance of municipal bonds	-	(166)
	6,690,619	**4,359,850**
c) Securities measured at AC		
Bonds issued by the Republic of Serbia in RSD	-	414,425
Bonds issued by the Republic of Serbia in foreign currencies	-	58,467
	-	**472,892**
TOTAL	**6,713,867**	**4,857,030**

As from January 1, 2018, in accordance with the requirements of IFRS 9, the Bank has been calculating impairment allowance for securities measured at fair value through other comprehensive income (FVtOCI). The said impairment allowance was not recorded as a reduction of the balance of such securities, but within revaluation reserves in equity, under line item of the reserves from changes in the value of debt instruments in the amount of RSD 14,177 thousand.

Reclassification of the financial assets

	December 31, 2018	December 31, 2017
Securities measured at fair value through profit or loss (FVtPL)	***23,248***	**-**
Financial assets measured at fair value through profit or loss, held for trading	**-**	***24,288***
Bank shares	1,239	814
Corporate shares	22,009	23,474
Receivables per derivatives held for trading	**-**	**470**
Securities measured at fair value through other comprehensive income (FVtOCI)	***6,690,619***	
Financial assets available for sale	**-**	***4,359,850***
Municipal bonds		
- City of Šabac	23,193	30,839
- Municipality of Stara Pazova	9,095	15,317
Bonds issued by the Republic of Serbia in RSD	6,336,076	4,020,424
Bonds issued by the Republic of Serbia in foreign currencies	322,255	293,436
Less: Imapirment allowance of municipal bonds (Note 10b)	-	(166)
Securities measured at amortized cost (AC)		
Financial assets held to maturity	-	***472,892***
Bonds issued by the Republic of Serbia in RSD	-	414,425
Bonds issued by the Republic of Serbia in foreign currencies	**-**	58,467

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

16. SECURITIES (Continued)

Following the initial application of IFRS 9 „Financial Instruments“, the Bank reclassifies its financial instruments as follows:
- instruments previously classified as held for trading were reclassified to those measured at fair value through profit or loss (FVtPL);
- instruments previously classified as available for sale were reclassified to those measured at fair value through the other comprehensive income (FVtOCI); and
- instruments previously classified held to maturity were reclassified to those measured at amortized cost (AC).

As of December 31, 2018, the securities and investments traded by the Bank in the Belgrade Stock Exchange comprised bank and corporate shares.

As at December 31, 2017, the Bank’s portfolio of securities held to maturity consisted of bonds issued by the Republic of Serbia. As of December 31, 2018, the Bank no longer had such securities in its portfolio.

The rates of return on the government securities in RSD purchased during 2018 ranged from 3.75% to 5.29% annually, while the rates of return on the Bank’s overall portfolio of securities ranged from 3.75% to 5.64%for RSD securities and from 2.59% to 4.2% annually for foreign currency securities.

17. LOANS AND RECEIVABLES DUE FROM BANKS AND OTHER FINANCIAL INSTITUTIONS

	December 31, 2018	December 31, 2017
Receivables for accrued interest on loans, deposits and other investments:		
- in RSD	16	15
- in foreign currencies	-	9
Foreign currency accounts	1,503,471	804,000
Receivables for accrued fees on loans, deposits and other investments in foreign currencies	-	2
Loans in RSD	1,073	1,711
Other investments:		
- in RSD	118,250	296,275
- in foreign currencies	228,429	266,692
Deposits:		
- in RSD	236,000	-
- in foreign currencies	190,828	153,412
Accrued receivables for interest on loans, deposits and other investments:		
- in RSD	5,059	2,447
- in foreign currencies	50	132
Deferred income from receivables carried at amortized cost using the effective interest rate	(3)	(3)
Gross loans and receivables due from banks and other financial institutions	**2,283,173**	**1,524,692**
Less: Imapirment allowance (Note 10b)	(1,922)	(79)
TOTAL	**2,281,251**	**1,524,613**

During 2018, in repo transactions with the National Bank of Serbia, the Bank realized interest at annual rates ranging from 2.35% to 2.56% (2017: from 2.52% to 2.96%).

As of December 2018, the Bank had no liquidity loans per repo transactions.

Foreign currency assets with the Central Securities Depository and foreign currency assets on transaction accounts held with foreign banks as of December 31, 2018 amounted to RSD 1,503,471 thousand (2017: RSD 804,000 thousand) and are presented within the line item of foreign currency accounts.

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

17. LOANS AND RECEIVABLES DUE FROM BANKS AND OTHER FINANCIAL INSTITUTIONS (Continued)

The item of other investments in RSD refers to receivables from the National Bank of Serbia for the contracted purchase and sale of foreign currency monetary assets.

The item of other investments in foreign currencies mostly relates to receivables for contracted purchase and sale of foreign currency monetary assets:
- from domestic banks – UnicCredit Bank in the amount of RSD 59,097 thousand (2017: the National Bank of Serbia, NLB Bank in the amount of RSD 236,945 thousand); and
- from foreign banks – Commerzbank AG, Frankfurt in the amount of RSD 127,210 thousand and Turkiye Vakiflar in the amount of RSD 42,109 thousand (2017: Commerzbank AG, Frankfurt in the amount of RSD 29,735 thousand).

18. LOANS AND RECEIVABLES DUE FROM CUSTOMERS

	December 31, 2018	December 31, 2017
Receivables for accrued interest on loans, deposits and other investments in RSD	114,613	90,821
Receivables for accrued fees on loans, deposits and other investments in RSD	3,556	11,814
Receivables for accrued interest on loans, deposits and other investments in foreign currencies	1,765	1,014
Loans in RSD and loans indexed to EUR	38,724,724	31,049,667
Other investments in RSD	43,930	277,394
Loans and receivables in foreign currencies	1,351,315	241,542
Deposits placed in foreign currencies	81,678	-
Accrued receivables for interest on loans, deposits and other investments in RSD	18,356	12,594
Accrued receivables for interest on loans, deposits and other investments in foreign currencies	13,045	1,285
Deferred income for receivables carried at amortized cost using the effective interest rate	(158,037)	(112,405)
Gross loans and receivables due from customers	**40,194,945**	**31,573,726**
Less: Imapirment allowance (Note 10b)	(1,429,818)	(2,678,820)
TOTAL	**38,765,127**	**28,894,906**

Short-term loans were extended to corporate customers and entrepreneurs for the improvement of production, trade of goods, provision of services, import, export, maintenance of current liquidity and other purposes. Short-term loans were approved for repayment periods of up to 12 months, in RSD, RSD equivalents of foreign currency amounts and in foreign currencies.

In 2018 RSD short-term loans were approved from the Bank's own resources at annual interest rates equal to 6-month BELIBOR + 0.25% p.a. to 9.0% .a., while short-term RSD loans with currency clause index and foreign currency loans were approved at annual interest rates equal to 6-month EURIBOR + 1.95% to 9.0% p.a.

Long-term loans were extended in RSD with and without foreign currency clause and in foreign currencies at fixed and variable interest rates.

Major portion of long-term loans approved in 2018 referred to:

- From Apex III/B approved by EIB, the Bank extended loans totaling EUR 13,589,000to Small and medium-sized entities for capital expenditures and working capital funding through the Youth Employment Program and in the form of standard EIB loans. These loans are to be repaid within up to 12 years, with granted grace periods of up to 2 years, at the interest rate equal to the Bank's margin of 1.75% + NBS margin of 0.175% + EIB margin for the Youth Employment Program or at the annual interest rate equal to equal to the Bank's margin of 2.5% + NBS margin 0.25% + EIB margin for standard EIB loans.

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

18. LOANS AND RECEIVABLES DUE FROM CUSTOMERS (Continued)

- RFC loans of EUR 2,379,000 from the NBS credit line - Revolving Credit Fund Management Department approved to small and medium-sized companies for the purchase of equipment, purchase and construction of production plant facilities and for working capital. The loan repayment period lasts up to 5 years, with a grace period of 12 months, at an annual interest rate of 3-mont LIBOR for EUR loans increased by a 2.55% to 3.25% p.a. margin;

- COSME loans under the guarantee of the European Investment Fund. COSME Program supports small business (SMEs) and enable them easier access to finance with provision of basic collaterals. In 2018 the Bank extended loans totaling EUR 46,129,000 from the funds of COSME Program. Such loans were approved to SMEs for fixed assets and working capital financing. The loans are to be repaid within up to 7 years with possible grace periods granted. The interest rates range from 2.95% to 4.55% + 6-month EURIBOR per annum.

- 2018 Program to Support Small Business in Purchase of Equipment in collaboration with the Ministry of Economy and Development Agency of the Republic of Serbia – these loans are intended for micro-sized and small companies for purchases of equipment and spare parts. In 2018, the Bank extended the total of EUR 4,250,000 out of these funds. The loan repayment terms last up to 5 years with a 6-month grace period and the applicable fixed interest rates range from 2.25% to 3.5% per annum.

Breakdown of Loans and Receivables due from Customers

- Gross loans and receivables due from customers – Corporate

As of December 31, 2018, the Bank's gross amount of loans and receivables due from corporate customers (excluding interest, fees and commissions and accrued fees and commissions) totaled RSD 28,455,074 thousand (2017: RSD 23,246,865 thousand) and are broken down as follows:

Loan type	December 31, 2018	December 31, 2017	% Variance
Loans from Bank's resources	23,838,508	18,503,811	28.83%
Loans from credit lines obtained from the International Financial Institutions	4,616,566	4,743,054	-2.67%
Total	**28,455,074**	**23,246,865**	**22.40%**

- Gross loans and receivables due from customers – Retail

As of December 31, 2018, the Bank's gross amount of loans and receivables due from retail customers without interest and fees yet including NPLs totaled 11,751,582 thousand (2017: RSD 8,321,738 thousand) and are broken down as follows:

Loan type	December 31, 2018	December 31, 2017	% Variance
Cash loans	6,632,890	4,529,143	46.45%
Housing loans	4,275,124	2,989,251	43.02%
Consumer loans – energy efficiency	263,960	261,769	0.84%
Consumer loans – other purposes	234,770	271,847	-13.64%
Authorized current account overdrafts	138,541	125,995	9.96%
Matured loan receivables	96,905	54,689	77.19%
Consumer loans – purchase of vehicle	75,017	55,952	34.07%
Unauthorized current account overdrafts	32,377	26,338	22.93%
Receivables per DinaCard credit cards	1,998	6,754	-70.42%
Total	**11,751,582**	**8,321,738**	**41.22%**

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

18. LOANS AND RECEIVABLES DUE FROM CUSTOMERS (Continued)

Movements on the impairment allowance accounts in 2018

	Cash and balances held with the central bank	Loans and receivables due from banks	Loans and receivables due from customers	Financial assets measured at FVtOCI	Other financial assets	2018 Total
Balance, beginning of year	**-**	**79**	**2,678,820**	**166**	**12,978**	**2,692,043**
Stage 1	-	79	49,331	166	3,719	53,295
Stage 2	-	-	17,167	-	1	17,168
Stage 3	-	-	2,612,322	-	9,258	2,621,580
Effects of IFRS 9 first-time adoption	**543**	**300**	**124,073**	**12,083**	**5,459**	**142,458**
Stage 1	543	290	21,859	12,034	(3,715)	31,011
Stage 2	-	-	5,092	-	-	5,092
Stage 3	-	10	97,122	49	9,174	106,355
Effects of IFRS 9 first-time adoption recorded within equity for securities at FVtOCI	**-**	**-**	**-**	**(11,994)**	**-**	**(11,994)**
Stage 1	-	-	-	(11,994)	-	(11,994)
imapirment allowance (Note 10)	**350**	**1,585**	**770,275**	**-**	**99**	**772,309**
Stage 1	350	1,585	94,947	-	-	96,882
Stage 2	-	-	67,300	-	-	67,300
Stage 3	-	-	608,028	-	99	608,127
Reversal of imapirment allowances (Note 10)	**-**	**(42)**	**(714,858)**	**(255)**	**(5,849)**	**(721,004)**
Stage 1	-	(32)	(74,574)	(206)	(4)	(74,816)
Stage 2	-	-	(16,604)	-	-	(16,604)
Stage 3		(10)	(623,680)	(49)	(5,845)	(629,584)
Foreign exchange effects	**1**	**-**	**(5,142)**	**-**	**1**	**(5,140)**
Stage 1	1	-	(2,862)	-	1	(2,860)
Stage 2	-	-	(2,280)	-	-	(2,280)
Write-offs	**-**	**-**	**(1,423,350)**	**-**	**-**	**(1,423,350)**
Stage 3	-	-	(1,423,350)	-	-	(1,423,350)
Balance, end of year	**894**	**1,922**	**1,429,818**	**-**	**12,688**	**1,445,322**
Stage 1	894	1,922	88,701	-	1	91,518
Stage 2	-	-	70,675	-	1	70,676
Stage 3	-	-	1,270,442	-	12,686	1,283,128

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

18. LOANS AND RECEIVABLES DUE FROM CUSTOMERS (Continued)

Movements on the impairment allowance accounts in 2017

					2017
	Loans and receivables due from banks	Loans and receivables due from customers	Financial assets available for sale	Other financial assets	Total
Balance, beginning of year	**19,746**	**2,777,210**	**225**	**19,177**	**2,816,358**
Individual allowance	19,733	2,707,329	-	6,936	2,733,998
Collective allowance	13	69,881	225	12,241	82,360
Impairment allowance of loans and receivables (Note 10)	**61**	**788,134**	**5**	**5,437**	**793,637**
Individual allowance	-	716,196	-	3,596	719,792
Collective allowance	61	71,938	5	1,841	73,845
Reversal of imapirment allowance of loans and receivables (Note 10)	**-**	**(540,154)**	**(63)**	**(3,264)**	**(543,481)**
Individual allowance	-	(473,047)	-	(1,149)	(474,196)
Collective allowance	-	(67,107)	(63)	(2,115)	(69,285)
Foreign exchange effects	**(606)**	**(48,131)**	**(1)**	**3**	**(48,735)**
Individual allowance	(606)	(48,076)	-	3	(48,679)
Collective allowance	-	(55)	(1)	-	(56)
Write-offs	**(19,122)**	**(262,571)**	**-**	**(6,391)**	**(288,084)**
Individual allowance	(19,122)	(262,571)	-	(6,391)	(288,084)
Collective allowance	-	-	-	-	-
Other	**-**	**(35,668)**	**-**	**(1,984)**	**(37,652)**
Individual allowance	-	(35,668)	-	-	**(35,668)**
Collective allowance	-	-	-	(1,984)	**(1,984)**
Balance, end of year	**79**	**2,678,820**	**166**	**12,978**	**2,692,043**
Individual allowance	5	2,604,163	-	2,995	2,607,163
Collective allowance	74	74,657	166	9,983	84,880

19. INTANGIBLE ASSETS, PROPERTY, EQUIPMENT AND INVESTMENT PROPERTY

a) Intangible Assets

	December 31, 2018	December 31, 2017
Cost		
Balance as of January 1	258,369	182,268
Additions	203,735	76,101
Balance as of December 31	462,104	258,369
Accumulated amortization		
Balance as of January 1	159,422	108,292
Charge for the year	29,544	51,130
Balance as of December 31	188,966	159,422
Net book value as of December 31	**273,138**	**98,947**

The most significant amount of additions, i.e., capital expenditures, made in 2018 relates to the purchase of Banksoft licenses in the amount of RSD 85,342 thousand, which the Bank will be using for development of its own card operation system within the so-called Tesla Project.

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

19. INTANGIBLE ASSETS, PROPERTY, EQUIPMENT AND INVESTMENT PROPERTY (Continued)

b) Property - Buildings

	December 31, 2018	December 31, 2017
Cost		
Balance as of January 1	705,640	704,105
Additions	23	1,535
Revaluation	3,620	-
Sales	(13,662)	-
Balance as of December 31		
Accumulated depreciation		
Balance as of January 1	230,477	212,747
Charge for the year	17,722	17,730
Revaluation	1,053	-
Sales	(1,956)	-
Balance as of December 31		
Net book value as of December 31	**448,325**	**475,163**

As of December 31, 2018, the Bank had proper title deeds of the property in its possession with no encumbrances registered over the assets, except four real estate whose net present value as of December 31, 2018 amounted to RSD 1,307 thousand (2017: RSD 1,177 thousand).

In accordance with the Bank's accounting policies, revaluation of building properties is performed every three years. The Bank engaged a certified appraiser to carry out the revaluation of all buildings owned by the Bank as of November 30, 2018. Upon valuation the comparative market method and income approach were used. In the appraisal report submitted to the Bank, the appraiser stated that the carrying amounts of buildings owned by the Bank did not depart significantly from their market values so that the total increase in their vale amounted to RSD 2,567 thousand. The effects of the revaluation performed were recognized in the amount of the certified appraiser's assessment within equity.

If the Bank were to apply the cost model less accumulated depreciation for measurement of the buildings owned by the Bank, the carrying value of its buildings would have amounted to RSD 324,243 thousand (2017: RSD 336,866 thousand).

Fair value of the Bank's buildings as of December 31, 2018 is presented as follows:

	Level 1	Level 2	Level 3	Total
Buildings	-	-	448,325	448,325
Total	**-**	**-**	**448,325**	**448,325**

Fair value of the Bank's buildings as of December 31, 2017 is presented as follows:

	Level 1	Level 2	Level 3	Total
Buildings	-	-	475,163	475,163
Total	**-**	**-**	**475,163**	**475,163**

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

19. INTANGIBLE ASSETS, PROPERTY, EQUIPMENT AND INVESTMENT PROPERTY (Continued)

The table below presents valuation techniques and significant unobservable inputs used in valuation of building properties:

Valuation technique	Significant unobservable inputs	Relationship between the key unobservable inputs and the fair value The assessed fair value would increase/(decrease) if
Upon appraisal of the Bank's properties, the income approach and comparative market method were used. The income approach considers the income that will be generated from the use of the property during its useful life, and the value is calculated by applying an appropriate capitalization rate to the rental income. The comparative method is based on the comparison of the assessed property to the identical or similar properties for which there is available information on the transactions realized and prices achieved.	Prices of properties in the local real estate market were observed and building properties comparable to the Bank's buildings were found. As of December 31, 2018, the comparable market prices at locations in Belgrade ranged from EUR 1,450 to EUR 3,000 per square meter, from EUR 100 to EUR 1,500 per square meter at locations in Čačak, Gornji Milanovac and Jagodina, from EUR 200 to EUR 1,000 per square meter in Kraljevo and from EUR 400 to EUR 1,000 per square meter in Kruševac and Užice.	the prices of comparable properties in the local market increased/(decreased)

The property revaluation process

The property revaluation is performed once every three years based on the appraisal reports prepared by qualified independent appraisers hired by the Bank, while the Bank internally reviews and reassess the market values of the building properties on an annual basis. The most recent appraisal performed by independent appraisers was made in December 2018.

The appraisal reports are prepared based on:

- the information obtained from the Bank on the current rent amounts, lease contract terms, utility service prices, amounts of capital expenditures made by the Bank, etc; such information is taken from the Bank's systems for finance management, property and collateral management and is subject to the general controls within the control environment;

- the assumptions and models used by the appraisers for revaluation of the Bank's property are usually market-bases, such as comparable prices, and depend on the professional estimates and judgments made by the appraisers, as well as on their observation of the market.

Information and data the Bank provides to the independent appraisers as well as the assumptions and models applied by the appraisers are subject to review of the Collateral Management Department and the Director of the Finance Management and Planning Division. Such a review entails analyses of changes in the fair values of the property items over the year. If the Director of the Finance Management and Planning Division finds the appraisal report adequate, the report is submitted to the Bank's Executive Board. The Executive Board considers and discusses the appraisal report as part of its regular activities.

In 2018 the Bank recorded the revaluation effects in accordance with the appraisal reports within equity.

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

19. INTANGIBLE ASSETS, PROPERTY, EQUIPMENT AND INVESTMENT PROPERTY (Continued)

c) Equipment

	December 31, 2018	December 31, 2017
Cost		
Balance as of January 1	956,677	873,075
Additions	159,072	94,517
Sales	(10,728)	(10,915)
Disposals and write-offs	(9,367)	-
Balance as of December 31	1,095,654	956,677
Accumulated depreciation		
Balance as of January 1	613,998	545,987
Charge for the year	99,033	78,927
Sales	(10,728)	(10,915)
Disposals and write-offs	(9,367)	(1)
Balance as of December 31	692,938	613,998
Net book value as of December 31	**402,716**	**342,679**

The largest portion of additions to the Bank's equipment made in 2018 relates to the purchases of IT equipment (RSD 35,533 thousand) and equipment for refurbishment of the newly opened branches (RSD 63,897 thousand).

d) Investment Property

	December 31, 2018	December 31, 2017
Cost		
Balance as of January 1	152,813	147,643
Additions	1	5,170
Balance as of December 31	152,814	152,813
Accumulated depreciation		
Balance as of January 1	25,086	21,306
Charge for the year	3,845	3,780
Balance as of December 31	28,931	25,086
Net book value as of December 31	**123,883**	**127,727**

The Bank's rental income – from the lease of investment property – amounted to RSD 1,476 thousand in 2018 (2017: RSD 2,987 thousand). Costs associated with the leases and incurred in earning the rental income (reinvoced to the lessees) amounted to RSD 446 thousand in 2018 (2017: RSD 1,277 thousand).

The appraised value of investment property according to the certified appraiser's report as at November 30, 2018 amounted to RSD 126,280 thousand. It was concluded that the fair value of investment property as of the reporting date did not depart from the carrying amount thereof.

Fair value of the Bank's investment property as of December 31, 2018 is presented as follows:

	Level 1	Level 2	Level 3	Total
Investment property	-	-	123,883	123,883
Total	**-**	**-**	**123,883**	**123,883**

Fair value of the Bank's investment property as of December 31, 2017 is presented as follows:

	Level 1	Level 2	Level 3	Total
Investment property	-	-	127,727	127,727
Total	**-**	**-**	**127,727**	**127,727**

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

19. INTANGIBLE ASSETS, PROPERTY, EQUIPMENT AND INVESTMENT PROPERTY (Continued)

Valuation technique	**Significant unobservable inputs**	**Relationship between the key unobservable inputs and the fair value** The assessed fair value would increase/(decrease) if
Upon appraisal of the Bank's properties, the income approach and comparative market method were used. The income approach considers the income that will be generated from the use of the property during its useful life, and the value is calculated by applying an appropriate capitalization rate to the rental income. The comparative method is based on the comparison of the assessed property to the identical or similar properties for which there is available information on the transactions realized and prices achieved.	Prices of properties in the local real estate market were observed and building properties comparable to the Bank's investment property buildings were found. At December 31, 2018, the comparable market prices at locations in Belgrade ranged from EUR 1,700 to EUR 3,000 per square meter, and from EUR 150 to EUR 1,000 per square meter in Čačak.	the prices of comparable properties in the local market increased/(decreased)

As of December 31, 2018, the Bank had proper title deeds of the investment properties in its possession with no encumbrances registered over the assets, except for two properties whose net present value as of December 31, 2018 amounted to RSD 78,295 thousand (2017: RSD 81,894 thousand).

The investment property revaluation process

The property revaluation is performed once every three years based on the appraisal reports prepared by qualified independent appraisers hired by the Bank, while the Bank internally reviews and reassess the market values of the building properties on an annual basis. The most recent appraisal performed by independent appraisers was made in December 2018.

The appraisal reports are prepared based on:

- the information obtained from the Bank on the current rent amounts, lease contract terms, utility service prices, amounts of capital expenditures made by the Bank, etc; such information is taken from the Bank's systems for finance management, property and collateral management and is subject to the general controls within the control environment;

- the assumptions and models used by the appraisers for revaluation of the Bank's property are usually market-bases, such as comparable prices, and depend on the professional estimates and judgments made by the appraisers, as well as on their observation of the market.

Information and data the Bank provides to the independent appraisers as well as the assumptions and models applied by the appraisers are subject to review of the Collateral Management Department and the Director of the Finance Management and Planning Division. Such a review entails analyses of changes in the fair values of the property items over the year. If the Director of the Finance Management and Planning Division finds the appraisal report adequate, the report is submitted to the Bank's Executive Board. The Executive Board considers and discusses the appraisal report as part of its regular activities.

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

20. OTHER ASSETS

	December 31, 2018	December 31, 2017
Receivables for calculated fees and commissions related to other assets	9,968	9,112
Trade receivables	2,751	4,377
Other receivables from regular operating activities	26,068	40,922
Receivables for accrued interest related to other assets	10	10
Other receivables in RSD	56,701	100,968
Other receivables in foreign currencies	43,070	37,372
Other investments	3,349	3,349
Other deferred expenses	13,038	10,278
Accrued receivables	-	107
Deferred interest expenses in foreign currencies	13,182	13,924
Other prepayments in foreign currencies	611	528
Inventories of materials, tools, spare parts and other inventories	55,288	43,684
	224,036	264,631
Less: Impairment allowance of other assets (Note 10)	(39,041)	(39,233)
TOTAL	**184,995**	**225,398**

The line item of other receivables in RSD mostly relates to receivables per VISA cards from OTP banka a.d. Novi Sad in the amount of RSD 15,670 thousand (2017: RSD 57,841 thousand), and advances paid to suppliers.

The line item of other receivables in foreign currencies pertains for the most part to the advances paid to the lessors to securitize liabilities and compliance with the relevant lease contracts.

21. DEPOSITS AND OTHER LIABILITIES DUE TO BANKS, OTHER FINANCIAL INSTITUTIONS AND THE CENTRAL BANK

	December 31, 2018	December 31, 2017
Deposits due to banks		
Transaction deposits	15,633	14,956
Earmarked deposits	543,408	201,569
Other deposits	3,165,352	2,973,830
Other financial liabilities due to banks	381,325	611,740
Interest and fee liabilities due to banks	606	1,740
Accrued liabilities for accrued interest on deposits and other financial liabilities due to banks	13,488	8,249
Total deposits and other liabilities due to banks and other financial institutions	**4,119,812**	**3,812,084**
Borrowings due to banks		
Borrowings due to banks	2,068,406	2,476,671
Liabilities for accrued interest on borrowings due to banks	5,974	6,208
Deferred expenses for liabilities measured at amortized cost using the effective interest rate	(13,500)	(17,212)
Total borrowings due to banks	**2,060,880**	**840,394**
Total: deposits, borrowings and other liabilities due to banks, other financial institutions and the central bank	**6,180,692**	**6,277,751**

The line item of other deposits refers to short-term RSD deposits of banks and insurance companies in the amount of RSD 689,112 thousand and to foreign currency deposits of other financial institutions in the amount of RSD 112,348 thousand, as well as foreign banks - Turkiye Halk Bankasi A.S. Head Office in the amount of RSD 2,363,892 thousand (2017: RSD 1,777,091 thousand). Short-term RSD deposits were mostly placed for periods of up to a year at interest rates from 1.9% to 4.1% p.a., while foreign currency deposits of domestic banks and other financial institutions with maturities of up to 7 days accrued interest at rates from 0.05% to 0.2% p.a., and those placed for periods of up to 6 months accrued interest at the rate of 1.2% p.a. The Parent Bank's deposits were mostly placed for periods of up to 7 days at an interest rate of 0.25% p.a.

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

21. DEPOSITS AND OTHER LIABILITIES DUE TO BANKS, OTHER FINANCIAL INSTITUTIONS AND THE CENTRAL BANK (Continued)

The line item of other financial liabilities due to banks mostly relates to:

- RSD financial liabilities due to domestic banks (UniCredit Bank Srbija AD) for contracted purchase and sale of foreign currency cash in the amount of RSD 59,100 thousand;
- Foreign currency financial liabilities relate to liabilities for contracted purchase and sale of foreign currency cash to: the National Bank of Serbia in the amount of RSD 118,173 thousand an Commerzbank AG, Frankfurt in the amount of RSD 127,185 thousand.

The item of borrowings due to banks in the amount of RSD 2,068,406 thousand in 2018 (2017: RSD 2,476,671 thousand) refers to the following credit lines: Demir-Halk Bank (Netherlands) NV, European Fund for Southeast Europe (EFSE) and Green for Growth Fund (GGF) credit line. The borrowings were obtained at interest rates ranging from 2.1% plus 6-month EURIBOR to 2.7% plus 6-month EURIBOR.

Maturities of borrowings due to banks:

Creditors	in EUR ‘000 Balance at December 31, 2018	in RSD ‘000 Balance at December 31, 2018	in EUR ‘000 Maturing in 2019	in RSD ‘000 Maturing after 2019
Demir-Halk Bank (Netherlands)	2,500	295,487	2,500	-
Green for Growth Fund (GGF)	5,000	590,973	294	4,706
European Fund for Southeast Europe	10,000	1,181,946	2,857	7,143
TOTAL	**17,500**	**2,068,406**	**5,651**	**11,849**

Creditors	in EUR ‘000 Balance at December 31, 2017	in RSD ‘000 Balance at December 31, 2017	in EUR ‘000 Matures in 2018	in RSD ‘000 Matures in 2019 and after 2019
Demir-Halk Bank (Netherlands)	5,000	592,364	2,500	2,500
Green for Growth Fund (GGF)	5,905	699,580	905	5,000
European Fund for Southeast Europe	10,000	1,184,727	-	10,000
TOTAL	**20,905**	**2,476,671**	**3,405**	**17,500**

22. DEPOSITS AND OTHER LIABILITIES DUE TO CUSTOMERS

	December 31, 2018	December 31, 2017
Deposits due to customers		
Transaction deposits	14,215,085	10,134,074
Savings deposits	10,451,981	8,220,491
Deposits securitizing loans	2,001,368	1,606,906
Earmarked deposits	505,130	311,067
Other deposits	5,066,022	3,176,552
Other financial liabilities due to customers	69,371	132,648
Interest and fee liabilities due to customers	2,320	1,592
Accrued liabilities for interest payable on deposits and other financial liabilities to customers	87,141	67,479
Total deposits and other liabilities due to customers	**32,398,418**	**23,650,809**
Borrowings due to customers		
Borrowings due to customers	6,765,419	5,109,228
Liabilities for accrued interest on borrowings	2,320	2,682
Deferred expenses for liabilities measured at amortized cost using the effective interest rate	(158)	(621)
Total borrowings due to customers	**6,767,581**	**5,111,289**
Total deposits, borrowings and other liabilities due to customers	**39,165,999**	**28,762,098**

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

22. DEPOSITS AND OTHER LIABILITIES DUE TO CUSTOMERS (Continued)

RSD and foreign currency demand deposits and current accounts of retail customers are non-interest bearing, i.e., they were deposited at the annual interest rate of 0.0%.Short-term retail deposits were deposited at annual interest rates ranging from 2.0% to 4.0% for RSD funds, and from 0.1% to 1.6% foreign currency funds. Long-term retail deposits in foreign currencies were deposited at annual interest rates ranging from 0.7% do 1.6%.

By ongoing monitoring of market trends, individual and proactive approach to the customers, the Bank increased the amount of corporate customer deposits by 50.04%. With its offer of several types of deposit products, the Bank provided its clients with adequate funds management, resulting in an increase of deposits of private individuals by 26.58% with the Bank's market share reaching 1.29%.

Deposits of corporate clients denominated in RSD were placed at interest rates ranging from 0.5% p.a. to 3.65% p.a., while deposits denominated in foreign currency were placed at interest rates ranging from 0.1% to 1.40% p.a.

Borrowings refer to long-term loans approved to the Bank by the European Investment Bank with the mediation of NBS in the amount of EUR 48.4 million, the German Development Bank – Kreditanstalt für Wiederaufbau (KfW) in the amount of EUR 0.9 million and the European Agency for Reconstruction in the amount of EUR 7.3 million. In addition, the Bank obtained borrowings from the Government of the Republic of Italy in the amount of EUR 0.6 million.

In accordance with the loan agreements concluded with the International Financial Institutions, the German Development Bank (KfW), European Fund for Southeast Europe (EFSE) and the Green for Growth Fund (GGF), the Bank is required maintain certain financial indicators at the defined levels until the final repayment of the borrowings.

As at December 31, 2018, the Bank was in full compliance with the defined covenants:

In accordance with the loan agreements concluded with the said International Financial Institutions, the Bank reports on a regular basis on the performance of its operating indicators and provides detailed explanations for each covenant breached. The Bank expects no adverse responses from creditors in this respect.

Maturities of borrowings due to customers

							EUR '000
Creditors	**Balance at 31, December 2018**	**Balance at 31, December 2018**	**Matures in 2019**	**Matures in 2020**	**Matures in 2021**	**Matures in 2022**	**Matures after 2022**
EIB	48,441	5,725,497	6,898	8,455	6,482	4,801	21,805
KFW	909	107,450	909	-	-	-	-
FRK	7,323	865,516	3,456	2,106	1,242	450	69
Government of Republic of Italy	567	66,956	161	146	130	130	-
TOTAL	**57,240**	**6,765,419**	**11,424**	**10,707**	**7,854**	**5,381**	**21,874**

Creditors	**EUR '000 Balance at 31, December 2017**	**RSD '000 Balance at 31, December 2017**	**Matures in 2018**	**Matures in 2019**	**Matures in 2020**	**Matures in 2021**	**Matures in 2022**	**EUR '000 Matures after 2022**
EIB	31,392	3,719,147	6,934	6,898	6,952	4,361	2,469	3,778
KFW	1,818	215,405	909	909	-	-	-	-
FRK	9,159	1,085,062	4,523	2,969	1,165	330	172	-
Government of Republic of Italy	756	89,614	189	161	146	130	130	-
TOTAL	**43,125**	**5,109,228**	**12,555**	**10,937**	**8,263**	**4,821**	**2,771**	**3,778**

Borrowings due to customers were approved to the Bank at the following annual interest rates:

- from 0.85 to 3.45% - fixed annual interest rates;
- 0.75% plus 3-month LIBOR for EUR loans;
- from 0.32% to 0.96% p.a. + 3-month EURIBOR; and
- from 0.36% to 0.45% p.a. + 6-month EURIBOR.

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

23. PROVISIONS

	December 31, 2018	December 31, 2017
a) Movements on provisions for potential losses on off-balance sheet items		
Balance as of January 1	5,055	9,569
Reversal of provisions due to IFRS 9 first-time adoption effects	(200)	-
Charge for the year (Note 10a)	4,476	4,625
Reversal of provisions (Note 10a)	(5,019)	(9,139)
Balance as of December 31	**4,312**	**5,055**
b) Movements on provisions for retirement benefits		
Balance as of January 1	27,139	29,523
Charge for the year (Note 11)	51,497	5,520
Reversal of provisions (Note 11)	-	(5,311)
Release of provisions	-	(3,583)
Actuarial losses	829	990
Balance as of December 31	**79,465**	**27,139**
c) Movements on the provisions for litigations		
Balance as of January 1	7,149	-
Charge for the year	6,751	7,149
Balance as of December 31	**13,900**	**7,149**
d) Movements on the provision for short-term severance pays		
Balance as of January 1	-	3,374
Charge for the year	-	-
Release of provisions	-	(3,374)
Balance as of December 31	**-**	**-**
TOTAL	**97,677**	**39,343**

Provisions for potential losses in the amount of RSD 4,312 thousand (2017: RSD 5,055 thousand) were created per guarantees and other off-balance sheet items.

Provisioning charge for employee benefits mostly relates to the short-term retirement benefit provisions.

In respect of the lawsuits filed against Bank and the relating claims, according to the status of the cases as of December 31, 2018, the Bank made a provision of RSD 13,900 thousand (2017: RSD 7,149 thousand).

24. OTHER LIABILITIES

	December 31, 2018	December 31, 2017
Trade payables	57,395	46,973
Advances received	60,073	99,427
Liabilities from consignment operations	167	189
Other operating liabilities	100,677	58,590
Liabilities in settlement	16,237	4,483
Temporary and suspense accounts	476	768
Liabilities for employee salaries	-	1,000
VAT liabilities	7,589	3,848
Liabilities for other taxes and contributions payable	1,689	1,486
Accrued liabilities	27,557	10,539
Deferred other income	30,588	22,679
Other accruals – subsidized interest	5,305	18
Other liabilities	1,284	278
TOTAL	**309,037**	**250,278**

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

24. OTHER LIABILITIES (Continued)

Trade payables totaling RSD 57,395 thousand pertain to the liabilities arising from the Bank's regular operations, which were paid in January 2019.

The line item of advances received relates to the payments received from customers for loan repayment liabilities not yet matured in the amount of RSD 53,785 thousand.

The line item of other operating liabilities mostly consists of liabilities for Banksoft licenses (RSD 56,261 thousand) and liabilities per securities sold and dividend payable in RSD – clients without current accounts (RSD 32,457 thousand). Liabilities in respect of securities sold and dividend payable in RSD pertain to the customers taken over from the broker-dealer companies that discontinued their business, in accordance with the rules of business operation of the Central Register of Securities.

Accrued liabilities refer to the costs incurred in the current reporting period for which the Bank had not received invoices and other relevant documents required for posting until the reporting date, so they were accrued.

25. EQUITY

Equity and the Bank's Share Capital

In accordance with the Articles of Association and the Statute, the Bank's equity consists of:
- share capital
- share premium
- profit and
- reserves.

The Bank is managed by its founders commensurately to their holdings of the Bank's ordinary shares, in accordance with the Bank's Articles of Association and the Statute.

Breakdown of the Bank's equity as at December 31, 2018 and 2017 is provided in the following table:

	December 31, 2018	December 31, 2017
Share capital – ordinary shares	5,658,940	1,819,820
Share capital – preference shares	601,340	601,340
Share premium	2,712,323	1,827,323
Revaluation reserves	452,553	364,162
Reserves from profit	1,312,431	1,312,431
Prior years' retained earnings	52,373	-
Current year's profit	361,725	194,631
TOTAL	**11,151,685**	**6,119,707**

The Bank's share capital consists of 565,894 ordinary (common stock) shares and 60,134 preference shares with the par value of RSD 10,000 per share. The total equity of the Bank consists of share capital in the amount of RSD 6,260,280 thousand (2017: RSD 2,421,160 thousand), share premium in the amount of RSD 2,712,323 thousand (2017: RSD 1,827,323 thousand), reserves from profit in the amount of RSD 1,312,431 thousand (2017: RSD 1,312,431 thousand), and revaluation reserves in the amount of RSD 452,553 thousand (2017: RSD 364,162 thousand). In 2018 the Bank realized and reported profit of RSD 361,725 thousand (2017: RSD 194,631 thousand).

The Bank is required to maintain the minimum capital adequacy ratio of 8% as prescribed by the National Bank of Serbia. The Bank's capital adequacy ratio as at December 31, 2018 was 27.82% (2017: 17.11%), which is well above the minimum prescribed by the National Bank of Serbia.

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

25. EQUITY (Continued)

Breakdown of Reserves

	December 31, 2018	December 31, 2017
Revaluation reserves		
Reserves from changes in the value of fixed assets	305,273	302,707
Reserves from changes in the value of RSD debt instruments	111,902	54,579
Reserves from changes in the value of foreign currency debt instruments	32,035	2,704
Actuarial gains	3,343	4,172
Total revaluation reserves	452,553	364,162
Reserves from profit	1,312,431	1,312,431
TOTAL	**1,764,984**	**1,676,593**

Reserves arising from revaluation of property, plant and equipment relate to effects of appraisal of the Bank's buildings from previous years and 2018. Reserves from changes in the value of securities (debt instruments) relate to the effects of fair value adjustments of securities measured at fair value through the other comprehensive income (FVtOCI) as of December 31, 2018, and the effects of fair value adjustments of securities available for sale as of December 31, 2017. The actuarial gains relate to the effects of changes in the value of employee retirement benefits determined by the actuarial assessment. Reserves from profit relate to cumulative effects of profit distribution and loss absorption from previous years.

Basic Earnings per Share

	December 31, 2018	December 31, 2017
Net profit for the year	361,725	194,631
Weighted average number of shares outstanding	565,894	181,982
Earnings per share in RSD	**639**	**1,070**

The Bank's Shareholders as of December 31, 2018

		RSD '000				Interest share (%)			
No.	**Shareholder**	**Ordinary Shares**	**Cumulative preference shares**	**Other preference shares**	**TOTAL**	**Ordinary Shares**	**Cumulative preference shares**	**Other preference shares**	**TOTAL**
1.	Turkiye Halk Bankasi a.s.	5,658,940	1,340	600,000	6,260,280	100,00	100,00	100,00	100,00
	TOTAL	**5,658,940**	**1,340**	**600,000**	**6,260,280**	**100,00**	**100,00**	**100,00**	**100,00**

The Bank's Shareholders as of December 31, 2017

		RSD '000				Interest share (%)			
No.	**Shareholder**	**Ordinary Shares**	**Cumulative preference shares**	**Other preference shares**	**TOTAL**	**Ordinary Shares**	**Cumulative preference shares**	**Other preference shares**	**TOTAL**
1.	Turkiye Halk Bankasi a.s.	1,817,640	900	600,000	2,418,540	99.88	67.16	100.00	99.89
2.	Mera invest doo Beograd	2,020	-	-	2,020	0.11	-	-	0.08
3.	SP Jugoprevoz DP Jagodina – in bankruptcy	-	440	-	440	-	32.84	-	0.02
4.	Mk rudnik ad Gornji Milanovac	130	-	-	130	0.01	-	-	0.01
5.	Milka Ćirović	20	-	-	20	-	-	-	-
6.	Ortačko društvo Agro Sašex	10	-	-	10	-	-	-	-
	TOTAL	**1,819,820**	**1,340**	**600,000**	**2,421,160**	**100.00**	**100.00**	**100.00**	**100.00**

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

25. EQUITY (Continued)

Basic Earnings per Share (Continued)

In 2018, the Bank increased its issued (share) capital through new share issues (31st and 32nd share issues).

- The first capital increase was conducted on February 20, 2018 through a new issue of 236,412 ordinary (common stock) shares with the par value of RSD 10,000 per share. Thereby the Bank's share capital was increased from RSD 4,248,483 thousand to RSD 6,612,603 thousand. The selling price amounted to RSD 10,000 per share, i.e., the capital was paid in without a share issue premium.

- Another capital increase was conducted on August 1, 2018 through a new share issue totaling RSD 2,360,000 thousand. The Bank issued 147,500 ordinary shares with the par value of RSD 10,000 per share. The total par value of the shares issued amounted to RSD 1,475,000 thousand. The ordinary shares issued were sold at the price of RSD 16,000 per share, which price was defined under the Decision on the Price for the 32nd Ordinary Share Issue Price enacted by the Bank's Shareholder Assembly. The difference between the share issue selling price and the par value of shares represent the share issue premium.

As of December 31, 2018, Turkiye Halk Bankasi AS was the sole (100%) of the Bank's shares.

December 31, 2018	Total Shares	Turkiye Halkbankasi	% Turkiye Halkbankasi	December 31, 2017	Total Shares	Turkiye Halkbankasi	% Turkiye Halkbankasi
Ordinary shares	565,894	565,894	100.00%	Ordinary shares	181,982	181,764	99.88%
Preference shares	60,134	60,134	100.00%	Preference shares	60,134	60,090	99.93%
Total	**626,028**	**626,028**	**100.00%**	**Total**	**242,116**	**241,854**	**99.89%**

26. OFF-BALANCE SHEET ITEMS

	December 31, 2018	December 31, 2017
a) Managed funds	**271,833**	**278,305**
b) Guarantees, sureties and irrevocable commitments		
Guarantees in RSD	6,128,796	4,034,871
Guarantees in foreign currencies	1,750,597	1,106,581
Total guarantees	7,879,393	5,141,452
Irrevocable commitments for undrawn loans in RSD	1,813,172	1,231,859
Irrevocable commitments for undrawn loans in foreign currencies	-	27,249
Total irrevocable commitments for undrawn loans	1,813,172	1,259,108
Total guarantees and irrevocable commitments	**9,692,565**	**6,400,560**
c) Financial assets pledged as collateral	**-**	**-**
d) Derivatives held for trading at the agreed value	**1,579,341**	**36,024**
e) Other off-balance sheet items		
Calculated suspended interest	4,713,469	4,542,059
Commitments for framework loans and facilities	6,197,659	3,929,284
Other off-balance sheet items	36,637,792	37,448,579
Total other off-balance sheet items	**47,548,920**	**45,919,922**
TOTAL	**59,092,659**	**52,634,811**

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

26. OFF-BALANCE SHEET ITEMS (Continued)

The line item of irrevocable commitments for undrawn (undisbursed) loans in RSD at December 31, 2018 relates to the approved yet unused corporate loans in the amount of RSD 1,626,133 thousand (2017: RSD 1,050,767 thousand), unused retail loans the amount of RSD 166,453 thousand (2017: RSD 161,156 thousand) and unused loans approved to entrepreneurs in the amount of RSD 20,587 thousand (2017: RSD 19,936 thousand).

The line item of other off-balance sheet items includes all tangible and intangible assets the Bank obtained as collateral securitizing repayment of loans totaling RSD 31,985,851 thousand at December 31, 2018 (2017: RSD 33,841,686 thousand).

In addition, as of December 31, 2018 other off-balance items included:

- receivables for suspended (broken period) interest in the amount of RSD 4,713,469 thousand (2017: RSD 4,542,059 thousand);
- bonds of the Republic of Serbia for prior deposited foreign currency savings in the amount of RSD 755,411 thousand (2017: RSD 777,689 thousand);
- assumed commitments per framework loans in the amount of RSD 6,197,659 thousand (2017: RSD 3,929,284 thousand); and
- other off-balance sheet items in the amount of RSD 3,896,530 thousand (2017: RSD 2,829,204 thousand).

As of December 31, 2018, within other off-balance sheet items the amount of RSD 3,208,517 thousand (2017: RSD 2,149,401 thousand) refers to the direct write-offs of receivables made under the relevant decisions of the Board of Directors and the accounting write-off in accordance with Decision on the Accounting Write-Off of Bank Balance Sheet Assets of the National Bank of Serbia, effective as from September 30, 2017. Within the meaning of this Decision, the accounting write-off is a write-off of a non-performing loan when the amount of the impairment of that loan calculated by the bank and credited to allowance for impairment equals 100% of its gross carrying amount. The Bank does not give up recovery of its receivables subject to the accounting write-off but simply transfers such receivables to the off-balance sheet items.

The Bank's commitments per operating lease arrangements, i.e. leases of business premises, ATMs and automobiles are presented in the following table:

	December 31, 2018	**December 31, 2017**
Commitments with maturity:		
- up to one year	3,261	10,194
- between 1 and 5 years	553,969	254,488
- over 5 years	58,505	506,370
TOTAL:	**615,735**	**771,052**

The Bank's total expenses per operating lease arrangements amounted to RSD 237,303 thousand in 2018 (2017: RSD 193,853 thousand).

27. RELATED PARTY DISCLOSURES

The Bank enters into transactions with its related parties. All balances of receivables and payables at the reporting date, as well as income and expenses realized/ incurred during the year, are the result of common regular business activities. The Bank charges and pays interest on its receivables and liabilities arising from the related party transactions, calculated by applying the usual interest rates.

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

27. RELATED PARTY DISCLOSURES (Continued)

The following table presents the total exposure to related parties that may have an impact on the Bank's performance:

	December 31, 2018	December 31, 2017
a) Loans, deposits and other receivables		
The parent and entities under the joint control of the parent		
Turkiye Halk Bankasi AS	1,078,895	314,550
Halkbank a.d. Skopje	69,750	86,496
Other related parties		
RVM d.o.o.	76,552	-
Company TGK d.o.o. Čačak	28,447	26,064
Tax Free d.o.o. Beograd	8,174	-
Inceptus d.o.o. Čačak	5,182	-
DOO Duomos Novi Pazar	3,912	-
Animals d.o.o. Aranđelovac	3,098	-
Agrohemija d.o.o. Čačak	2,237	3,866
Profesional 2000 d.o.o. Gornji Milanovac	1,328	578
Other entities	3,175	1,091
Individuals	346,786	140,981
TOTAL:	**1,627,536**	**573,626**
b) Borrowings, deposits and other liabilities		
The parent and entities under the joint control of the parent		
Turkiye Halk Bankasi AS	2,363,974	1,777,091
Other related parties		
Demir Halkbank Netherlands	295,867	592,364
Profesional 2000 d.o.o. Gornji Milanovac	4	-
Company TGK d.o.o. Čačak	2	-
Individuals	195	167,079
TOTAL:	**2,660,042**	**2,536,534**
c) Off-balance sheet items		
The parent and entities under the joint control of the parent		
Halkbank a.d. Skopje	118,195	118,473
Turkiye Halk Bankasi AS	15,072	5,935
Other related parties		
Ninex d.o.o. Čačak – in bankruptcy	67,049	67,388
RVM d.o.o.	17,702	-
Agrohemija d.o.o. Čačak	4,046	5,831
Quince M Pro d.o.o. Beograd Zemun	-	7,390
Company TGK d.o.o. Čačak	4,246	4,254
Company Silver d.o.o. Čačak	2,238	546
Profesional 2000 d.o.o. Gornji Milanovac	1,345	300
Other entities	1,541	1,000
Individuals	22,300	14,386
TOTAL:	**253,734**	**225,503**

Borrowings and deposits approved and received from the parent entity and entities under the joint control and/or significant influence of the Bank's parent were extended to and placed with the Bank at the prevailing market interest rates disclosed in Notes 17, 18, 21 and 22 to the accompanying financial statements.

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

27. RELATED PARTY DISCLOSURES (Continued)

	December 31, 2018.	December 31, 2017.
d) Interest, fee and commission income		
The parent and entities under the joint control of the parent		
Turkiye Halk Bankasi AS	2,828	1,447
Other related parties		
RVM d.o.o.	2,115	-
Company TGK d.o.o. Čačak	770	522
Animals d.o.o. Aranđelovac	513	-
Agrohemija d.o.o. Čačak	244	410
Inceptus d.o.o. Čačak	179	-
Profesional 2000 d.o.o. Gornji Milanovac	101	101
Company Silver doo Čačak	87	-
Ivex Drink d.o.o. Ivanjica	67	-
Company Interprogres Čačak	65	38
DOO Duomos Novi Pazar	44	-
TIBO Kompanija doo Beograd Mladenovac	29	26
Jelena Mijailović PR	24	14
Tax Free d.o.o. Beograd	20	-
Big Win d.o.o.	18	-
ST-KR Dekoratex	15	-
Ena Ugljanin PR	15	-
Transport Grujičić Milovan PR	8	7
Other entities	162	34
Individuals	19,284	8,283
TOTAL:	**26,588**	**10,882**
e) Interest, fee and commission expenses		
The parent and entities under the joint control of the parent		
Turkiye Halk Bankasi AS	4,813	2,458
Halkbank a.d. Skopje	-	18
Entities under the significant influence of the parent		
Demir Halkbank Netherlands	15,101	16,466
Other related parties		
Agrohemija d.o.o. Čačak	-	1
Company Interprogres Čačak	-	3
PD Banprom d.o.o. Pirot	-	-
Company Silver doo Čačak	-	-
Individuals	653	423
TOTAL:	**20,567**	**19,369**

Gross remunerations to the Chairmen and members of the Bank's Board of Directors and Executive Board in 2018 amounted to RSD 51,804 thousand (2017: RSD 48,984 thousand). Net remunerations to the Chairmen and members of the Board of Directors and Executive Board in 2018 amounted to RSD 41,842 thousand (2017: RSD 39,308 thousand).

28. RISK MANAGEMENT

Introduction

In accordance with the effective Law on Banks (Official Gazette of RS nos. 107/2005, 91/2010 and 14/2015), NBS Decision on Risk Management by Banks (Official Gazette of RS nos. 45/2011, 94/2011, 119/2012, 123/2012, 23/2013 – the other decision, 43/2013, 92/2013, 33/2015, 61/2015, 61/2016, 103/2016, 119/2017 and 76/2018), NBS Decision on Bank Liquidity Risk Management (Official Gazette of RS nos. 103/2016), and the Bank's internally adopted policies, methodologies and procedures, Halkbank a.d. Beograd (the " Bank") has identified the following risks it is exposed to in its operations:

- Liquidity risk;
- Credit risk, which includes the residual risk, downgrade risk, settlement/free delivery risk, counterparty risk, credit-interest rate risk, credit-foreign exchange risk and concentration risk;
- Risk of incurring losses due to the external factors;
- Interest rate risk;
- Market risks, which include foreign exchange risk, price risks and commodity risk;
- Risk of outsourcing;
- Risk of money laundering and terrorism financing;
- Risk relating to the introduction of new products/services;
- Investments risks relating to investments in other entities and own fixed assets;
- Country risk relating to the country of origin of the counterparty;
- Operational risk, including legal risk;
- Reputation risk;
- Strategic risk;
- Regulatory compliance risk, which includes the risk of sanctions by the regulator, risk of financial loss and reputation risk; and
- Environmental risk.

The Bank's objectives in risk management, defined within the risk management system, are minimization of the adverse effects of the Bank's exposure to the above listed risks on the Bank's performance and capital with simultaneous adherence to the defined limits of the acceptable risk levels and maintenance of the required capital adequacy ratio. During 2018 the Bank did not amend the objectives of risk management as specified above, but it significantly improved the risk management framework and adequate articulation of the overall risk management objectives by introducing new strategies, policies, procedures, methodologies and instructions.

In 2018, the Bank improved the risk management processes by completing the following activities:

- Adoption of new policies, methodologies and procedures relating to:
  - Risk appetite framework;
  - Statement on the risk assumption appetite;
  - Identification of material risk;
  - Calculation of internal capital requirements; and
  - Stress testing of the material risks;
- Alignment of and improvement to the existing strategies, policies, procedures, methodologies and instructions relating to the risk identification, measurement, assessment, mitigation and management and capital management.

The Bank's risk management system in place is comprised of:

- Risk management strategies and policies as well as the procedures and instructions for risk identification, measurement, assessment and management;
- Risk aptitude – the Bank's intention to assume risks in order to implement its strategies and policies (the risk structure) and definition of the acceptable levels of the assumed risks (risk tolerance);
- Risk profile – the Bank's estimate of the structure and levels of all the risks it is or may be exposed to in the course of its operations;
- Risk appetite framework (RAF) – the overall approach, including strategies, policies, procedures, processes, controls and systems for establishing, communicating and reviewing the roles and responsibilities of the Bank's organizational units in charge of supervising RAF implementation and monitoring. RAF considers risks material to the Bank, as well as to the high esteem and reputation of the Bank among its customers, depositors, creditors and in the market in general. RAF is aligned with the Bank's business strategy;
- Risk appetite statement (RAS) – represents an aggregate risk level the Bank is ready and willing to accept, or avoid, in order to achieve its business goals; it includes qualitative descriptions, and quantitative measures expressed as relative to the income, capital, risk measurement, liquidity and other relevant indicators. In addition, RAS enables quantification of the risk levels that are difficult to measure, such as the reputation risk, compliance risk and risks of money laundering and terrorism financing.

28. RISK MANAGEMENT (Continued)

Introduction (Continued)

- Internal organization, i.e., organizational structure that ensures functional and organizational separation of the risk management activities from the risk assumption activities, with clearly defined segregation of duties for employees, which prevents conflicts of interests;
- Effective and efficient risk management process entailing mitigation, monitoring and control of the risks the Bank is or may be exposed to;
- Internal control system as a set of processes and procedures in place intended to ensure adequate risk control, operational effectiveness and efficiency monitoring, financial and other data reliability and compliance with the effective legislation and the Bank's internal bylaws with a view to achieve safe and stable banking operations;
- Adequate information system.

The Bank's Board of Directors is responsible for establishment of a uniform risk management system throughout the Bank and for supervision of that system. The Board of Directors must ensure that the Bank's Executive Board will identify the risks the Bank is exposed to and control such risks in accordance with the bank's adopted policies and procedures.

The Bank's Executive Board implements the risk management strategies and polices adopted by the Board of Directors, defines procedures, instructions and guidelines for risk identification, measurement, assessment and management, analyzes their efficiency and reports to the Board of Directors on these activities. The Audit Committee is in charge of an ongoing oversight of implementation of the risk management policies and procedures and performance of the internal control system. The Asset and Liability Management Committee ("ALCO") is in charge of monitoring the Bank's exposure to the risks arising from the structure of the Bank's receivables and liabilities and off-balance sheet items, and proposes measures for risk management. The Audit Committee assists the Board of Directors in overseeing the work of the Executive Board and the Bank's employees.

The Competent Credit Committees decide on loan approval and origination of other receivables as well as on the amendments to the contracted terms of such loans and receivables. They decide in the loan recovery matters, including rescheduling and restructuring of loans and all other matters relating to the potentially non-performing, non-performing loans and receivable and bad and doubtful debts.

28.1 Credit Risk

Credit Risk Management

Credit risk is a risk of possible adverse effects on the Bank's financial performance and capital arising from the customers failing to meet their obligations toward the Bank. The effects of this risk are measured by the amount of the Bank's expenses incurred due to the customer default.

The following organizational units of the Bank are responsible for credit risk management:

- The Board of Directors, which defines the risk management strategy and credit risk management policy;
- The Executive Board, which implements the adopted strategy and policy and defines procedures and instructions for risk management;
- ALCO, which monitors the Bank's exposure to the credit risk and proposes adequate measures for credit risk management;
- The Bank's Credit Committees, which approve loans and make decision on all the matters of collection of potential NPLs, NPLs and doubtful receivables;
- Credit Monitoring Department, which assess the customer credit risk; and
- Risk Management Department, which monitors the loan portfolio quality.

Assessment of the credit risk exposure is carried out within the Crediting Division and Risk Management Department. Within the Crediting Department credit risk exposure is assessed upon analysis of the customer loan requests.

Within the Crediting Division credit risk is identified, controlled and monitored at the individual borrower level, through the assessment of the borrower credit rating and collateral quality.

Credit risk identification, control and monitoring on a portfolio basis are performed by the Risk Management Department through preparation and analysis of the report on the Bank's portfolio, control over classification of the balance sheet assets and off-balance sheet items, calculation and recording of reserves for estimated losses, calculation of impairment allowance and provisions and control of the quality of the balance sheet assets and off-balance sheet items.

28. RISK MANAGEMENT (Continued)

28.1 Credit Risk (Continued)

28.1.2 Analysis of the Financial Assets, Financial Liabilities and Off-Balance Sheet Items

The following tables provide the breakdowns of the Bank's financial assets and financial liabilities as of December 31, 2018 and 2017 as per:

- Items of the statement of the financial position, in the net amounts,
- Credit risk exposure, in the gross amounts,
- Impairment, in the gross and net amounts,
- Internal categories in accordance with IFRS 39, in the gross and net amounts,
- Fair value of collaterals, in the gross amounts,
- LTV ratio for financial assets securitized with mortgages,
- Past-due intervals, in the gross and net amounts,
- Industry, in the gross and net amounts,
- Geographic region, in the net amounts,
- Fair value,
- Assets acquired in lieu of debt collection,
- Write-off of receivables, and
- Breakdown of restructured financial assets.

Structure of the Net Financial Assets, Financial Liabilities and Off-Balance Sheet Items

The Bank's financial assets, financial liabilities and off-balance sheet items are presented in the following breakdowns in the net amounts. Loans and receivables due from banks and other financial institutions as well as loans and receivables due from customers are presented net of the collected but not credited to income loan processing fees, which are included in the effective interest rate calculation upon loan approval, and subsequently recognized within interest income using the effective interest rate and net of impairment allowances. As for off-balance sheet items, the Bank has no deferred fees for processing costs (the effective interest method) but defers the fees on a straight-line basis. Therefore, the off-balance sheet items are also presented in the net amounts, i.e., their gross amounts are decreased by the provisions for losses.

As of December 31, 2018, the Bank's cash, cash equivalents and balances held with the central bank increased by RSD 2,803,266 thousand compared to December 31, 2017 and comprised 13.77% of the Bank's total financial assets. Financial assets available recorded an increase by RSD 1,856,837 thousand, and loans and receivables due form customers were by RSD 9,870,221 thousand higher, comprising 69.86% of the Bank's total financial assets.

As of December 31, 2018 the Bank's deposits and other liabilities due to customers increased by RSD 10,403,901 thousand compared to December 31, 2017.

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

28. RISK MANAGEMENT (Continued)

28.1 Credit Risk (Continued)

28.1.2 Analysis of the Financial Assets, Financial Liabilities and Off-Balance Sheet Items (Continued)

Structure of the Net Financial Assets, Financial Liabilities and Off-Balance Sheet Items (Continued)

Financial assets and financial liabilities (on-balance sheet exposure), net

The following table presents the Bank's financial assets classified in accordance with IAS 39:

	December 31, 2018	December 31, 2017
Financial assets	**55,488,326**	**40,259,372**
Cash and balances held with the central bank	7,643,117	4,839,851
Financial assets at fair value through profit or loss, held for trading (including pledged assets)	-	24,758
Financial assets available for sale (including pledged assets)	-	4,359,850
Financial assets held to maturity (including pledged assets)	-	472,892
Loans and receivables due from banks and other financial institutions	2,281,251	1,524,613
Loans and receivables due from customers	38,765,127	28,894,906
Other assets	78,686	142,502
Financial liabilities	**45,614,578**	**35,259,993**
Deposits and other liabilities due to banks, other financial institutions and the central bank	6,180,692	6,277,751
Deposits and other liabilities due to customers	39,165,999	28,762,098
Other liabilities	267,887	220,144

Upon implementation of IFRS 9, the Bank made no reclassification of its financial assets and liabilities. The following table presents the Bank's financial assets classified in accordance with IFRS 9:

	December 31, 2018	December 31, 2017
Financial assets	**55,488,326**	**40,259,372**
Cash and balances held with the central bank	7,643,117	4,839,851
Receivables under financial derivatives	6,278	470
Securities	6,713,867	4,857,030
Loans and receivables due from banks and other financial institutions	2,281,251	1,524,613
Loans and receivables due from customers	38,765,127	28,894,906
Other assets	78,686	142,502
Financial liabilities	**45,614,578**	**35,259,993**
Deposits and other liabilities due to banks, other financial institutions and the central bank	6,180,692	6,277,751
Deposits and other liabilities due to customers	39,165,999	28,762,098
Other liabilities	267,887	220,144

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

28. RISK MANAGEMENT (Continued)

28.1 Credit Risk (Continued)

Off-balance credit risk exposure, net

	December 31, 2018	December 31, 2017
Off-balance sheet items, net	**15,885,912**	**10,324,789**
Guarantees and letter of credit	**7,878,526**	**5,141,392**
Large corporate customers	693,640	603,489
SMEs, micro-sized entities and entrepreneurs	6,770,974	4,523,186
Retail customers	708	10,663
Other customers	413,204	4,054
Commitments per undrawn loans	**8,007,386**	**5,183,397**
Large corporate customers	516,977	271,155
SMEs, micro-sized entities and entrepreneurs	7,251,205	4,672,415
Retail customers	238,776	237,535
Other customers	428	2,292

Gross Credit Risk Exposure

Gross credit risk exposure per loans and receivables due from customers increased by RSD 8,621,219 thousand. Exposure to SMEs, micro business and entrepreneurs rose by RSD 7,740,979 thousand, to large corporate entities by RSD 274,008 thousand, while exposure to retail customers – individuals rose by RSD 3,435,623 thousand. On the other hand, exposure to other customers – non-profit entities, entities involved in social activities and entities in bankruptcy – decreased by RSD 2,424,693 thousand and the exposures to the public sector went down by RSD 404,698 thousand.

Within loans and receivables due from customers, gross, the most significant decrease of 93.86% and 86.35% was recorded by other customers and the public sector, respectively, while the other categories had increases, as follows: retail customers – individuals by 41.60%, SMEs, micro businesses and entrepreneurs by 40.27% and large corporate customers by 26.39%.

Credit risk – gross exposure

	December 31, 2018	December 31, 2017
Financial assets	**56,933,648**	**42,951,415**
Cash and balances held with the central bank	**7,644,011**	**4,839,851**
Receivables under derivative financial instruments	**6,278**	**470**
Securities	**6,713,867**	**4,857,196**
Loans and receivables due from banks and other financial institutions	**2,283,173**	**1,524,692**
Loans and receivables due from customers	**40,194,945**	**31,573,726**
Of which:		
Public sector	63,987	468,685
Large corporate customers	1,312,234	1,038,226
SMEs, micro-sized entities and entrepreneurs	26,965,841	19,224,862
Retail customers - individuals	11,694,196	8,258,573
Other customers	158,687	2,583,380
Other assets	**91,374**	**155,480**

Gross credit risk exposure per off-balance sheet items increased by RSD 5,560,380 thousand as of December 31, 2018 in comparison to December 31, 2017. Gross credit risk exposures per guarantees and letters of credit to large corporate customers, SMEs, micro-sized entities and entrepreneurs as well as other customers increased by RSD 90,157 thousand, RSD 2,248,561 thousand and RSD 409,178 thousand, respectively, while the exposures to the retail customers decreased b RSD 9,954 thousand.

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

28. RISK MANAGEMENT (Continued)

28.1 Credit Risk (Continued)

Gross Credit Risk Exposure (Continued)

Commitments per undrawn loans were by RSD 2,822,438 thousand or 54.40% higher as of December 31, 2018 in comparison to December 31, 2017. The gross exposures in this respect increased toward large corporate customers by RSD 245,792, thousand, toward SMEs, micro-sized entities and entrepreneurs by RSD 2,577,271 thousand and to retail customers by RSD 1,246 thousand, while the gross exposure to other customers (non-profit organizations and entities) fell by RSD 1,871 thousand.

Gross credit risk exposure per off-balance sheet items

	December 31, 2018	December 31, 2017
Off-balance sheet items	**15,890,224**	**10,329,844**
Guarantees and letter of credit	**7,879,393**	**5,141,452**
Large corporate customers	693,646	603,489
SMEs, micro-sized entities and entrepreneurs	6,771,807	4,523,246
Retail customers	709	10,663
Other customers	413,232	4,054
Commitments per undrawn loans	**8,010,830**	**5,188,392**
Large corporate customers	517,027	271,235
SMEs, micro-sized entities and entrepreneurs	7,254,515	4,677,244
Retail customers - individuals	238,858	237,612
Other customers	430	2,301

Total on-balance sheet and off-balance sheet exposures to certain sectors/customer segments were within the prescribed limits:

- For the public sector (government bodies and agencies, the mandatory social insurance funds, the autonomous province, local governance units, legal entities financed from the budget) the prescribed maximum is 10% of the gross balance sheet assets and off-balance sheet items subject to classification; as of December 31, 2018 the share of this sector equaled 0.35%.
- For corporate customers the prescribed maximum is 90% of the gross balance sheet assets and off-balance sheet items subject to classification; as of December 31, 2018 the share of this sector equaled 64.39%.
- For retail customers 25% the prescribed maximum is 25% of the gross balance sheet assets and off-balance sheet items subject to classification; as of December 31, 2018 the share of this sector equaled 20.42%.

Financial Assets – Impairment

Introduction

In accordance with the requirements of IFRS 9, the Bank put in place the methodology for assessing the impairment allowance of the financial assets (Methodology for Calculation of Impairment Allowance under IFRS9). This methodology is applied to all financial instruments measured at amortized cost (AC) and at fair value through other comprehensive income (FVtOCI), except for:

- Investments in subsidiaries, associates and joint ventures accounted for in accordance with IFRS 10 “Consolidated Financial Statements”, IAS 27 “Separate Financial Statements” or IAS 28 “Investments in Associates and Joint Ventures” (save for the instances when IFRS 10, IAS 10, IAS 27 or IAS 28 allow the reporting entity to account for investments in subsidiaries, associates or joint ventures in accordance with some or all of the requirements of IFRS 9);
- Employer rights and obligations per employee benefit plans, within the scope of IAS “Employee Benefits”;
- Rights and obligations within the scope of IFRS 15 “Revenue from Contracts with Customers” that are financial instruments other than those to be accounted for under this standard.

A financial instrument is defined by IAS 32 as a contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity. Therefore, financial assets for the purposes of imapirment requirements are:

- Cash and
- Contractual rights entailing receipts of cash or another financial asset from another entity or exchange of financial assets or financial liabilities with another entity under potentially favorable conditions.

28. RISK MANAGEMENT (Continued)

28.1 Credit Risk (Continued)

Recognition and Modification of Financial Assets

The Bank recognizes a financial asset in its financial statements when it has become a part to the contractual terms of the instrument. Upon initial recognition, the Bank measures a financial asset at fair value increased or decreased by transaction costs that can be directly attributable to the acquisition or issuance of the financial asset.

In some circumstances, renegotiation or modification of the contractual cash flows of a financial asset may lead to derecognition of the existing financial asset in accordance with IFRS 9. When modification of financial assets results in derecognition of the existing assets and subsequent recognition of modified assets, the modified assets will be deemed a “new” financial asset for the purposes of IFRS 9.

In such instances, the Bank performs both qualitative and quantitative assessments to determine whether there is a significant difference between the cash flows of the original financial asset and the cash flows of the modified asset. If there is a significant difference, the contractual rights to the original financial assets will be deemed expired and the new asset, issued under new terms is to be recognized. A significant difference between the cash flows of the two assets means a change in the present value of the cash flows of above 10% (the so-called quantitative test).

A financial asset may modified or replaced as part of a transaction with the same counterparty. For example, when the Bank’s customer (borrower) is experiencing financial difficulties, restructuring of some or all of the borrower’s liabilities may be negotiated in order to enable adequate debt repayment capacity, in part or in full. Such circumstances are commonly referred to as “forbearance” in the banking practice.

Modifications resulting in derecognition of the existing assets and initial recognition of the new assets, driven by deteriorated credit rating and repayment capacity of the borrowers, give rise to initial recognition of the financial assets defined by IFRS 9 as purchased or originated credit-impaired assets (“POCI assets”), i.e., assets impaired at the time of initial recognition.

In instances of significant modification of a financial instrument, IFRS 9 prescribes derecognition of the original financial asset and recognition of the new asset at fair value as of the recognition date. Derecognition of the gives rise to a permanent gain or loss, which must be recognized within profit or loss, in the amount equal to the difference between the amortized cost of the original financial assets and the fair value of the new financial assets net of the expected credit losses recognized as the impairment allowance of the financial assets.

Expected Credit Losses (ECL)

IFRS 9 introduces a concept of expected credit losses (ECL) the Bank is to identify and recognize for all financial assets within the scope of the standard. The Bank calculates and recognizes impairment allowance in accordance with its methodology for financial instruments recognized at AC and all the financial assets measured at FVtOCI.

Impairment allowance for financial assets at FVtOCI and at AC is included in expenses within the income statement. However, the accumulated impairment allowance in the financial statements is not deducted from the fair value of assets but from the cumulative change in the fair value recorded within the other comprehensive income.

The calculated expected credit losses represent probability-weighted estimates of credit losses (the present value of all the differences between the contractual cash flows and the cash flows he Bank expects to receive) during the expected life of a financial instrument. Therefore, for financial assets, the credit loss is the present value of the difference between:

- the contractual cash flows belonging to the Bank under the relevant contract and
- the cash flows the Bank expects to receive,

while for commitments per undrawn loans, credit loss is the present value of the difference between:

- the contractual cash flows belonging to the Bank if the user draws down the loan funds and
- the cash flows the Bank expects to receive if the loan is drawn down.

28. RISK MANAGEMENT (Continued)

28.1 Credit Risk (Continued)

Expected Credit Losses (ECL) (Continued)

The Bank classifies all financial assets measured at AC into the following three stages depending on the risk level, i.e., the expected credit loss, as follows:

- Stage 1 includes all new financial assets upon initial recognition except for purchased or originated credit-impaired (POCI) assets, and instruments without a significant increase in credit risk since initial recognition and low-risk financial assets;
- Stage 2 includes financial assets with a significant increase in credit risk since initial recognition, but without objective evidence of impairment based on the credit losses; and
- Stage 3 includes financial assets with objective evidence of impairment at the reporting date, including all POCI assets as impaired upon initial recognition.

For the purposes of the analysis, the Bank identified a series of criteria used in the assessment for comparison to the status at initial recognition of financial instruments under IFRS 9. Identification of one or more of the listed triggers may indicate that three has been a significant increase in the credit risk, which will cause allocation of the asset to Stage 2, as follows:

- Corporate customer segment
    1) 30 days past due in continuity at the date of assessment;
    2) Account blockade of over 30 consecutive days;
    3) FBE PE status;
    4) Gearing ratio: total debt (long-term liabilities + short-term liabilities)/equity >1 and at the same time changes in the sales, i.e., decrease in revenue of over 30%;
    5) Gearing ratio: total debt (long-term liabilities + short-term liabilities)/equity >1 and at the same maturity mismatch (current assets – current liabilities) < 1 and inadequate cash flows (cash flows from operating activities – short-term financial liabilities) <1;

Criteria 4 and 5 are not considered for newly founded entities.

- Retail customer segment
    1) 30 days past due in continuity at the date of assessment;
    2) FBE PE status.

FBE PE status designates forborne performing loans/receivables where contractual terms of the loans have been changed but not due to the deterioration of the borrower's financial situation.

For allocation to Stage 3, the Bank identified a list of triggers which need to be monitored for identification of the default status, based on the general (regulatory) default indicators (days past due, bank account blockade, bankruptcy, FBE NPE status) as well as on the quantitative indicator within the borrower's financial statements, determined based on the history of the Bank's portfolio movements, as follows:

- Corporate customer segment
    1) 90 days past due in continuity at the date of assessment;
    2) Account blockade of over 90 consecutive days;
    3) FBE NPE status;
    4) Instigated bankruptcy or liquidation procedures;
    5) Loss exceeding equity, ad the same time, inadequate cash flows (cash flows from operating activities – short-term financial liabilities) <1 and at the same time decrease in revenue of over 50% according to the official financial statements for the past two years;
    6) POCI

Criterion 5 is not considered for newly founded entities.

- Retail customer segment
    1) 90 days past due in continuity at the date of assessment;
    2) Claimed in lawsuit;
    3) FBE NPE;
    4) POCI.

FBE NPE status designates forborne non-performing loans/receivables where contractual terms of the loans have been changed due to the deterioration of the borrower's financial situation.

28. RISK MANAGEMENT (Continued)

28.1 Credit Risk (Continued)

Expected Credit Losses (ECL) (Continued)

Days past due criterion includes material arrears defined as arrears per at least 1% of an individual receivable but not below RSD 1,000 thousand for retail and not below RSD 10,000 for corporate customers.

Accordingly, at each reporting date, the Bank calculates impairment allowance in the amount of lifetime expected credit losses if the credit risk of an instrument has increased significantly since initial recognition or there is identified objective evidence of impairment (assets in Stage 2 and Stage 3), or in the amount equal to 12-month expected credit losses for all financial instruments without a significant increase in credit risk since initial recognition (assets in Stage 1). Lifetime ECL calculated in this manner represent losses recognized by the Bank for the purposes of imapirment allowance of assets in Stage 2, while the12-month ECL portion calculated in this way represents expected credit losses recognized for financial assets in Stage 1.

Lifetime expected credit losses calculated in this manner represent losses the Bank recognizes for the purposes of Stage and Stage 3 impairment allowances whereas 12-month ECL as the portion of the lifetime ECL is recognized for Stage 1 financial instruments.

The Bank calculates lifetime expected credit losses using the following formula:

$$ECL = \sum_{t=1}^{T} (EAD_t * MPD_t * LGD_t * DF_t)$$

ECL - Expected credit loss
EAD - Exposure at default
MPD - Marginal probability of default
LGD - Loss given default
DF - EIR based discount factor

EAD parameter
EAD, exposure at default is an estimate of the carrying amount of the Bank's receivables under IFRs 9 at the time of default, taking into account the profile of the contractual cash flows and possible additional drawdowns from the approved lines of credit before the time of default. For the financial instruments with no contractually defined cash flows or maturities, the Bank determines those based on the historical experience.

Accordingly, the Bank calculates credit conversion factors (CCF) separately for:
- Payment and performance guarantees and letters of credit;
- Undrawn amounts (up to defined limits) of the approved credit lines (separately for revocable and irrevocable commitments per credit lines);
- Credit cards;
- Approved current overdrafts per segment.

PD parameter
Probability of default (PD), i.e., the probability that a borrower will default on the loan repayment liabilities to the Bank some time during the lifetime of the financial instrument, represents one of the basic parameters used in calculation of the impairment allowance under IFRS 9. As such, this parameter has undergone significant changes compared to the PD calculation previously used for impairment allowance calculation under IAS 39.

Migration matrices, as the basis for PD calculation, are calculated by the Bank separately for each sub-segment by observing the annual borrower migrations form internal rating categories 1, 2, 3 and 4 to internal category 5 (default category) over the period from December 31, 2012 to December 31, 2018.

Within the context of multiannual – through the cycle (TTC) PDs, it is very important that several types of PDS are appropriately distinguished. Therefore, the Bank consistently applies the terminology defined within the Methodology. All of the below described PD types are available at both the individual financial instrument level and the internal rating level within each of the sub-segments:
- Marginal PD refers to the (unconditional) PD that will occur exactly at the moment (point in time) t.
- Forward PD (as conditional PD) refers to PD that will occur during the period t assuming that no default has happened between the moment *t0* and the beginning of the period t.

28. RISK MANAGEMENT (Continued)

28.1 Credit Risk (Continued)

Expected Credit Losses (ECL) (Continued)

PD parameter (Continued)

- Cumulative PD refers to PD that will occur at the end of the period t. The probability of default before or at the maturity T corresponds to the lifetime PD, i.e., PD over the entire lifetime of the financial instrument.
- Forward lifetime PD refers to the conditional probability that default will occur within the interval (t,) assuming that no default has happened between the moment *t0* and the beginning of the period t.

In developing PD parameters used for impairment allowance calculation in accordance with the Methodology, for alignment with the requirements of IFRS 9, the Bank applies the following adjustments:

- the point-in-time (PiT) adjustment;
- consideration of the forward-looking information on the macroeconomic conditions, whereby the Bank does not investigate the relations between the actually realized default rates and the following factors identified as material: internally assessed PD rate per segment at the given point in time, GDP movements, unemployment rate, inflation rate, M3 monetary aggregate and movements in RSD/EUR exchange rate.

Forward-Looking Information (FLI)

Impact of the macroeconomic variables, their movements and trends, on the default rate movements is examined by separately for the retail and corporate segments(yet summarily for all the sub-segments within the two) in order to determine regularities and patterns and the relation that existed between the realized quarterly default rate and the independent variables during the observed period.

Here the Bank examines the relations (correlations) between the default rates (as the dependent variable) and the movements in macroeconomic factors identified as having material effects on the default rates (as independent variables).

The Bank uses linear regression model to assess the relation between the observed parameters at the beginning of the calendar year and, on an annual basis, updates the model components and reassesses the linear regression itself so that the parameters used apply to the following reporting period observed. To this end, and for reliability validation, care is taken that the linear regression meets the statistical significance criteria.

LGD parameter

Loss given default represents an estimate of a loss on and individual financial instruments assuming that default has occurred/will have occurred. LGD is one of the key components in calculation of the risk parameters for expected credit loss (ECL) calculation.

In its estimation of the losses measured in accordance with its Methodology under IFRS 9, the Bank wishes to reflect the possibilities of collection of receivables from both the borrower's regular operating cash flows and from the collateral foreclosure cash flows, directly relating to the financial instruments. Therefore, the Bank applies the concept of LGD split to LGDsecured and LGDunsecured components, depending on the securitization of each individual exposure.

For calculation of LGDsecured, i.e., expected loss rate after collateral foreclosure, the Bank takes into account all internally available collaterals with assessment of collectability. In the process, the Bank relies on the historical experience in collateral realization.

For calculation of LGDunsecured, the Bank monitors collection of defaulting loans and identifies the sources of collection. For this purpose, the Bank considers each migration to the default status separately and chronologically identifies all collections of payments in respect thereof.

Approach to the segment of exposures to the governments and financial institutions

In the absence of historical collection data, the Bank uses LGD in accordance with Basel regulations for calculation of the impairment allowance in line with its Methodology.

28. RISK MANAGEMENT (Continued)

28.1 Credit Risk (Continued)

Expected Credit Losses (ECL) (Continued)

Stage 3 and Expected Credit Losses

Introduction

In accordance with the Bank's Methodology, impairment allowance assessment is made for all Stage 3 exposures that:

- have identified default status; and
- meet the criteria of POCI definition in accordance with IFRS 9.

For the aforesaid financial instruments, impairment allowance is calculated as the difference between the gross carrying value of the asset and the present value of the estimated future cash flows discounted using the original effective interest rate of the financial asset.

In the event of POCI assets, as the original or initial effective interest rate, the credit-adjusted effective interest rate is calculated. Such an effective interest rate is the internal rate of return that discounts the present value of the expected cash flows of a POCI asset to the fair value of the POCI asset at the time of its initial recognition. It is believed that the effective interest rate arrived at in this manner already included the expected credit losses.

Individual Impairment Assessment

Since, under IFRS 9, expected credit losses (ECL) represent probability-weighted estimates of credit losses, the Bank considers several possible scenarios of collection in estimating the future cash flows. The scenarios considered are:

- collateral foreclosure,
- loan rescheduling or restructuring (forbearance),
- instigation of bankruptcy proceedings over the borrower,
- sale of the receivable,
- settlement, and
- everything else deemed relevant.

The Bank assesses sources of collection from the borrower's expected future operating cash flows (the borrower continues operating as a going concern), or expects to collect its receivables from activation of collaterals (the borrower ceases to operate as a going concern and becomes gone concern) based on the following criteria:

1) Corporate customers – at the moment of being assigned FBE NPE status, all borrowers are automatically considered gone-concern borrowers and the assessment of impairment is made based on the expected collection from collateral foreclosure, while the defined period of monitoring and probation covers 6 months or 3 consecutive payments (of either both the principal and interest or interest), with no days past due identified of over 90 days. Following the defined monitoring and probation period, the borrower may return to the going-concern status and the impairment may be assessed based on the estimated collection from the borrower's future operating cash flows.
2) Retail customers – at the moment of being assigned FBE NPE status, all borrowers with proven credit repayment capacity (a. from regular salary paid by the employer and/or b. other regular income that can be documented, such as rental income, fees received under service contracts, closed-end employment contract, income from farming business, services rendered or temporary and seasonal work), may be treated as going-concern borrowers and impairment allowance may be made based on the expected future operating cash flows. Otherwise, they are treated as gone-concern borrowers, up to the fulfillment of the aforesaid condition of credit repayment capacity, and the impairment allowance will be made based on the assessed collection form the collateral foreclosure.

Upon determining the probabilities of certain scenarios (expressed as percentages), the Bank relies on the historical collection of NPLs but considers the specificities of individual financial instruments as well, and assigns the scenarios appropriate weights accordingly, which must add up to 100% in the sum of all the scenarios considered. If the borrower meets the going-concern criteria, the Bank may define at least one scenario of collection form the expected operating future cash flows. Otherwise, the scenarios are defined under the gone-concern assumption, with collection expected from collateral activation and foreclosure. In this manner, the ultimately calculated credit losses meet the definition form IFRS 9 – they represent probability-weighted estimates of credit losses.

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

28. RISK MANAGEMENT (Continued)

28.1 Credit Risk (Continued)

Expected Credit Losses (ECL) (Continued)

Stage 3 and Expected Credit Losses (Continued)

Individual Impairment Assessment (Continued)

The Bank applies collateral haircuts and realization periods as prescribed by the Collateral Management, Valuation and Insurance Procedure. In the above described manner, the Bank estimates ECL for all financial instruments in Stage 3 that exceed the respective materiality levels of RSD 1.5 million at the retail loan facility level and RSD 2.5 million at the corporate borrower level. Upon defining the materiality levels, the Bank observed the materiality levels existing within its internal loan approval procedures, and the materiality level to the overall portfolio ratio, taking into account the operating capability to calculate an adequate number of facilities based on the case-by-case assessments.

Collective Impairment Assessment

The Bank applies the group (portfolio) or collective approach to all other exposures, which entails grouping of the financial instruments remaining within Stage 3 into the sub-segments, as follows:

- retail customers,
- corporate customers (including banks and other financial institutions without an external credit rating), and
- exposures to the governments and other government institutions (state authorities, local governance units, other government agencies, banks and financial institutions).

The retail customer segment is further classified into groups per product:

- housing loans,
- cash and consumer loans,
- loans to farmers/entrepreneurs,
- credit cards and current account overdrafts, and
- receivables for fees per payment operations from farmers/entrepreneurs/legal entities.

The corporate customer segment is viewed on the whole.

Guarantees where the debtor is a private individual are classified into the corporate customer segment.

Within each of the subsegements, borrowers are further distributed into groups per days past due, i.e., into the following internal rating categories:

Internal rating category	Days past due
1	0
2	1 to 30
3	31 to 60
4	61 to 90
5	Over 90

Borrowers in group 5 are default status borrowers.

The effect of the first-time adoption of IFRS 9 amounted to RSD 142,258 thousand as of January 1, 2018 as a result of increased impairment of the financial assets for the same amount.

Differences in the carrying values of the financial assets as a result of the first-time adoption of IFRS 9 were recognized within equity as of January 1, 2018.

The first-time adoption of IFRS 9 as of January 1, 2018 did not cause any decrease in the capital adequacy ratio since the effects gave rise to the adjustment of an equity item that is not included in the regulatory capital.

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

28. RISK MANAGEMENT (Continued)

28.1 Credit Risk (Continued)

Expected Credit Losses (ECL) (Continued)

Stage 3 and Expected Credit Losses (Continued)

Collective Impairment Assessment (Continued)

The table below presents the effects of IFRS 9 first-time adoption as of January 1, 2018 on the Bank's on-balance exposure:

	Impairment allowance at December 31, 2018			Impairment allowance after IFRS 9 FTA at January 1, 2018			Impairment allowance at December 31, 2017
	Stage 1	**Stage 2**	**Stage 3**	**Stage 1**	**Stage 2**	**Stage 3**	**Closing balance**
Financial assets measured at AC							
Cash and balances held with the central bank	894	-	-	543	-	-	-
Loans and receivables due from banks and other financial institutions	1,922	-	-	369	-	10	79
Loans and receivables due from customers	88,701	70,675	1,270,442	71,190	22,259	2,709,444	2,678,820
Other assets	1	1	12,686	4	1	18,432	12,978
Financial assets measured at FVtOCI							
Securities	-	-	-	12,200	-	49	166
Total	**91,518**	**70,676**	**1,283,128**	**84,306**	**22,260**	**2,727,935**	**2,692,043**

The table below presents the effects of IFRS 9 first-time adoption as of January 1, 2018 on the Bank's off-balance exposure. Provisions for off-balance sheet items refer to the exposures per guarantees, letters of credit and commitments for undrawn loans, which are all affected by the credit risk.

	Provisions for off-balance sheet items at December 31, 2018			Provisions for off-balance sheet items after IFRS 9 FTA at January 1, 2018			Provisions for off-balance sheet items at December 31, 2017
Measured at AC	**Stage 1**	**Stage 2**	**Stage 3**	**Stage 1**	**Stage 2**	**Stage 3**	**Closing balance**
Guarantees and letters of credit	83	33	748	679	10	6	59
Commitments per undrawn loans	3,203	235	10	3,507	291	362	4,996
Total	**3,286**	268	758	**4,186**	301	**368**	**5,055**

During the implementation of IAS 39, calculation of the impairment allowance of securities did not include exposures to the Republic of Serbia. With IFRS 9 coming into force, the scope of the calculation was extended to all exposures per securities, irrespective of the debtor/issuer type. After calculation of IFRS 9 first-time adoption effects, the amounts of impairment allowance for securities were cancelled from the equity account and recognized as losses on the change in the value debt instruments.

The table below shows movements of the impairment allowance following the period of IFRS 9 first-time adoption as of December 31, 2018

	Stage 1			**Stage 2**			**Stage 3**		
	Changes to the parameters (PD, LGD, EAD)	Change to methodology	FX effects and other changes	Changes to the parameters (PD, LGD, EAD)	Change to methodology	FX effects and other changes	Changes to the parameters (PD, LGD, EAD)	Change to methodology	FX effects and other changes
Cash and balances held with the central bank	350	-	1	-	-	-	-	-	-
Securities	(206)	-	(11,994)	-	-	-	(49)	-	-
Loans and receivables due from banks and other financial institutions	1,553	-	-	-	-	-	(10)	-	-
Loans and receivables due from customers	20,373	-	(2,862)	50,696	-	(2,280)	(1,439,002)	-	-
Other assets	(3)	-	-	-	-		(5,747)	-	1
Total	22,067	-	(14,855)	50,696	-	(2,280)	(1,444,808)	-	1

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

28. RISK MANAGEMENT (Continued)

28.1 Credit Risk (Continued)

Expected Credit Losses (ECL) (Continued)

Stage 3 and Expected Credit Losses (Continued)

Collective Impairment Assessment (Continued)

The effect of decreased impairment allowance of securities did not result from any reversal of impairment but rather from the transfer of effects following the calculation of the first-time adoption from the impairment allowance account to the profit or loss account – the item of gains/losses from the changes in value of debt instruments.

The table below presents movements of the gross credit risk exposures per Stage over the period from IFRS 9 first-time adoption up to December 31, 2018:

Movements in the credit risk exposure from IFRS 9 FTA to December 31, 2018

	Opening balance at January 1, 2018	Stage 1	Stage 2	Stage 3
Cash and balances held with the central bank	Opening balance at January 1, 2018.	4,839,851	-	-
	Transfer to Stage 1	-	-	-
	Transfer to Stage 2	-	-	-
	Transfer to Stage 3	-	-	-
	Increases through origination	2,804,160	-	-
	Decreases through repayment, write-off and transfer to off-balance sheet items	-	-	-
	Closing balance at December 31, 2018	7,644,011	-	-
Receivables under derivative financial instruments	Opening balance at January 1, 2018.	470	-	-
	Transfer to Stage 1	-	-	-
	Transfer to Stage 2	-	-	-
	Transfer to Stage 3	-	-	-
	Increases through origination	5,808	-	-
	Decreases through repayment, write-off and transfer to off-balance sheet items	-	-	-
	Closing balance at December 31, 2018	6,278	-	-
Securities	Opening balance at January 1, 2018.	4,857,084	52	60
	Transfer to Stage 1	274	(274)	-
	Transfer to Stage 2	-	47	(47)
	Transfer to Stage 3	(22)	-	22
	Increases through origination	2,631,931	-	-
	Decreases through repayment, write-off and transfer to off-balance sheet items	(775,721)	449	12
	Closing balance at December 31, 2018	6,713,546	274	47
Loans and receivables due from banks and other financial institutions	Opening balance at January 1, 2018.	1,524,680	-	12
	Transfer to Stage 1	4	-	(4)
	Transfer to Stage 2	-	-	-
	Transfer to Stage 3	(12)	-	12
	Increases through origination	758,497	-	-
	Decreases through repayment, write-off and transfer to off-balance sheet items	-	-	(16)
	Closing balance at December 31, 2018	2,283,169	-	4
Loans and receivables due from customers	Opening balance at January 1, 2018.	23,693,709	2,934,096	4,945,921
	Transfer to Stage 1	638,796	(609,169)	(29,627)
	Transfer to Stage 2	(1,031,140)	1,043,956	(12,816)
	Transfer to Stage 3	(39,865)	(58,650)	98,515
	Increases through origination	21,315,583	2,988,450	16,485
	Decreases through repayment, write-off and transfer to off-balance sheet items	(11,892,884)	(1,493,979)	(2,312,437)
	Closing balance at December 31, 2018	32,684,200	4,804,703	2,706,041
Other assets	Opening balance at January 1, 2018.	99,466	388	55,626
	Transfer to Stage 1	782	(59)	(723)
	Transfer to Stage 2	(113)	292	(179)
	Transfer to Stage 3	(1,756)	(47)	1,803
	Increases through origination	15,981	586	532
	Decreases through repayment, write-off and transfer to off-balance sheet items	(64,365)	(387)	(16,453)
	Closing balance at December 31, 2018	49,995	773	40,606
Total	**Closing balance at December 31, 2018**	**49,381,199**	**4,805,750**	**2,746,698**

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

28. RISK MANAGEMENT (Continued)

28.1 Credit Risk (Continued)

Expected Credit Losses (ECL) (Continued)

Stage 3 and Expected Credit Losses (Continued)

Collective Impairment Assessment (Continued)

The table below presents movements of the impairment allowance per Stage over the period from IFRS 9 first-time adoption up to December 31, 2018:

Movements in the impairment allowance from IFRS 9 FTA to December 31, 2018

	Opening balance at January 1, 2018	Stage 1	Stage 2	Stage 3
	Opening balance at January 1, 2018.	543	-	-
	Transfer to Stage 1	-	-	-
	Transfer to Stage 2	-	-	-
	Transfer to Stage 3	-	-	-
	Increases through origination	351	-	-
Cash and balances held	Decreases through repayment, write-off and transfer to off-balance sheet items	-	-	-
with the central bank	Closing balance at December 31, 2018	894	-	-
	Opening balance at January 1, 2018.	12,200	-	49
	Transfer to Stage 1	-	-	-
	Transfer to Stage 2	-	-	-
	Transfer to Stage 3	-	-	-
	Effects of IFRS 9 first-time adoption recorded within equity per securities at FVtOCI	(11,994)	-	-
	Decreases through repayment, write-off and transfer to off-balance sheet items	(206)	-	(49)
Securities	Closing balance at December 31, 2018	-	-	-
	Opening balance at January 1, 2018.	369	-	10
	Transfer to Stage 1	16	(16)	-
	Transfer to Stage 2	-	-	-
	Transfer to Stage 3	-	-	-
	Increases through origination	1,537	16	-
Loans and receivables due from banks and	Decreases through repayment, write-off and transfer to off-balance sheet items	-	-	(10)
other financial institutions	Closing balance at December 31, 2018	1,922	-	-
	Opening balance at January 1, 2018.	71,190	22,259	2,709,444
	Transfer to Stage 1	2,275	(2,191)	(84)
	Transfer to Stage 2	(14,931)	15,409	(478)
	Transfer to Stage 3	(22,864)	(8,577)	31,441
	Increases through origination	63,389	44,735	7,470
Loans and receivables	Decreases through repayment, write-off and transfer to off-balance sheet items	(10,358)	(960)	(1,477,351)
due from customers	Closing balance at December 31, 2018	88,701	70,675	1,270,442
	Opening balance at January 1, 2018.	4	1	18,432
	Transfer to Stage 1	539	(1)	(538)
	Transfer to Stage 2	-	97	(97)
	Transfer to Stage 3	(44)	-	44
	Increases through origination	4	1	270
	Decreases through repayment, write-off and transfer to off-balance sheet items	(502)	(97)	(5,425)
Other assets	Closing balance at December 31, 2018	1	1	12,686
Total	**Closing balance at December 31, 2018**	**91,518**	**70,676**	**1,283,128**

Breakdown of Financial Assets per Impairment Stages

The Bank's aggregate impairment allowance totaling RSD 1,445,322 thousand as of December 31, 2018 (December 31, 2017: RSD 2,692,043 thousand) decreased by RSD 1,246,721 thousand or 46.31% compared to December 31, 2017, primarily as a result of the improved portfolio quality to collection of NPLs and write-off of fully impaired receivables.

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

28. RISK MANAGEMENT (Continued)

28.1 Credit Risk (Continued)

Expected Credit Losses (ECL) (Continued)

Breakdown of Financial Assets per Impairment Stages (Continued)

The table below presents the breakdown of the Bank's financial assets per impairment Stage in accordance with IFRS 9.

	December 31, 2018	December 31, 2017
Cash and balances held with the central bank	**7,644,011**	**4,839,851**
Stage 1	7,644,011	4,839,851
Receivables under derivative financial instruments	**6,278**	**470**
Stage 1	6,278	470
Securities	**6,713,867**	**4,857,196**
Stage 1	6,713,546	4,857,084
Stage 2	274	52
Stage 3	47	60
Loans and receivables due from banks and financial institutions	**2,283,173**	**1,524,692**
Stage 1	2,283,169	1,524,680
Stage 3	4	12
Loans and receivables due from customers	**40,194,945**	**31,573,726**
Stage 1	32,684,200	23,693,709
Stage 2	4,804,703	2,934,096
Stage 3	2,706,041	4,945,921
Other assets	**91,374**	**155,480**
Stage 1	49,995	99,466
Stage 2	773	388
Stage 3	40,606	55,626
Total gross carrying value	**56,933,648**	**42,951,415**
Stage 1 total impairment allowance (Note 18)	91,518	53,295
Stage 2 total impairment allowance (Note 18)	70,676	17,168
Stage 3 total impairment allowance (Note 18)	1,283,128	2,621,580
Total impairment allowance	**1,445,322**	**2,692,043**
Total net carrying value	**55,488,326**	**40,259,372**

Financial Assets per Stage

The following breakdown shows the Bank's financial asset per Stage used for impairment allowance calculation as follows:

- Assets not □lassified into Stages under IFRS 9;
- Assets □lassified into Stage 1 under IFRS 9;
- Assets □lassified into Stage 2 under IFRS 9;
- Assets classified into Stage 3 under IFRS 9.

The shares of the gross and net financial assets within Stages in the total financial assets as of December 31, 2018 and 2017 are presented in the following table:

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

28. RISK MANAGEMENT (Continued)

28.1 Credit Risk (Continued)

Expected Credit Losses (ECL) (Continued)

Financial Assets per Stage (Continued)

Breakdown of the Bank’s financial assets per Stage and internal rating category in accordance with the Impairment Allowance Methodology under IFRS 9:

	December 31, 2018		December 31, 2017	
Category	**Gross exposure**	**Net exposure**	**Gross exposure**	**Net exposure**
Cash and balances held with the central bank	**7,644,011**	**7,643,117**	**4,839,851**	**4,839,851**
Stage 1, of which:	**7,644,011**	**7,643,117**	**4,839,851**	**4,839,851**
Internal rating category 1	3,641,686	3,641,686	2,496,308	2,496,308
Government, state and other institutions with external ratings	4,002,325	4,001,431	2,343,543	2,343,543
Receivables under derivative financial instruments	**6,278**	**6,278**	**470**	**470**
Stage 1, of which:	**6,278**	**6,278**	**470**	**470**
Internal rating category 1	6,278	6,278	470	470
Securities	**6,713,867**	**6,713,867**	**4,857,196**	**4,857,030**
Stage 1, of which:	**6,713,546**	**6,713,546**	**4,857,084**	**4,856,978**
Internal rating category 1	55,215	55,215	4,857,084	4,856,978
Government, state and other institutions with external ratings	6,658,331	6,658,331	-	-
Stage 2, of which:	**274**	**274**	**52**	**52**
Internal rating category 1	274	274	52	52
Stage 3, of which:	**47**	**47**	**60**	**-**
Internal rating category 1	47	47	60	-
Loans and receivables due from banks and other financial institutions	**2,283,173**	**2,281,251**	**1,524,692**	**1,524,613**
Stage 1, of which:	**2,283,169**	**2,281,247**	**1,524,680**	**1,524,613**
Internal rating category 1	441,637	440,107	1,494,941	1,494,874
Internal rating category 2	-	-	4	4
Government, state and other institutions with external ratings	1,841,532	1,841,140	29,735	29,735
Stage 3, of which:	**4**	**4**	**12**	**-**
Internal rating category 1	-	-	12	-
Internal rating category 5	4	4	-	-
Loans and receivables due from customers	**40,194,945**	**38,765,127**	**31,573,726**	**28,894,906**
Stage 1, of which:	**32,684,200**	**32,599,461**	**23,693,709**	**23,643,701**
Internal rating category 1	29,126,918	29,075,104	21,810,977	21,766,198
Internal rating category 2	3,557,282	3,524,339	1,882,732	1,877,503
Government, state and other institutions with external ratings	-	18	-	-
Stage 2, of which:	**4,804,703**	**4,734,049**	**2,934,096**	**2,916,956**
Internal rating category 1	3,859,229	3,814,354	2,588,036	2,575,869
Internal rating category 2	775,072	761,331	180,041	179,395
Internal rating category 3	114,464	108,829	153,323	150,221
Internal rating category 4	55,938	49,517	12,696	11,471
Government, state and other institutions with external ratings	-	18	-	-
Stage 3, of which:	**2,706,042**	**1,431,617**	**4,945,921**	**2,334,249**
Internal rating category 1	246,780	193,587	1,676,468	1,105,885
Internal rating category 2	50,257	44,448	23,975	22,538
Internal rating category 3	1,225	238	55,080	50,526
Internal rating category 4	27,169	23,726	16,759	15,517
Internal rating category 5	2,380,611	1,169,600	3,173,639	1,139,783
Government, state and other institutions with external ratings	-	18	-	-
Other assets	**91,374**	**78,686**	**155,480**	**142,502**
Stage 1, of which:	**49,995**	**45,981**	**99,466**	**99,070**
Internal rating category 1	48,199	44,186	99,271	98,882
Internal rating category 2	1,796	1,795	148	141
Government, state and other institutions with external ratings	-	-	47	47
Stage 2, of which:	**773**	**770**	**388**	**359**
Internal rating category 1	185	184	313	290
Internal rating category 2	33	32	12	12
Internal rating category 3	48	47	54	52
Internal rating category 4	507	507	9	5
Government, state and other institutions with external ratings	-	-	-	-
Stage 3, of which:	**40,606**	**31,935**	**55,626**	**43,073**
Internal rating category 1	806	397	43,939	36,497
Internal rating category 2	9	2	50	28
Internal rating category 3	11	2	70	50
Internal rating category 4	15	1	55	28
Internal rating category 5	13,394	7,262	11,512	6,470
Government, state and other institutions with external ratings	26,371	24,271	-	-

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

28. RISK MANAGEMENT (Continued)

28.1 Credit Risk (Continued)

Fair Value of Collaterals

The Bank's collateral management system entails a set of activities and prescribed measured and rules implemented for ongoing recording, allocation and valuation of collaterals

In order to mitigate its credit risk exposure, the Bank obtains collaterals from the borrowers to securitize loan repayment. Security instruments (collaterals) the Bank accepts may be in the form of:

- Financial assets (guarantee deposits);
- Guarantees issued by other banks on behalf of the borrowers;
- Mortgage liens instituted over immovable assets, i.e., property (residential and commercial real estate);
- Pledge liens instituted over movable assets (machinery, equipment and vehicles); and
- Other collaterals

The Bank does not approve loans to customers based on the collateral value but on the positive assessment of the customer's financial situation and repayment capacity. The collaterals are therefore used exclusively to reduce or mitigate the credit risk exposure.

Collateral types and fair values at the time of issue of the financial instruments securitized are aligned with the loan type, maturity and borrower type.

Collaterals are recorded within the relevant registers that are publicly available to all the concerned parties.

The Bank may activate and/or foreclose collaterals only after the default status has been declared and the after the contract with the borrower is terminated. The manner of collection from the collateral depends on the collateral type. The aggregate fair value (collected value) of the collaterals the Bank activated in 2018 totaled RSD 494,144 thousand (2017: RSD 520,341 thousand).

For the purposes of assessing the additional credit risk arising from possible difficulties or problems in collateral activation and the time lapse between the borrower's default and the Bank's ability to foreclose the collateral, the market value of the collateral underlying the security instrument (lien) in favor of the Bank is reduced (using haircuts) to arrive at the value that the Bank would achieve in case of possible sale of the of the asset for collection of the receivables securitized by the asset.

The fair values of collaterals are presented in the following breakdown per appraised market value but only to the amount of the respective receivables securitized with mortgage and pledge lines, deposits and guarantees received from borrowers.

Coverage of the total financial assets by collaterals valued as described above equaled 32.89% as of December 31, 2017. The total collateral coverage ratio for Stage 1 equaled 86.73%, while the mortgage collateral coverage ratio was 68.99%. The total collateral coverage ratio for Stage 2 equaled 8.44%, while the mortgage collateral coverage ratio was 13.23%. The total collateral coverage ratio for Stage 3 equaled 4.82%, while the mortgage collateral coverage ratio was 17.78%.

Assessment of the collateral fair value per financial asset as of December 31, 2018

	Gross assets	Mortgages	Pledges	Deposits	Other
Financial assets	**56,933,648**	**14,024,512**	**2,448,601**	**1,379,344**	**875,462**
Stage 1	49,381,200	9,675,750	2,003,935	1,272,512	179,246
Stage 2	4,805,751	1,855,545	413,243	106,212	696,216
Stage 3	2,746,698	2,493,217	31,423	619	-

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

28. RISK MANAGEMENT (Continued)

28.1 Credit Risk (Continued)

Fair Value of Collaterals (Continued)

Assessment of the collateral fair value per financial asset as of December 31, 2017

	Gross assets	Mortgages	Pledges	Deposits	Other
Financial assets	**42,951,415**	**12,960,160**	**1,792,535**	**1,083,028**	**833,046**
Stage 1	35,016,721	7,554,497	1,430,635	957,832	129,068
Stage 2	2,934,494	1,309,493	237,746	117,712	474,332
Stage 3	5,000,199	4,096,169	124,155	7,484	229,646

The calculated ECL may be zero if the financial instrument at hand is fully securitized with collaterals. However, as there is a certain risk of difficulty in collateral activation/foreclosure, the Bank's practice is not to present impairment allowance amounts equal to 0. In such cases, the impairment allowance is calculated using the average ECL for the particular sub-segment and quality level.

LTV ratio

As for the financial assets securitized with mortgages, as of December 31, 2018 the largest share of 32.99% was that of the mortgages with LTV ratios below 50%, followed by the share of mortgages with LTV ratios ranging from 71% to 90% equal to 24.31%, the share of mortgages with LTV ratios ranging between 51% and 70% (share of 20.53%), mortgages with LTV ratios above 100% (share of 12.61%) while the mortgages with LTV ratios from 91% to 100% had a share of 9.57%.

LTV ratio balances as of December 31, 2018

	Below 50%	51%-70%	71%-90%	91%-100%	Above 100%
Financial assets securitized with mortgages	**4,626,333**	**2,879,892**	**3,408,919**	**1,341,529**	**1,767,840**
Stage 1	2,965,126	2,605,800	2,461,549	580,547	1,062,728
Stage 2	801,124	101,778	454,557	103,337	394,748
Stage 3	860,082	172,315	492,813	657,644	310,363

LTV ratio balances as of December 31, 2017

	Below 50%	51%-70%	71%-90%	91%-100%	Above 100%
Financial assets securitized with mortgages	**4,376,279**	**2,300,948**	**2,867,821**	**1,495,794**	**1,919,318**
Stage 1	2,770,377	1,892,392	1,964,411	336,826	590,491
Stage 2	752,889	104,896	194,401	15,302	242,004
Stage 3	853,013	303,659	709,009	1,143,665	1,086,824

Financial Assets per Number of Days Past Due

As of December 31, 2018, the financial assets without days past due had a share of 87.63% in the total financial assets, gross, those from 1 to 30 days past due had a share of 5.74%, assets from 31 to 90 days past due had a share of 0.34%, assets from 91 to 180 and from 181 to 365 days past due had respective shares of 4.54% and 0.09%, while the share of assets with a number of days past due of over 365 days was 1.66%.

Breakdown of financial assets per past-due interval

	December 31, 2018		December 31, 2017	
	Gross exposure	Net exposure	Gross exposure	Net exposure
Without delays, no days past due	49,890,806	49,699,540	37,811,455	37,159,614
From 1 to 30 days past due	3,267,054	3,231,597	1,734,323	1,728,364
From 31 to 90 days past due	195,171	179,885	228,734	220,614
From 91 to 180 days past due	2,583,339	1,892,554	293,786	47,445
From 181 to 365 days past due	52,000	28,763	19,394	11,940
Over 365 days past due	945,278	455,987	2,863,723	1,091,395
Total	**56,933,648**	**55,488,326**	**42,951,415**	**40,259,372**

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

28. RISK MANAGEMENT (Continued)

28.1 Credit Risk (Continued)

Financial Assets per Industry

Financial assets are presented below per industry in the gross and net amounts.

As of December 31, 2018, the largest share in the total gross financial assets was that of the retail customers – of 20.76%, followed by the processing industry – 19.41%, and then banks, financial institutions and insurance companies – of 14.81%.

Concentration of the financial assets per industry

	December 31, 2018		December 31, 2017	
	Gross exposure	Net exposure	Gross exposure	Net exposure
Agriculture, forestry and fisheries	734,719	731,584	478,124	475,875
Mining and quarrying	82,773	81,552	77,526	77,194
Manufacturing and processing industry	11,053,575	10,087,980	10,841,064	9,048,551
Electricity, gas, steam and air conditioning supply	416,728	414,435	422,008	368,978
Construction industry	2,320,018	2,038,009	1,793,577	1,536,430
Wholesale and retail trade and repair of motor vehicles and motorcycles	7,613,711	7,548,899	5,876,843	5,559,506
Transport and storage, hotel and restaurant services, information and communications	3,010,431	2,974,879	2,479,693	2,270,445
Real estate, professional, scientific and technical activities, arts, entertainment and leisure	1,484,816	1,479,580	675,921	673,368
Banks, financial institutions and insurance companies	8,429,329	8,421,139	3,925,227	3,920,047
Private individuals	11,821,701	11,755,980	8,274,969	8,223,999
Other	9,965,846	9,954,288	8,106,463	8,104,979
Total	**56,933,648**	**55,488,326**	**42,951,415**	**40,259,372**

Exposures to the customers within the other (business activities):

- Non-residents, including foreign banks without defined and registered business activity in line with the Regulation on the Classification of Business Activities of the Government of the Republic of Serbia;
- Government agencies, state authorities;
- Administrative, ancillary services;
- Travel agencies, education;
- Health care and welfare; and
- Art and leisure industry.

Concentration of the off-balance sheet items per industry

	December 31, 2018		December 31, 2017	
	Gross exposure	Net exposure	Gross exposure	Net exposure
Agriculture, forestry and fisheries	25,918	25,895	80,900	80,887
Mining and quarrying	21,730	21,728	22,758	22,745
Manufacturing and processing industry	3,777,173	3,775,528	3,251,335	3,248,971
Electricity, gas, steam and air conditioning supply	76,573	76,553	29,280	29,247
Construction industry	4,091,116	4,090,754	2,922,811	2,922,461
Wholesale and retail trade and repair of motor vehicles and motorcycles	3,246,558	3,246,035	2,081,186	2,079,933
Transport and storage, hotel and restaurant services, information and communications	1,238,615	1,238,368	677,947	677,229
Real estate, professional, scientific and technical activities, arts, entertainment and leisure	2,312,250	2,310,896	450,854	450,712
Banks, financial institutions and insurance companies	118,231	118,230	396,795	396,791
Private individuals	239,567	239,483	248,275	248,197
Other	742,793	742,444	167,703	167,616
Total	**15,890,224**	**15,885,914**	**10,329,844**	**10,324,789**

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

28. RISK MANAGEMENT (Continued)

28.1 Credit Risk (Continued)

Financial Assets per Geographic Region

The table below shows financial assets per exposure to certain geographic regions. As of December 31, 2018, the predominant share was the share of exposure to customers in Serbia (94.34%). The share of the exposure to the European Union borrowers was 1.18%, USA and Canada's share was 0.15%, and the share of borrowers from other regions equaled 4.33%.

Concentration of the financial assets per region, net exposures

	December 31, 2018	December 31, 2017
Serbia	52,350,447	39,317,692
European Union	653,564	526,979
USA and Canada	81,679	-
Other	2,402,637	414,701
Total	**55,488,326**	**40,259,372**

Financial Assets per Serbian Region

The table below shows financial assets per exposure to certain geographic regions in Serbia. As of December 31, 2018, the predominant share was the share of exposure to customers in Belgrade (50.12%), followed by the share of exposure to borrowers in Western Serbia (31.72%). while Vojvodina, Southern Serbia and Eastern Serbia had shares of 7.55%, 6.87% and 3.74%.

Concentration of the financial assets per Serbian region, net exposures

	December 31, 2018	December 31, 2017
Belgrade	26,236,062	18,520,362
Vojvodina	3,951,576	2,653,336
Southern Serbia	3,600,519	2,579,735
Eastern Serbia	1,955,817	1,792,501
Western Serbia	16,606,473	13,771,758
Total	**52,350,447**	**39,317,692**

Write-Off of Receivables

The Bank will adequately manage collection of NPLs as long as it assesses that collection activates are economically justified, i.e., as long as there are possibilities of collection. The Bank holds that it is no longer economic justified to attempt collection in the following instances:

- Severe difficulties in collection including death of the borrower or pledge debtor;
- Lack of assets for execution/enforcement procedure;
- Prolonged period without collection and no prospects of further collection; and
- Debt amount is low and does not justify the use of the Bank's effort and resources for collection.

If the Bank assesses that a loan will not (cannot) be collected, the Bank performs the so-called debt relief. If the Bank permanently waives collection of receivables due from the borrowers, based on the settlement executed with the borrower/co-guarantors, final court ruling, final document of execution writ (adjudication or decision), relevant decision of the Bank's competent body or assignment of receivables giving rise to cessation of entitlement to further collection, the Bank may conduct such debt relief. In such a case, all the Bank's receivables are derecognized from the Bank's on-balance and off-balance sheet items. The relief of a loan and/or receivable may but need not be preceded by the direct write-off of the loan and/or receivable. On the other end, the Bank performs the so-called accounting write-off of on-balance sheet assets with low recoverability. The accounting write-off entails transfer of the on-balance sheet assets to the off-balance sheet items of the Bank. The on-balance sheet assets here relate to NPLs and other bad receivables. The accounting write-off does not mean the Bank's waiver of its legal and contractual rights, or of the collection. It simply entails an accounting write-off, with such loans and receivables further carried within the off-balance sheet items and the Bank continues the commenced collection activities.

28. RISK MANAGEMENT (Continued)

28.1 Credit Risk (Continued)

Write-Off of Receivables (Continued)

The Bank performs the accounting write-off of its on-balance sheet assets with low recoverability in the event that the calculated impairment allowance of such receivables recorded on the impairment allowance account amounts to 100% (full) of the gross carrying value of the receivables, i.e., if the receivables are fully impaired. The accounting write-off is performed at least quarterly. In 2018, the Bank performed the accounting write-off of NPLs in the aggregate amount of RSD 1,528,318 thousand.

Receivables collected within the bankruptcy procedures

The Bank registers claims against the bankruptcy estates in the bankruptcy proceedings by submitting the claim registration in writing to the competent court. The Bank is required to register the claims in the currency of the original receivables claimed in accordance with the Bankruptcy Law. At the date of the bankruptcy procedure instigation, the creditors' claims from the bankruptcy debtor not yet matured are considered matured and past due. Foreign currency claims are calculated in RSD equivalent at the official middle exchange rate of NBS at the bankruptcy instigation date, and are further recorded in RSD in the books of account. Functional currency (RSD) receivables and receivables per currency clause-indexed loans are carried in RSD after bankruptcy instigation. After the Bankruptcy Administrator has determined the ultimate list of the claims recognized, the amount of the receivable claimed is adjusted in the Bank's books to the amount stated in the list of the claims recognized and any difference is transferred to the Bank's off-balance sheet items.

In respect of the Guidelines for Disclosure of Bank Data and Information Related to the Quality of Assets (the "Guidelines"), the required qualitative and quantitative information will be disclosed within data prepared and presented in accordance with the Decision on Disclosure of Data and Information by Banks (Official Gazette of RS nos. 125/2014. 4/2015 and 103/2016).

Loan Rescheduling and Restructuring

In 2018, the Bank rescheduled, i.e., extended, loan repayment periods in accordance with NBS Decision on Classification of Balance Sheet Assets and Off-Balance Sheet Items (Official Gazette of RS nos. 4/2011, 57/2012, 123/2012, 43/2013, 113/2013, 135/2014, 25/2015, 38/2015, 61/2016, 69/2016, 91/2016, 101/2017 and 114/2017).

In accordance with the amended NBS Decision on Classification of Balance Sheet Assets and Off-Balance Sheet Items dated June 29, 2016, days past due in collection of receivables are calculated from the last contractual defined maturity date for materially significant amount of receivables.

Restructuring entails approval of concessions on repayment of individual loans and receivables due to borrower's financial difficulties, which would not otherwise be allowed, regardless of the maturity, impairment or default status of the receivables in accordance with the decision governing capital adequacy of banks, in at least one of the following ways:

- modification of the original terms of the loan and/or receivable, particularly if the subsequently agreed terms of repayment are more favorable than the original terms (reduction of the interest rate, write-off of a portion pf the principal outstanding, entailing derecognition of that portion in the balance sheet assets, write-off of a portion of the accrued interest, release of a portion of the amount due, extension of the maturity of the principal and/or interest, etc.) or than the terms that would be approved to another borrower with the same or similar risk level at the time of the modification of terms;
- refinancing of the loan where a new receivable is originated from a loan approved to settle a portion of or the entire amount of the borrower's liability to the Bank or another entity to which the receivable due from the borrower has been assigned.

Restructured receivables due from corporate customers are:

- receivables restructured at the Bank level, where the Bank defines the restructuring terms;
- receivables restructured in collaboration with other creditors, either under interbank agreement on equal terms of restructuring or under the Law on Consensual Financial Restructuring of Companies with participation of an institutional mediator;
- receivables due from debtors where, in the pre-bankruptcy procedure, a pre-packed reorganization plan has been proposed and adopted; and
- receivables due from debtors where, in the bankruptcy procedure, a bankruptcy debtor reorganization plan has been proposed and adopted.

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

28. RISK MANAGEMENT (Continued)

28.1 Credit Risk (Continued)

Loan Rescheduling and Restructuring (Continued)

Restructured receivables from retail customers are receivables due from borrowers that the Bank assessed, based on the credit repayment capacity, as able to settle the loan repayment liabilities to the Bank in a timely manner in the forthcoming period if certain repayment concessions are granted by the Bank.

Upon undertaking restructuring measures, the Bank is required to estimate whether the loan restructuring approved to a debtor is sustainable and economically justified for both the Bank and the debtor and to determine the restructuring schedule and regularly monitor its implementation and effects.

On a regular basis, at least semi-annually, the Bank monitors implementation of the loan restructuring schedule and reports thereon in the Report on the Rescheduled Receivables at the Client Level.

The Bank may cease to treat a loan and/or receivable as restructured if at the end of the trial period the following criteria are met:

- the restru□tured loan/re□eivable is not □lassified as NPL;
- the borrower has repaid through regular payments of principal and/or interest amounts materially signifi□ant portion of the debt during at least half of the trial period; and
- the borrower is not over 30 days past due in any liability settlement toward the Bank.

The probation period of at least 2 years starts from the moment the restructured receivable is classified ad performing.

The table below presents balance of restructured loans as of December 31, 2018, number of borrowers and number of loans – 22 loans for 18 borrowers were reconstructed in 2018.

Balance as of December 31, 2018	Number of borrowers	Number of restructured loans
450,178	18	22

The table below presents balance of restructured loans as of December 31, 2017, number of borrowers and number of loans – 33 loans for 22 borrowers were reconstructed in 2017.

Balance as of December 31, 2017	Number of borrowers	Number of restructured loans
675,767	23	33

The gross balance of all the restructured impaired loans as of December 31, 2018 amounted to RSD 2,602,508 thousand and the net balance amounted to RSD 1,518,567 thousand.

Breakdown of the total restructured and impaired loans as of December 31, 2015

Category	December 31, 2018			
	Gross exposure	Net exposure	Number of borrowers	Number of loan facilities
Stage 1	-	-	-	-
Stage 2	240,334	235,639	8	8
Stage 3	2,362,174	1,282,928	65	92
Total	**2,602,508**	**1,518,567**	**73**	**100**

Breakdown of the total restructured and impaired loans as of December 31, 2017

Category	December 31, 2017			
	Gross exposure	Net exposure	Number of borrowers	Number of loan facilities
Stage 1	1,161	1,147	2	2
Stage 2	511,088	508,573	8	13
Stage 3	3,530,712	1,629,321	81	128
Total	**4,042,961**	**2,139,041**	**91**	**143**

28. RISK MANAGEMENT (Continued)

28.1 Credit Risk (Continued)

Fair Value of Assets and Liabilities

The fair value stated in the financial statements is the amount for which an asset could be exchange or a liability settled between knowledgeable, willing parties in an arm's length transaction.

Fair value is calculated using the market information available as of the reporting date.

Whenever possible, the Bank measures the fair vale using the market prices available in an active market for the specific instrument. A market is deemed active if the quoted prices are easily and regularly available and reflect actual common market transactions performed at arms' length.

The fair value of a current liquid instrument presented at its nominal value approximates its carrying value. This applies to cash as well as receivables and liabilities without determined maturity or without a fixed interest rate. For the other receivables and liabilities, the expected future cash flows are discounted to their net present values using the market prevailing effective rates.

Quoted market prices are used to determine the fair values of trading securities. The fair value is calculated as the net present value of the expected future cash flows using the interest rates applied to the similar securities.

In determining the fair value of municipal bonds issued by the local governance units in the Republic of Serbia, the applicable discount rate is increased by the issuer risk/premium at the time of the municipal bond issue or at the more recent date if such an input is available. The Bank applies an approach based on the initially assessed value of the risk premium to the calculated credit spread, which is determined as the cost of risk.

Given that there is no sufficiently developed secondary market for loans where the fair value of these financial instruments could be determined, it is necessary to use inputs of the level lower than Levels 1 and 2, i.e., level 3 inputs. The unit for fair value assessment is a single loan, i.e., loan facility, and the approach used is the income approach and discounted cash flow method.

Disbursement of new loans to the retail and corporate customers in 2018 was in line with the market conditions (departures per months in certain product categories, taking into account maturity, currency and loan type were within the range of +/-1 p.p.). Given the foregoing, the fair values determined for loans disbursed in 2018 are equal to their carrying values.

Loans disbursed before 2018 are assessed in two separate groups - loans at variable interest rates and loans at fixed interest rates.

Since up to December 31, 2018 the Bank performed at least semi-annual interest rate adjustments, (repricing based on the variable portion of the interest rate) all loans in the group of loans at variable interest rates have fair values equal to their carrying values.

Loans at fixed interest rates disbursed before 2018 were subject to discounting using the interest rates available at the website of the National Bank of Serbia, in the Report on interest rates of banks applied to the loans approved to retail and non-FSI customers per type, maturity and purpose – newly approved loans, The Bank used inputs for December 2018.

Fair values of deposits and other liabilities to the customers were calculated by discounting the value of non-interest-bearing earmarked deposits at the market interest rate of 0.6%.

Valuation of Financial Instruments

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

- Level 1: Quoted market price (unadjusted) in an active market for an identical asset or a liability accessible to the market participants as of the fair value measurement date;
- Level 2: Valuation techniques based on observable inputs other than Level 1 quoted prices, either directly (i.e. as prices) or indirectly (i.e. derived from prices, interest rates, correlations, etc.). 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.

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

28. RISK MANAGEMENT (Continued)

28.1 Credit Risk (Continued)

Fair Value of Assets and Liabilities (Continued)

Valuation of Financial Instruments (Continued)

Financial assets measured at fair value

December 31, 2018	Level 1	Level 2	Level 3	Total
Securities				6,713,867
• Financial assets measured at fair value through profit or loss (FVtPL)	23,248	-	-	23,248
• Securities at fair value through other comprehensive income (FVtOCI)	-	6,690,619	-	6,690,619

December 31, 2017	Level 1	Level 2	Level 3	Total
Securities				4,384,138
• Financial assets at fair value through profit or loss, held for trading (including pledged assets)	24,288	-	-	24,288
• Financial assets available for sale (including pledged assets)	-	4,359,850	-	4,359,850

Financial assets and liabilities measured at other than fair value

December 31, 2018	Level 1	Level 2	Level 3	Total
Financial assets				
Cash and balances held with the central bank	-	7,643,117	-	7,643,117
Receivables under derivative financial instruments	-	-	6,278	6,278
Loans and receivables due from banks and other financial institutions	-	-	2,281,251	2,281,251
Loans and receivables due from customers	-	-	39,855,685	39,855,685
Other assets	-	-	78,686	78,686
Financial liabilities				
Deposits and other liabilities due to banks, other financial institutions and the central bank,	-	-	6,180,692	6,180,692
Deposits and other liabilities due to customers	-	-	39,152,821	39,152,821
Other liabilities	-	-	267,887	267,887
December 31, 2017				
Financial assets				
Cash and balances held with the central bank	-	4,839,851	-	4,839,851
Receivables under derivative financial instruments	-	-	470	470
Securities	-	-	472,892	472,892
Loans and receivables due from banks and other financial institutions	-	-	1,524,613	1,524,613
Loans and receivables due from customers	-	-	30,337,329	30,337,329
Other assets	-	-	121,271	121,271
Financial liabilities				
Deposits and other liabilities due to banks, other financial institutions and the central bank,	-	-	6,277,751	6,277,751
Deposits and other liabilities due to customers	-	-	28,748,134	28,748,134
Other liabilities	-	-	220,144	220,144

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

28. RISK MANAGEMENT (Continued)

28.1 Credit Risk (Continued)

Fair Value of Assets and Liabilities (Continued)

Breakdown of financial assets and liabilities at fair value – comparison of their carrying and fair values calculated for the purpose of disclosure in the Notes to the Financial Statements:

December 31, 2018	FVtPL	FVtOCI	Other – AC	Total carrying value	Total fair value
Financial assets					
Cash and balances held with the central bank	-	-	7,643,117	7,643,117	7,643,117
Receivables under derivative financial instruments	-	-	6,278	6,278	6,278
Securities	23,248	6,690,619	-	6,713,867	6,713,867
Loans and receivables due from banks and other financial institutions	-	-	2,281,251	2,281,251	2,281,251
Loans and receivables due from customers	-	-	38,765,127	38,765,127	39,855,685
Other assets	-	-	78,686	78,686	78,686
Financial liabilities					
Deposits and other liabilities due to banks, other financial institutions and the central bank	-	-	6,180,692	6,180,692	6,180,692
Deposits and other liabilities due to customers	-	-	39,165,999	39,165,999	39,152,821
Other liabilities	-	-	267,887	267,887	267,887

December 31, 2017	FVtPL	FVtOCI	Other – AC	Total carrying value	Total fair value
Financial assets					
Cash and balances held with the central bank	-	-	4,839,851	4,839,851	4,839,851
Receivables under derivative financial instruments	-	-	470	470	470
Securities	24,288	4,359,850	472,892	4,857,030	4,857,030
Loans and receivables due from banks and other financial institutions	-	-	1,524,613	1,524,613	1,524,613
Loans and receivables due from customers	-	-	28,894,906	28,894,906	30,337,329
Other assets	-	-	142,502	142,502	142,502
Financial liabilities					
Deposits and other liabilities due to banks, other financial institutions and the central bank	-	-	6,277,751	6,277,751	6,277,751
Deposits and other liabilities due to customers	-	-	28,762,098	28,762,098	28,748,134
Other liabilities	-	-	220,144	220,144	220,144

28. RISK MANAGEMENT (Continued)

28.2 Capital and Capital Adequacy

The Bank manages capital and capital adequacy ratios in order to maintain the required level of capital to support the development of the Bank and its business activities.

The capital adequacy ratio represents the Bank's capital relative to its risk-weighted assets. The Bank's risk weighted assets equal the sum of its credit-risk weighted assets and the capital requirements for the foreign exchange and operational risks multiplied by the reciprocal value of the capital adequacy ratio.

The Bank's capital is comprised of the core capital and supplementary capital less the sum of deductible items. The Bank is thereby required to maintain the minimum amount of capital of no less that EUR 10,000,000 in RSD equivalent at all times.

The Bank calculates the capital requirement for credit risk using the standardized approach, by multiplying the total credit risk-weighted assets by 8%. The Bank's credit risk-weighted assets comprise the sum of the gross carrying values of the Bank's balance sheet assets less impairment allowances and the reserve for estimated losses and the gross carrying values of the Bank's off-balance sheet items less provisions and the required reserve for estimated losses, multiplied by the credit conversion factors.

The Bank calculates the capital requirement for foreign exchange risk by multiplying the sum of the total net open foreign currency position and absolute value of the net open position in gold by 8%. The total net open foreign currency position represents the absolute value of the higher of the total long and total short foreign currency positions.

The Bank calculates the capital requirement for operational risk by applying the basic indicator approach equal to the three-year average exposure indicator multiplied by the capital requirement rate of 15%.

Since the Bank has not reached the prescribed limits, it is not required to calculate, in addition to the above said capital requirements for credit, foreign exchange and operational risks, and ensure coverage for capital requirements for other market risks arising from the items in the Bank's trading book.

As of December 31, 2018, the Bank's capital and capital adequacy were calculated under the relevant decisions of NBS, which are aligned with Basel III Standard.

As of December 31, 2018, the Bank achieved the following capital adequacy ratios:

- the Bank's total capital adequacy ratio (CAR) was 27.82%
- the Bank's core capital adequacy ratio (T1 ratio) was 27.81%, and
- Bank's common equity Tier 1 capital ratio (CET 1 ratio) was 24.60%,

which were well above the minimum values for those ratios defined by the Decision on Capital Adequacy of Banks:

- the total capital adequacy ratio (CAR) minimum of 8%;
- the core capital adequacy ratio (T1 ratio) minimum of 6%; and
- the common equity Tier 1 capital ratio (CET 1 ratio) minimum of 4.5%**.**

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

28. RISK MANAGEMENT (Continued)

28.2 Capital and Capital Adequacy (Continued)

Item no.	Item	December 31, 2018	December 31, 2017
1	**CAPITAL**	**10,380,711**	**5,045,235**
1.1	**CORE CAPITAL**	**10,379,371**	**5,034,895**
1.1.1	**Common equity Tier 1 capital**	**9,179,371**	**3,843,895**
1.1.1.1	**Common equity Tier 1 instruments and relevant share premium**	**7,771,263**	**3,047,143**
1.1.1.1.1	Paid in common equity Tier 1 instruments	5,658,940	1,819,820
1.1.1.1.2	Relevant share premium with the common equity Tier 1 instruments	2,112,323	1,227,323
1.1.1.2	(-) Loss	**-**	**-**
1.1.1.3	Revaluation reserves and other unrealized gains/losses	**438,377**	**364,162**
1.1.1.4	Reserves from profit, other reserves and reserves for general banking risks	**1,312,431**	**1,312,431**
1.1.1.5	(+/-) Regulatory adjustment of the common equity Tier 1 capital	**(7,168)**	**(5,499)**
1.1.1.6	(-) Goodwill decreased by the related deferred tax liabilities	**-**	**-**
1.1.1.7	(-) Other intangible assets decreased by related deferred tax assets	**(273,138)**	**(98,947)**
1.1.1.8	(-) Deferred tax assets dependable on the Bank's future profitability, except for those arising from the temporary differences less related deferred tax liabilities	**(62,393)**	**(62,393)**
1.1.1.9	(-) Amount of the required reserve for estimated losses on the Bank's balance sheet assets and off-balance sheet items	**(0)**	**(713,002)**
1.1.2	**Additional Tier 1 capital**	**1,200,000**	**1,200,000**
1.1.2.1	**Common additional Tier 1 capital instruments and relevant share premium**	1,200,000	1,200,000
1.1.2.1.1	Paid in additional Tier 1 capital instruments	600,000	600,000
1.1.2.1.2	Relevant share premium with the additional Tier 1 capital instruments	600,000	600,000
1.2	**SUPPLEMENTARY CAPITAL**	**1,340**	**1,340**
1.2.1	Supplementary capital instruments, subordinated liabilities and he relevant share premium	1,340	1,340
1.2.1.1	Paid in supplementary capital instruments	1,340	1,340
1.2.1.2	Relevant share premium with the supplementary capital instruments	**-**	**-**
2.	**TOTAL RISK-WEIGHTED ASSETS:**	**37,317,799**	**29,486,849**
2.1	Risk-weighted credit risk exposures	33,594,005	25,885,182
2.2	Risk-weighted foreign exchange risk exposures	-	126,707
2.3	Risk-weighted market risk exposures	3,723,794	3,474,960
3.	**CAPITAL ADEQUACY RATIOS**		
3.1	Total capital adequacy ratio	**27.82%**	**17.11%**
3.2	Tier 1 capital ratio (T1 ratio)	**27.81%**	**17.11%**
3.3	Common Equity Tier 1 capital ratio (CET 1 ratio)	**24.60%**	**13.04%**

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

28. RISK MANAGEMENT (Continued)

28.3 Assets Acquired in Lieu of Debt Collection

The Bank is actively involved in sales of assets acquired in lieu of debt collection and may retain the foreclosed assets for a certain time only in the event that prompt sale would result in the Bank's significant losses.

Assets acquired in lieu of debt collection as of December 31, 2018 and 2017:

No.	Acquired asset	Area (m^2)	Acquisition date	Execution debtor	Net book value December 31, 2018	Net book value December 31, 2017
1.	Business premises, counter room, cadastral lot no. 3120/1 CM Šume	48	26/12/2014	Mercury internacional a.d. Ivanjica	1,415	1,415
2.	Outlet 45/i Kraljevo at no. 45, Cara Dušana St., Kraljevo	27	24/04/2017	Trgomen Nekretnine d.o.o. Ratina	1,831	1,831
3.	Outlet 45/j Kraljevo at no. 45, Cara Dušana St., Kraljevo	43	24/04/2017	Trgomen Nekretnine d.o.o. Ratina	2,814	2,814
4.	Outlet 45/k Kraljevo at no. 45, Cara Dušana St., Kraljevo	34	24/04/2017	Trgomen Nekretnine d.o.o. Ratina	2,168	2,168
5.	Apartment at no. 29, Tomislava Andrića-Džigija St., Kraljevo	140	16/06/2017	Zoran Milašinović	10,477	10,221
6.	Business premises, CM Ćuprija	82	20/12 2018	Interhem-him	4,619	-
7.	Business premises, CM Ćuprija	89	20/12/2018	Interhem-him	4,485	-
	Total				**29,666**	**18,449**

28.4 Liquidity Risk

Liquidity risk is a risk of adverse effects on the Bank's financial performance and capital due to its inability to discharge its liabilities when these fall due. Hence, the aim of liquidity risk management is to maintain the Bank's liquid assets at the level that ensures the Bank's timely settlement of its liabilities.

The Bank manages its assets and liabilities in the manner that enables settlement of its liabilities matured at any time (liquidity) and permanent settlement of all its liabilities (solvency).

The following organizational units of the Bank are responsible for liquidity risk management:

- The Board of Directors, which defines the liquidity risk management policy and the contingency business plan (liquidity crisis plan);
- The Executive Board, which implements the adopted policy and defines procedures and instructions for liquidity risk management;
- ALCO, which monitors the Bank's exposure to the liquidity risk and proposes adequate measures for liquidity risk management;
- The Bank's Liquidity Committee, which determines and monitors liquidity on a daily basis and proposes adequate measure for prevention of elimination of the non-liquidity causes; and
- Risk Management Department and Treasury, which monitor and maintain liquidity on a daily basis.

Liquidity risk is measured by the Risk Management Department by means of calculation of the liquidity ratio, quick ratio and liquidity coverage ratio as well as additional internal liquidity ratios, deposit concentration ratio, GAP analyses and stress testing.

The Bank's exposure to the liquidity risk is measured by monitoring the liquidity ratio, rigid or quick ratio and liquidity coverage ratio as prescribed by NBS Decision on Liquidity Risk Management by Banks and the Bank's Liquidity Risk Management Procedure. The liquidity ratio is the sum of the level 1 and level 2 liquid receivables relative to the sum of liabilities payable on demand or without contractually defined maturity and liabilities falling due within a month from the ratio calculation date. The rigid or quick liquidity ratio is the sum of level 1 liquid receivables relative to the sum of liabilities payable on demand or without contractually defined maturity and liabilities falling due within a month from the ratio calculation date. The liquidity coverage ratio represents the Bank's liquidity buffer relative to the net liquid asset outflows over an assumed 30-day stress period.

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

28. RISK MANAGEMENT (Continued)

28.4 Liquidity Risk (Continued)

Liquidity ratios and quick ratios achieved by the Bank

	Liquidity ratio	
	2018	**2017**
At December 31	1.69	1.51
Average	1.53	1.71
Maximum	2.02	2.21
Minimum	1.28	1.37

	Quick ratio	
	2018.	**2017.**
At December 31	1.42	1.26
Average	1.27	1.45
Maximum	1.70	1.98
Minimum	1.02	1.04

The Bank's liquidity was also monitored via its liquid asset ratio, which represents liquid assets relative to the total assets.

Liquid asset ratios achieved by the Bank

	2018	**2017**
At December 31	28.51%	25.14%
Average	26.42%	26.51%
Maximum	29.26%	28.73%
Minimum	23.04%	23.93%

During 2018, the Bank monitored its liquidity levels based on the movements of its additional liquidity ratios, defined by its internal Liquidity Risk Management Procedure, as well as based on the covenants stipulated by the loan/line of credit agreements that the bank executed with the international financial institutions. Values of the ratios and covenants were within limits prescribed by the said Procedure and the relevant agreements with the international financial institutions.

The critical element of liquidity risk monitoring and management is monitoring of asset and liability maturity matching. Maturity match and controlled mismatch of the asset and liability maturities are critical to the Bank's management. It is uncommon for banks to achieve complete maturity matching of their assets and liabilities since transactions are often performed for indefinite periods and are different in nature and type. Mismatched position may increase profitability but at the same time it increases a risk of a financial loss.

The negative liquidity presented in the following table in the bucket of up to a month does not require the Bank to take any extraordinary measures as it is a result of deposits without contractually defined maturities being included in this bucket. Such deposits are not expected to be fully withdrawn within a month, as is presented in the following table. Instead, only partial withdrawals are expected (ranging from 10% to 20%, based on the historical data). (

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

28. RISK MANAGEMENT (Continued)

28.4 Liquidity Risk (Continued)

The table below presents the Bank's assets and liabilities grouped in maturity buckets as per their remaining maturities – from the reporting date to their respective contractually defined maturity dates.

December 31, 2018	Up to 30 days	30 to 90 days	90 to 365 days	1 to 5 years	Over 5 years	Total
Cash and balances held with the central bank	7,643,117	-	-	-	-	**7,643,117**
Receivables under derivative financial instruments	6,278	-	-	-	-	**6,278**
Securities	881,551	1,000,000	509,097	2,686,830	1,636,389	**6,713,867**
Loans and receivables due from banks and other financial institutions	2,003,185	41,940	235,340	786	-	**2,281,251**
Loans and receivables due from customers	838,422	971,574	5,657,351	18,383,269	12,914,511	**38,765,127**
Other assets	74,000	-	-	-	4,686	**78,686**
Total financial assets	**11,446,553**	**2,013,514**	**6,401,788**	**21,070,885**	**14,555,586**	**55,488,326**
Deposits and other liabilities due to banks, other financial institutions and the central bank,	3,213,034	255,848	938,891	1,181,946	590,973	**6,180,692**
Deposits and other liabilities due to customers	18,659,443	3,093,445	8,641,941	4,928,338	3,842,832	**39,165,999**
Other liabilities	267,887	-	-	-	-	**267,887**
Total financial liabilities	**22,140,364**	**3,349,293**	**9,580,832**	**6,110,284**	**4,433,805**	**45,614,578**
Maturity match/mismatch (gap)	**(10,693,811)**	**(1,335,779)**	**(3,179,044)**	**14,960,601**	**10,121,781**	**9,873,748**

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

28. RISK MANAGEMENT (Continued)

28.4 Liquidity Risk (Continued)

December 31, 2017	Up to 30 days	30 to 90 days	90 to 365 days	1 to 5 years	Over 5 years	Total
Cash and balances held with the central bank	4,839,851	-	-	-	-	**4,839,851**
Receivables under derivative financial instruments	470	-	-	-	-	**470**
Securities	242,615	399,784	58,459	3,603,227	552,945	**4,857,030**
Loans and receivables due from banks and other financial institutions	1,423,793	99,116	524	1,180	-	**1,524,613**
Loans and receivables due from customers	1,366,619	698,641	4,635,635	14,171,753	8,022,258	**28,894,906**
Other assets	116,915	-	-	-	4,356	**121,271**
Total financial assets	**7,990,263**	**1,197,541**	**4,694,618**	**17,776,160**	**8,579,559**	**40,238,141**
Deposits and other liabilities due to banks, other financial institutions and the central bank,	2,736,965	50,000	479,783	1,807,091	1,203,912	**6,277,751**
Deposits and other liabilities due to customers	12,484,335	2,245,690	6,086,690	6,049,710	1,895,673	**28,762,098**
Other liabilities	220,144	-	-	-	-	**220,144**
Total financial liabilities	**15,441,444**	**2,295,690**	**6,566,473**	**7,856,801**	**3,099,585**	**35,259,993**
Maturity match/mismatch (gap)	**(7,451,181)**	**(1,098,149)**	**(1,871,855)**	**9,919,359**	**5,479,974**	**4,978,148**

28. RISK MANAGEMENT (Continued)

28.5 Market Risk (Interest Rate Risk, Foreign Exchange Risk and Security Price Risk)

28.5.1 Interest Rate Risk

Interest rate risk is a risk of a possible adverse effects on the Bank's financial performance and capital due to changes in interest rates. The Bank is exposed to the interest rate risk per items recorded in its banking book.

The objective of the Bank's interest rate risk management is to minimize the adverse effects that may arise from the changes in the market interest rates.

The following organizational units of the Bank are responsible for interest rate risk management:

- The Board of Directors, which defines the interest rate risk management policy;
- The Executive Board, which implements the adopted policy and defines procedures and instructions for interest rate risk management;
- ALCO, which monitors the Bank's exposure to the interest rate risk and proposes adequate measures for interest rate risk management;
- Risk Management Department, which implements the risk management policy and procedure and reports to the Bank's management on this risk exposure; and
- Marketing Division, which monitors market interest rates on a daily basis and proposes interest rates for the Bank's products.

Interest rate risk is measured by the Risk Management Department by means of repricing risk measurement, basis risk, yield curve risk and optionality risk measurements.

The following tables provide breakdowns of the interest bearing assets and liabilities grouped into maturity buckets for items at fixed interest rates and repricing periods for instruments at variable interest rates.

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

28. RISK MANAGEMENT (Continued)

28.5 Market Risk (Interest Rate Risk, Foreign Exchange Risk and Security Price Risk) (Continued)

28.5.1 Interest Rate Risk (Continued)

December 31, 2018	Up to 30 days	30 to 90 days	90 to 365 days	1 to 5 years	Over 5 years	Non-interest bearing	Total
Cash and balances held with the central bank	3,419,765	-	-	-	-	4,223,352	7,643,117
Receivables under derivative financial instruments	-	-	-	-	-	6,278	6,278
Securities	300,001	1,000,000	509,097	2,686,830	1,636,389	581,550	6,713,867
Loans and receivables due from banks and other financial institutions	186,133	41,940	235,340	786	-	1,817,052	2,281,251
Loans and receivables due from customers	14,567,640	2,708,403	8,298,588	9,965,175	1,913,356	1,311,965	38,765,127
Other assets	-	-	-	-	-	78,686	78,686
Total financial assets	**18,473,539**	**3,750,343**	**9,043,025**	**12,652,791**	**3,549,745**	**8,018,883**	**55,488,326**
Deposits and other liabilities due to banks, other financial institutions and the central bank,	2,806,299	255,848	2,711,810	-	-	406,735	6,180,692
Deposits and other liabilities due to customers	1,709,265	3,093,442	8,641,944	4,928,338	3,842,832	16,950,178	39,165,999
Other liabilities	-	-	-	-	-	267,887	267,887
Total financial liabilities	**4,515,564**	**3,349,290**	**11,353,754**	**4,928,338**	**3,842,832**	**17,624,800**	**45,614,578**

December 31, 2017	Up to 30 days	30 to 90 days	90 to 365 days	1 to 5 years	Over 5 years	Non-interest bearing	Total
Cash and balances held with the central bank	1,512,004	-	-	-	-	3,327,847	4,839,851
Receivables under derivative financial instruments	-	-	-	-	-	470	470
Securities	-	399,784	58,458	3,603,227	552,945	242,616	4,857,030
Loans and receivables due from banks and other financial institutions	50,758	99,116	526	-	-	1,374,213	1,524,613
Loans and receivables due from customers	9,831,497	3,100,547	3,591,666	7,816,595	3,724,869	829,732	28,894,906
Other assets	-	-	-	-	-	142,502	142,502
Total financial assets	**11,394,259**	**3,599,447**	**3,650,650**	**11,419,822**	**4,277,814**	**5,917,380**	**40,259,372**
Deposits and other liabilities due to banks, other financial institutions and the central bank,	4,501,484	50,000	1,070,581	30,000	-	625,686	6,277,751
Deposits and other liabilities due to customers	3,607,099	3,217,679	6,641,870	2,513,705	196,923	12,584,822	28,762,098
Other liabilities	-	-	-	-	-	220,144	220,144
Total financial liabilities	**8,108,583**	**3,267,679**	**7,712,451**	**2,543,705**	**196,923**	**13,430,652**	**35,259,993**

**within the line item of loans and receivables due from customers, the amount of NPLs is presented as non-interest bearing (net)*

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

28. RISK MANAGEMENT (Continued)

28.5 Market Risk (Interest Rate Risk, Foreign Exchange Risk and Security Price Risk) (Continued)

28.5.1 Interest Rate Risk (Continued)

The following table presents the Bank's sensitivity to changes in interest rates. The sensitivity is measured against the impact of the parallel shift of the yield curve by 200 basis points on the Bank's capital and income.

	2018		2017	
	Impact on capital	**Impact on income**	**Impact on capital**	**Impact on income**
At December 31	105,379	89,913	(41,650)	49,793
Average	55,434	71,655	(41,281)	46,402
Maximum	137,396	89,913	49,569	75,672
Minimum	(59,284)	49,955	(177,973)	34,218

28.5.2 Foreign Exchange Risk

Foreign exchange risk is a risk of adverse effects on the Bank's financial performance and capital due to fluctuations in the foreign exchange rates. The Bank is exposed to the foreign exchange risk per items maintained in both the banking book and the trading book.

The Bank manages foreign exchange risk to minimize losses arising from changes in foreign exchange rates.

The following organizational units of the Bank are responsible for foreign exchange risk management:

- The Board of Directors, which defines the market risk management policy;
- The Executive Board, which implements the adopted policy and defines procedures and instructions for foreign exchange risk management;
- ALCO, which monitors the Bank's exposure to the foreign exchange risk and proposes adequate measures for foreign exchange risk management;
- Risk Management Department and Treasury, which monitor and manage the currency structure of sources of assets on a daily basis.

The foreign exchange risk is measured by the Risk Management Department based on the foreign exchange ratio as the net open foreign currency position and the Bank's capital, in accordance with NBS Decision on Capital Adequacy of Banks and Decision on Reporting Requirements for Banks and the Bank's Procedure for Foreign Exchange Risk Management.

Foreign exchange risk ratios achieved by the Bank

	2018	**2017**
At December 31	0.63%	2.51%
Average	1.37%	1.94%
Maximum	5.68%	6.53%
Minimum	0.18%	0.18%

In the course of 2018, the foreign exchange risk, measured by the foreign exchange risk ratio, was mostly in the low risk range. The average value of the ratio for the year equaled 1.37%.

The following tables present the breakdown of the open net foreign currency positions per currency as of December 31, 2018 and 2017.

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

28. RISK MANAGEMENT (Continued)

28.5 Market Risk (Interest Rate Risk, Foreign Exchange Risk and Security Price Risk) (Continued)

28.5.2 Foreign Exchange Risk (Continued)

Breakdown of assets and liabilities per currency

December 31, 2018	EUR	USD	CHF	Other currencies	Total FX	RSD	Total
Cash and balances held with the central bank	3,189,671	42,878	129,176	18,011	3,379,736	4,263,381	**7,643,117**
Receivables under derivative financial instruments	-	-	-	-	-	6,278	**6,278**
Securities	353,162	-	-	-	353,162	6,360,705	**6,713,867**
Loans and receivables due from banks and other financial institutions	1,373,711	280,806	117,871	149,438	1,921,826	359,425	**2,281,251**
Loans and receivables due from customers	26,442,442	82,097	-	-	26,524,539	12,240,588	**38,765,127**
Other assets	7,689	377	11	37	8,114	70,572	**78,686**
Total financial assets	**31,366,675**	**406,158**	**247,058**	**167,486**	**32,187,377**	**23,300,949**	**55,488,326**
Deposits and other liabilities due to banks, other financial institutions and the central bank,	5,023,295	10,476	20	71,053	5,104,844	1,075,848	6,180,692
Deposits and other liabilities due to customers	24,765,708	395,858	260,457	83,284	25,505,307	13,660,692	39,165,999
Other liabilities	67,935	2,385	4	17	70,341	197,546	267,887
Total financial liabilities	**29,856,938**	**408,719**	**260,481**	**154,354**	**30,680,492**	**14,934,086**	**45,614,578**
Net foreign currency position	**1,509,737**	**(2,561)**	**(13,423)**	**13,132**	**1,506,885**	**8,366,863**	**9,873,748**

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

28. RISK MANAGEMENT (Continued)

28.5 Market Risk (Interest Rate Risk, Foreign Exchange Risk and Security Price Risk) (Continued)

28.5.2 Foreign Exchange Risk (Continued)

Breakdown of assets and liabilities per currency

December 31, 2017	EUR	USD	CHF	Other currencies	Total FX	RSD	Total
Cash and balances held with the central bank	2,774,440	35,090	82,153	11,686	2,903,369	1,936,482	**4,839,851**
Receivables under derivative financial instruments	-	-	-	-	-	470	**470**
Securities	395,893	-	-	1	395,894	4,461,136	**4,857,030**
Loans and receivables due from banks and other financial institutions	784,088	212,688	136,445	90,953	1,224,174	300,439	**1,524,613**
Loans and receivables due from customers	20,912,882	-	-	-	20,912,882	7,982,024	**28,894,906**
Other assets	21,634	733	10,187	17,771	50,325	70,946	**121,271**
Total financial assets	**24,888,937**	**248,511**	**228,785**	**120,411**	**25,486,644**	**14,751,497**	**40,238,141**
Deposits and other liabilities due to banks, other financial institutions and the central bank,	5,109,964	-	-	-	5,109,964	1,167,787	6,277,751
Deposits and other liabilities due to customers	19,644,408	241,758	224,418	103,987	20,214,571	8,547,527	28,762,098
Other liabilities	10,095	48	4	15	10,162	209,982	220,144
Total financial liabilities	**24,764,467**	**241,806**	**224,422**	**104,002**	**25,334,697**	**9,925,296**	**35,259,993**
Net foreign currency position	**124,470**	**6,705**	**4,363**	**16,409**	**151,947**	**4,826,201**	**4,978,148**

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

28. RISK MANAGEMENT (Continued)

28.5 Market Risk (Interest Rate Risk, Foreign Exchange Risk and Security Price Risk) (Continued)

28.5.2 Foreign Exchange Risk (Continued)

The tables below present the impact of the change in the RSD to foreign currency exchange rates by 15% on the Bank's net foreign currency position as of December 31, 2018 and 2017. RSD items with currency clause index are presented within the FX items (EUR and USD) of the currency to which they are indexed.

December 31, 201	EUR	EUR 15%	EUR -15%	USD	USD 15%	USD -15%	CHF	CHF 15%	CHF -15%
Financial assets	31,366,675	36,071,676	26,661,674	406,158	467,082	345,234	247,058	284,117	209,999
Financial liabilities	29,856,938	34,335,479	25,378,397	408,719	470,027	347,411	260,481	299,553	221,409
Net currency position	**1,509,737**	**1,736,198**	**1,283,276**	**(2,561)**	**(2,945)**	**(2,177)**	**(13,423)**	**(15,436)**	**(11,410)**

December 31, 2017	EUR	EUR +15%	EUR -15%	USD	USD +15%	USD -15%	CHF	CHF +15%	CHF -15%
Financial assets	24,888,937	28,622,278	21,155,596	248,511	285,788	211,234	228,785	263,103	194,467
Financial liabilities	24,764,467	28,479,137	21,049,797	241,806	278,077	205,535	224,422	258,085	190,759
Net currency position	**124,470**	**143,141**	**105,799**	**6,705**	**7,711**	**5,699**	**4,363**	**5,018**	**3,708**

28.5.3 Security Price Risk

Security price risk is a risk of adverse effects on the Bank's financial performance and capital due to changes in prices of securities within the Bank's portfolio.

The Bank manages the risk of changes in prices of securities to minimize the adverse effects of changes in prices of securities in the Bank's portfolio.

The following organizational units of the Bank are responsible for security price risk management:

- The Board of Directors, which defines the security portfolio management policy and market risk management policy;
- The Executive Board, which implements the adopted policies;
- ALCO, which monitors the Bank's exposure to the security price risk and proposes adequate measures for this risk management;
- Treasury, which manages the portfolio of securities on a daily basis and the Risk Management Department, which monitor the values of the trading book items and reports to the Bank's management.

Based on the relevant sources of market information, the Risk Management Department actively monitors the values of securities in the Bank's possession and controls their compliance with the internally prescribed limits.

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

28. RISK MANAGEMENT (Continued)

28.5 Market Risk (Interest Rate Risk, Foreign Exchange Risk and Security Price Risk) (Continued)

28.5.3 Security Price Risk (Continued)

Value of the Bank's portfolio

	Market value at December 31,	
	2018	**2017**
Securities at fair value through profit or loss (FVtPL)	**23,248**	-
Securities at fair value through profit or loss, held for trading	**-**	**24,758**
Bank shares	1,239	814
Corporate shares	22,009	23,474
Receivables under derivatives held for trading	-	470
	6,690,619	-
Securities at fair value through other comprehensive income (FVtOCI)	-	**4,359,850**
Financial assets available for sale		
Municipal bonds:	23,193	30,839
City of Šabac	9,095	15,317
Municipality of Stara Pazova	322,255	293,436
Bonds issued by the Republic of Serbia in foreign currencies	6,336,076	4,020,424
Bonds issued by the Republic of Serbia in RSD	-	(166)
Impairment allowance of the municipal bonds		
	-	-
Securities at fair value through other comprehensive income (FVtOCI)		**472,892**
Financial assets held to maturity	**-**	**414,425**
In RSD	-	414,425
Bonds issued by the Republic of Serbia	**-**	**58,467**
In foreign currencies	-	58,467
Bonds issued by the Republic of Serbia		

28.6 Operational Risk

Operational risk is the risk of the adverse effects on the Bank's financial result and capital due to failures in the employees performance, inadequate internal procedures and processes, inadequate management of the information and other systems in the Bank or due to unforeseen external events. Operational risk includes legal risk but not the reputation and strategic risks.

The following organizational units of the Bank are responsible for operational risk management:
- The Board of Directors, which defines the operational risk management poli□y;
- The Executive Board, which implements the adopted policy and defines the operational risk management pro□edure;
- ALCO, which monitors the Bank's exposure to the operational risk and proposes adequate measures for this risk management;
- Risk Management Department, which on a daily basis monitors the risk, collects information on the operational risk events, and reports to the management on the Bank's exposure to the operational risk;

Operational risk exposure is measured by the Risk Management Department through identification of the operational risks, creation, maintenance and analysis of the database on the operational risk events in accordance with the Bank's Operational Risk Management Procedure in place.

The Bank's exposure to the operational risk is in fact measured by monitoring the number of events of the same type during the calendar year and the financial effect of each such event:

	2018	**2017**
Number of events	129	105
Gross loss (EUR)	340,085	1,358,404
Net loss (EUR)	55,045	9,700

28. RISK MANAGEMENT (Continued)

28.6 Operational Risk (Continued)

In 2018, 129 operational risk events were recorded – 24 up year-on-year. The largest number of events relate to the cashier shortages or surpluses and those were successfully resolved (58 events of cashier shortages and 34 events of cashier surpluses). The remaining 37 events pertained to instances of external fraud, disruptions in operations and system failures, technical problems, power outage, non-compliance with the procedures upon loan approval, accounting errors, problems regarding reserves on the customer current accounts, problems in using software applications, etc.

The Bank assesses the risk of activity outsourcing. Outsourcing is performed under the relevant contracts where rights and obligations of the contracting parties are clearly defined.

The Bank also identifies and assesses operational risks upon each introduction of new products, processes and systems of new business activities.

28.7 Risk of Inadequate Information System Management

The Bank's objective in managing the risk of inadequate information system management is to minimize negative effects that may arise from the Bank's IS exposure to public networks, malicious internal attacks, hardware fault, breakdown, and sabotage and to maintain such risk exposures within the prescribed limits. In accordance with NBS Decision on the Minimum Standards for Financial Institution IS Management (Official Gazette of RS, nos. 23/2013, 113/2013 and 2/2017), the Bank has undertaken a number of activities for full compliance with the said Decision.

To this end, the Bank has adopted the IS Development Strategy, the Business Continuity Strategy, Exit Strategies for Outsourced Activities, and IS Security Policy. Furthermore, a series of new procedures and quality assurance instructions have been adopted, all in accordance with NBS Decision on the Minimum Standards for Financial Institution IS Management.

The Bank is currently in the process of PCI DSS certification so as to ensure an adequate level of data protection, primarily for improvement of card operations, which are also being set up. The process of compliance with PCI DSS standard induced not only processing improvements, but information system protection enhancement as well, which will consequently enable higher levels of protection for card operations as well as the Bank's overall business processes.

The Bank's information system has functionalities to support the business processes, ensure timely, accurate and complete information significant for decision making and risk management. The Bank continuously improves its information system.

The current IS Development Strategy is regularly updated. For a better quality IS management, regular meetings of the IT Committee are held where current and pending IT projects are discussed. The framework for IS management comprises the adopted Project Management Methodology and system of reporting on the information system function and security.

The following organizational units of the Bank are responsible for management of the inadequate IS management risk:

- The Board of Directors, which defines the IS Development Strategy, the IS Security Policy and the Business Continuity Strategy;
- The Executive Board, which implements the adopted strategies and policies and defines relating procedures and instructions;
- IT Committee, which monitors IS functioning and development, makes relevant decisions and proposes adequate measure to the Bank's Executive Board;
- IT Division, which plans, proposes and performs all activities related to the Bank's information system and reports to the IT Committee.

The Information Security Manager assesses the IS security risk and reports to the IT Committee on the assessment.

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

28. RISK MANAGEMENT (Continued)

28.8 Exposure Risk

The Bank manages the exposure risk in order to minimize the negative effects that may arise from the concentration of the Bank's exposure to a single entity or a group of related entities and entities/persons related to the Bank and to maintain such exposures within prescribed limits.

The following organizational units of the Bank are responsible for exposure risk management:

- The Board of Directors, which decides on the Bank's exposures to a single entity or a group of related entities in excess of 10% of the Bank's capital and on exposures to the entities related to the Bank;
- The Executive Board, which defines the exposure risk management procedure, decides on the Bank's exposures to a single entity or a group of related entities up to 10% of the Bank's capital and on exposures to the entities related to the Bank in accordance with the Board of Directors' Decision on Authorizing the Bank's Executive Board to Execute Legal Transactions with a Related Party;
- ALCO, which monitors the Bank's exposures to a single entity, a group of related entities and entities/persons related to the Bank and proposes adequate measures for exposure risk management;
- Risk Management Department, which reports to the management on the Bank's exposures to a single entity, a group of related entities and entities/persons related to the Bank.

Exposure risks are measured by the Risk Management Department through preparation of the reports prescribed by the relevant NBS decision and the Bank's procedures.

Net exposures to the Bank's related parties and large exposures

	2018		2017	
	Exposure amount	Share in capital	Exposure amount	Share in capital
Bank's related parties	1,281,466	12.34%	664,850	13.18%
Large exposures	1,281,466	12.34%	523,714	10.38%

In 2018, the Bank's exposures to a single entity/a group of related entities and entities/persons related to the Bank were within the prescribed limits. For all exposures within the medium exposure risk level range, prior approval of the Executive Board was obtained.

The Bank monitors its concentration ratio for 20 largest gross exposures. The concentration ratio for 20 gross largest exposures represents the Bank's balance sheet assets and off-balance sheet items subject to classification for 20 largest business groups other than banks, relative to the total classifying assets less assets representing exposures to the other banks. The Bank's goal is to maintain this ratio at the levels below 300%.

As of December 31, 2018, the Bank's balance sheet assets and off-balance sheet items subject to classification for 20 largest business groups other than banks amounted to RSD 9,310,466 thousand. December 31, 2018, the Bank's concentration ratio for 20 largest gross exposures equaled 89.69%, whereas the Bank's concentration ratio for 20 largest gross exposures equaled 143.62% as of December 31, 2017, having decreased by 53.93 p.p. as a result of the capital increase.

28.9 Investment Risks – Investments in Non- FSI Entities and Own Fixed Assets

Investments in other entities are investments whereby the Bank acquires equity interests or share in entities that do not belong to the financial services industry. Such investments are not associated with acquisition of shares for further sales within six months from their acquisition date.

The following organizational units of the Bank are responsible for investment risk management:

- The Board of Directors, which decides on the individual investments to be made in the Bank's own fixed assets in excess of EUR 250 thousand in RSD equivalent;
- The Executive Board, which defines the investment risk procedure and decides on the investments to be made in the Bank's own fixed assets up to EUR 250 thousand in RSD equivalent;
- ALCO, which monitors the bank's investments risks and proposes adequate measures for the investment risk management;
- IT Division, Technical Affairs Unit and Information Security Unit, which are in charge of acquisition of fixed assets.

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

28. RISK MANAGEMENT (Continued)

28.9 Investment Risks – Investments in Non- FSI Entities and Own Fixed Assets (Continued)

The Bank's investment risks are measured by the Risk Management Department and Financial Management and budgeting Department.

Investments in non- FSI entities and own fixed assets relative to the Bank's capital

	December 31, 201.	December 31, 2017
Investments in non-FSI entities	0.00%	0.00%
Total investments in non-FSI entities and Bank's own fixed assets	9.39%	18.74%

During 2018, the Bank's investment were within the low risk level range.

28.10 Country Risk

Country risk is the risk relating to the country of origin of the entities/persons the Bank is exposed to, i.e., a risk of negative effects on the Bank's financial performance and capital due to the Bank's inability to collect receivables due from non-residents for reasons resulting from political, economic and social circumstances prevailing in the country of origin of such entities/persons.

The following organizational units of the Bank are responsible for country risk management:
- The Board of Dire□tors, whi□h defines the □ountry risk management poli□y;
- The Executive Board, which implements the adopted policy and defines the country risk management pro□edure;
- ALCO, which monitors the Bank's exposure to the country risk and proposes adequate measures for this risk management;
- Payment Operations Department, which is involved in account opening and closing and money transfers with correspondent banks.

Country risk is measured by the Risk Management Department, where the monthly identification of the country risk is made upon preparation of the monthly report on the Bank's risk exposure.

The Bank has system in place for classification of countries per country risk level based on the risk categories assigned to countries by the largest international credit rating agencies (Moody's, Standard & Poors and Fitch).

In 2018, the Bank had funds deposited on accounts held with banks operating in the countries, which, according to the rating of the said rating agencies and in line with the Bank's relevant procedure, were classified as low-risk and medium-risk countries.

The Bank's exposure to the low-risk countries is not limited. As of December 31, 2018, such countries were Germany, Belgium, Austria and the USA. As of December 31, 2018, the medium-risk countries were Turkey, Macedonia, Croatia and Albania. The Bank's exposure to these four medium-risk countries was significantly lower that the internally prescribed limits during December 2018.

List of countries to which the Bank was exposed as of December 31, 2018

Country	Risk level	Limit	Share in the Bank's capital
Germany	low	No limit	3.75%
Belgium	low	No limit	0.12%
Austria	low	No limit	2.38%
United States	low	No limit	0.79%
Turkey	medium	100% of regulatory capital	23.75%
Macedonia	medium	100% of regulatory capital	3.23%
Croatia	medium	10% of regulatory capital	0.04%
Albania	medium	25% of regulatory capital	1.14%

28. RISK MANAGEMENT (Continued)

28.11 Compliance Risk and Risk Management Activities Relating to Prevention of Money Laundering and Financing of Terrorism

Compliance entails performance of banking operations in accordance with the legislation, regulations, standards, procedures, business policies and other internal bylaws. Compliance risk occurs as a result of failure to align banking operations with the said regulations and enactments.

The Bank manages the compliance risk in order to avoid sanctions of the regulatory authority, financial losses, compromise to the Bank's reputation and clients' trust.

The following organizational units of the Bank are responsible for compliance risk management:

- The Board of Directors, which defines the compliance risk management policy;
- The Executive Board, which implements the adopted policy and defines the compliance risk management procedure;
- Compliance and AML Department, which identifies, assesses and monitors the compliance risk.

In 2018, the Compliance and AML Department identified and assessed compliance risk by implementing adequate control activities and conducting inspections prescribed by the Rules of Procedure in the manner governed by the Compliance Risk Management Procedure.

The report on the conducted inspection of compliance and risk management activities relating to the prevention of money laundering and financing of terrorism

The report contains information on the conducted compliance inspections and undertaken activities on identification and monitoring of compliance risk of money laundering and financing of terrorism.

1. In accordance with the Annual Operating Plan, during 2018, based on the randomly selected sample, the Compliance and AML Department personnel conducted 10 inspections of the compliance with the legislation and internal bylaws in several organizational units of the Bank.

Compliance inspections were also conducted in the following branches: Large Client Branch, Makedonska Street, New Mill, Novi Beograd, Zemun and Topola, Vrnjačka Banja, Tutin, Mladenovac and Paraćin.

Recommendations were provided and deadlines set for elimination of risks and findings identified upon inspection. All the suggested recommendations were implemented within the deadlines set.

The findings identified upon inspections conducted in the above said organizational units of the Bank were evaluated as *acceptable with certain corrections* in 9 reports and as *fully compliant* in 1 report, since the operations subject to inspection were performed in compliance with the relevant effective legislation and the Bank's procedures.

2. The Compliance and AML Department had a preventive role in compliance risk identification and monitoring by keeping track of novel solutions in and amendments to the effective legislation, by notifying the competent management on significant new developments and obligations of aligning the Bank's procedures and instructions with the legislation and by overseeing implementation and incorporation of the legislation in the Bank's internal bylaws.

During 2018, heads of the Bank's competent organizational units were promptly notified of amendments to 46 legislative regulations.

The more relevant new laws and decisions enacted by the National Bank of Serbia published in the Official Gazette of RS during 2017 that have a significant impact on the Bank's operations are: Decision the Amendments to the Decision on the Rate and Manner of Maintaining the Systemic Risk Buffer, Decision on the Guidelines for Implementation of the Law on Prevention of Money Laundering and Terrorism Financing for the Obligors Supervised by NBS, Decision on Submission of Information on the Interbank Monetary Market Loans to NBS, Decision on Amendments and Supplements to the Decision on the Implementation of the Provisions of the Law on Banks Relating to the Issue of Preliminary Approvals, Operating Permits and Certain Other Approvals by NBS, the Law on the Amendments and Supplements to the Law on Foreign Exchange Operations, Decision on Amendments and Supplements to the Decision on the Conditions and Manner of Functioning of the Foreign Exchange Market, the Law on the Centralized Records of Ultimate Beneficial Owners, Law on the Amendments and Supplements to the Law on Payment Services, Law on the Interbank Fees and Special Rules for Payment Card Operations,

28. RISK MANAGEMENT (Continued)

28.11 Compliance Risk and Risk Management Activities Relating to Prevention of Money Laundering and Financing of Terrorism (Continued)

Decision on Amendments and Supplements to the Decision on the Information and Data Submitted to the National Bank of Serbia for Preparation and Update of Bank and Banking Group Restructuring Plan, Decision on Amendments and Supplements to the Decision on the Manner of Calculation of the Effective Interest Rate, and Appearance and Contents of the Forms submitted to the Beneficiary, Decision on the General Rules on Execution of the Instant Transfers of Credited Amounts, Decision on Amendments and Supplements to the Decision on the Form, Contents and Use of the Payment Order Forms for RSD Payment Transactions, Decision on Amendments and Supplements to the Decision on the Conditions for Opening and Manner of Maintenance of Resident Foreign Currency Accounts and Non-Resident RSD and Foreign Currency accounts, Decision on Amendments and Supplements to the Decision on Detailed Criteria for the Opening, Maintenance and Closing of Current Accounts, Decision on Amendments and Supplements to the Decision on Risk Management, Law on the Personal Data Protection, bylaws adopted in accordance with the amendments to the Law on Payment Services, Decision on the Management of the Concentration Risk Arising from the bank's Exposure to Certain Product Types, Decision on Amendments and Supplements to the Decision on the Capital Adequacy of Banks, and Decision on Amendments and Supplements to the Decision on Classification of Bank Balance Sheet Assets and Off-Balance Sheet Items.

At the request of the Bank's Risk Management Department, an inspection was conducted on the Report on publishing the Bank's data and information as of June 30, 2018, which found that the Report was prepared in conformity with the relevant NBS decision and that it contained all the prescribed elements. In 2018, an inspection was made on the Report on the process of internal assessment of the Bank's capital adequacy for 2017 (Report to ICAAP). It was found that the Report was prepared in conformity with the relevant NBS decision and that it contained all the prescribed elements.

3. In order to identify and detect suspicious transactions, the Compliance and AML Department staff performed daily control and inspection activities, analyses and reporting of the cash transactions amounting to and in excess of EUR 15,000 in RSD equivalent (at the middle exchange rate of NBS) to the Administration for Prevention of Money Laundering. During 2018, the Department reported 5,466 regular cash transactions to the Administration for Prevention of Money Laundering.

Particular attention was paid to the monitoring, analysis and detection of suspicious transactions of the Bank's customers. In the observed period, the staff reported 11 suspicious transactions to the Administration for Prevention of Money Laundering, of which 7 were carried out by corporate customers (entities) and 3 by individuals (one individual was reported twice.).

4. In accordance with both external and internal regulations, the following reports were prepared for the competent Bank's bodies and regulators:

- The annual report on the conducted analysis and assessment of the Bank's exposure to the risk of money laundering and finan□ing of terrorism;
- The annual report on the conducted compliance inspections with identified and assesses main compliance risks and risk management plan;
- The annual report on the conducted internal inspection and actions undertaken in the area of prevention of money laundering and finan□ing of terrorism;
- Quarterly reports on the conducted compliance inspections and actions undertaken in the area of prevention of money laundering and financing of terrorism.

In accordance with the effective regulations, the Bank prepared the annual plan and program of staff education and training for implementation of the regulations and procedures in the area of prevention of money laundering and financing of terrorism.

In 2017 the Bank's authorized personnel held trainings for all the Bank's employees and tested their knowledge in the area of prevention of money laundering and financing of terrorism.

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

28. RISK MANAGEMENT (Continued)

28.12 Environmental Risks

The Bank manages the environmental risks in order to identify, assess and control risks that may cause jeopardy to the natural and social environment in accordance with the Environmental Risk Management Policy and Procedure.

The following organizational units of the Bank are responsible for environmental risk management:

- The Board of Directors, which defines and at least annually reviews the environmental risk policy and assesses the need to amend this policy;
- The Executive Board, which implements the adopted policy and defines procedures for environmental risk management;
- Credit Committees, which decide on the loan approval in accordance with the available information and opinion of the Credit Division on the risk of impact on the natural and social environment;
- The Bank's Crediting Department, which assesses the impact of the borrower's business activities and financed assets/purposes during the assessment of the borrower credit quality; and
- Risk Management Department, which monitors the loans at the portfolio level per categories of environmental risk through preparation and analysis of the risk reports.

Upon processing an individual client's loan request, the first step is to classify the environmental risk per the client's core business activity and the activity that is to be financed.

Environmental risk categories are:

- High – exclusion list;
- High – category A;
- High;
- Medium; and
- Low.

If the activity subject to financing is included in the exclusion list, the client's loan request is denied. If it is classified into high risk category A, the client is required to provide the Assessment of the Impact on the Environment and the impact on the environment is further considered before a decision is made on loan approval by the competent Credit Committee.

Upon checkup of the loan request analysis with the proposed decision to the competent Credit Committee, the Crediting Department checks the classification of the activity that is to be financed according to the environmental risk level, checks the information on the impact of the client and the client's activity subject to financing on the natural and social environment.

The Bank's loan and other contracts contain provisions and clauses regarding the protection of the natural and social environment to be observed by both the clients and the Bank.

The Bank monitors the balances of loans and receivables per client industry, business activity and environmental risk category through preparation and analysis of the relevant risk reports.

Breakdown of corporate loans per environmental risk category

	Number of customers		Loan and receivable amounts (on and off balance)		
Risk category	**December 31, 2018**	**December 31, 2017**	**December 31, 2018**	**December 31, 2017**	**Increase / decrease**
High – exclusion list	2	-	238,534	-	238,534
High – category A	8	8	72,576	70,640	1,936
High	292	244	7,895,397	7,682,454	212,943
Medium	1,359	1,048	16,655,673	11,748,016	4,907,657
Low	2,287	1,975	19,560,691	13,960,351	5,600,340
Total	**3,948**	**3,275**	**44,422,871**	**33,461,461**	**10,961,410**

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

29. COMPLIANCE WITH NBS REGULATIONS

Performance/adequacy ratio	Values prescribed by NBS	Values achieved at December 31, 2018	Values achieved at December 31, 2017
Amount of the Bank's capital	min EUR 10,000,000	EUR 87.827.288	EUR 42.585.634
Total capital adequacy ratio	min 8%	27.82%	17.11%
Tier 1 capital ratio (T1 ratio)	min 6%	27.81%	17.11%
Common Equity Tier 1 capital ratio (CET 1 ratio)	min 4.5%	24.60%	13.04%
Foreign exchange risk ratio	max 20%	0.63%	2.51%
Liquidity ratio	min 1	1.69%	1.51
Rigid (cash) liquidity ratio	min 0.7	1.42%	1.26
Total exposure to the entities related to the Bank	-	16.67%	13.18%
Exposure to a single entity/a group of related entities	max 25%	12.34%	10.38%
Sum of all large Bank's exposures	max 400%	12.34%	10.38%
Investments in non-FSI entities	max 10%	0.00%	0.00%
Total investments in non-FSI entities and the Bank's fixed assets	max 60%	9.39%	18.74%

30. RECONCILIATION OF OUTSTANDING BALANCES RECEIVABLE AND PAYABLE WITH COUNTERPARTIES

In accordance with Article 18 of the Law on Accounting (Official Gazette of RS no. 62/130), the Bank reconciled its balances of receivables and payables with its legal entity customers and creditors as of December 31, 2018. The aggregate balance of receivables and payables for which balance confirmations were requested amounted to RSD 90,359,219 thousand. The amount of reconciled receivables represents 90% of the total amount of receivables for which the balance confirmation requests were responded to by the clients. The total amount of unreconciled receivables immaterial. All of the Bank's liabilities were reconciled with counterparties.

31. EVENTS AFTER THE REPORTING PERIOD

After the end of the reporting period, there have been no events with material effects on the Bank's financial statements for the year ended December 31, 2018.

32. LITIGATION

As of December 31, 2015, there were 156 legal suits filed against the Bank (2017: 23 lawsuits) filed against the Bank, with claims totaling RSD 41,933 thousand (2017: RSD 31,486 thousand). The Bank expects partially adverse outcomes in nine of these cases. Accordingly, provisions were made in this respect in the amount of RSD 13,900 thousand.

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

33. EXCHANGE RATES

The official middle exchange rates for certain major currencies determined on the Interbank Foreign Exchange Market, and used for translation of the statement of financial position components denominated in foreign currencies into RSD were as follows:

	December 31, 2018	In RSD December 31, 2017
USD	103.3893	99.1155
EUR	118.1946	118.4727
CHF	104.9779	101.2847

Belgrade
February 27, 2019

Vesna Petrović	Radojica Popović	Kenan Bozkurt
Head of the Financial Management and Planning Division	Member of the Executive Board	Chairman of the Executive Board

ANNUAL OPERATING REPORT FOR 2018

Belgrade, March 2019

CONTENTS **Page**

I DEVELOPMENT, ORGANISATIONAL STRUCTURE AND BUSINESS ACTIVITIES

1. ESTABLISHMENT

HALKBANK a.d. Beograd has been operating in the Republic of Serbia since 2015 when Turkiye Halk Bankasi A.S. became the major owner of Cacanska banka (operating since 1956).

The Bank was registered with the Serbian Business Registers Agency under Decision no. BD 54244 dated 13 September 2005.

The Bank has been operating under the name of Halkbank a.d. Beograd since 22 October 2015 when the change of its legal name was registered in the Serbian Business Registers Agency under Decision no. BD 89155/2015.

2. ORGANISATION OF OPERATIONS

HALKBANK a.d. Beograd is a universal bank which offers all types of banking products and services to corporate clients, entrepreneurs and retail clients. The Bank encourages and finances growth and development of the domestic economy, but is also a safe place for savings deposits of all clients. The Bank's primary goal is to create products that will completely satisfy all customers' expectations.

The Bank is registered in the Republic of Serbia for performance of payment operations and credit and deposit operations in the country and abroad and it operates in compliance with the Law on Banks.

HALKBANK a.d. Beograd has successfully expanded its business network and client base. Today the Bank offers services and products through a network of 24 branches, 9 sub-branches and 4 cash desks. As at 31 December 2018 the Bank was comprised of 8 branches in Belgrade, 2 branches in Čačak and branches located in the towns of Jagodina, Gornji Milanovac, Kraljevo, Užice, Kragujevac, Kruševac, Aranđelovac, Valjevo, Šabac, Niš, Novi Sad, Pančevo, Novi Pazar and Subotica and 9 sub-branches in Paraćin, Požega, Topola, Ivanjica, Vrnjačka Banja, Leskovac, Mladenovac, Tutin and Čačak.

3. BASIC PERFORMANCE RATIOS

(in RSD thousand)

Income Statement	**31.12.2017.**	**31.12.2018.**	**Budgeted for 2018**	**Budget realization**
Net interest income	1,489,305	1,752,511	1,833,210	96%
Net fee and commission income	604,345	698,552	709,630	98%
Net income/(losses) on impairment of financial assets	-269,765	-75,127	-224,716	33%
Operating expenses	1,685,888	2,044,457	2,057,926	99%
Net profit before tax	194,631	361,725	295,679	122%

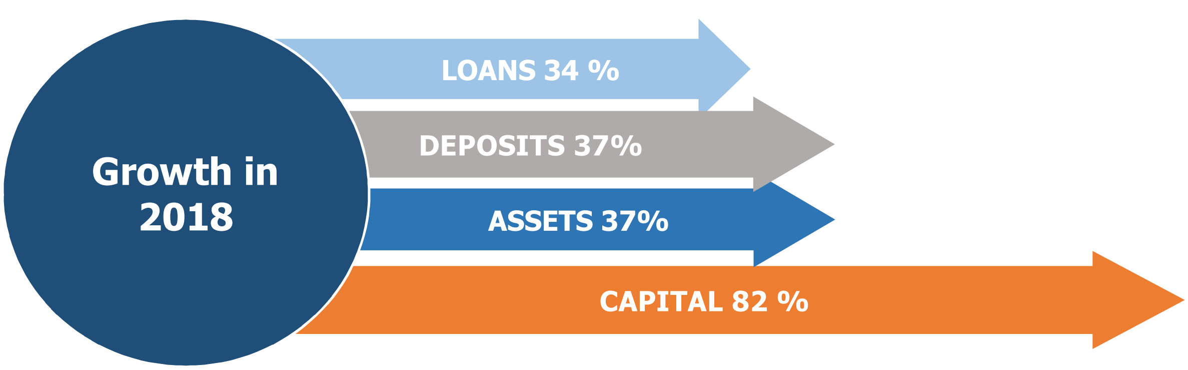
Balance Sheet	**31.12.2017.**	**31.12.2018.**	**Budgeted for 2018**	**Planned growth realization**
Loans to clients	28,907,976	38,786,695	35,458,380	151%
Deposits from other clients	23,449,090	32,239,586	29,666,845	141%
Equity	6,119,707	11,151,685	10,951,321	104%
Total assets	41,449,177	56,905,090	50,823,678	165%

Key Performance Indicators (KPI)	**31.12.2017.**	**31.12.2018.**	**Budgeted for 2018**
Costs to Income Ratio (CIR)	79.38%	82.58%	80.18%
Non-interest income to Operating costs Ratio	37.26%	35.09%	35.63%
Capital Adequacy Ratio (CAR)	17.11%	27.82%	26.51%
ROA	0.52%	0.74%	0.64%
ROE	3.20%	3.93%	3.46%
NIM	5.12%	4.56%	-

All financial projections for 2018 were prepared in EUR and realization of goals is followed up in EUR. The budgeted amounts in this report are translated to RSD using the middle RSD/EUR exchange rate effective at 31 December 2018 for the balance sheet positions and the average annual exchange rate for 2018 was used for the income statement positions.

The difference between the line items "Loans to clients" and "Deposits from other clients" and the corresponding line items in the Bank's official balance sheet form are explained in sections 3.1 and 3.2 hereof.

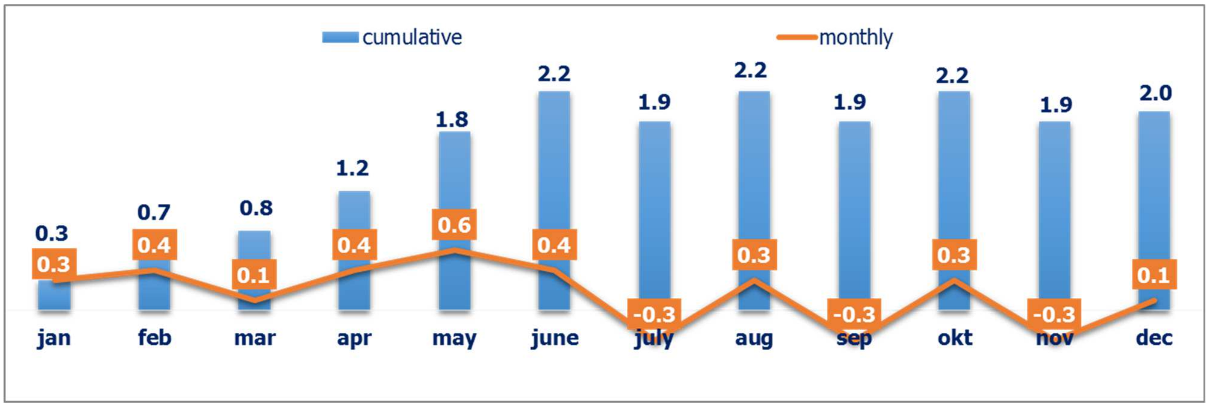
*In order to calculate the cost-to-income ratio (CIR), cost of provisions for liabilities was excluded from the "Other expenses" position in the statutory statement. Income from the "Other income"position, with the exception of Reversal of provisions for liabilities, was included within revenues along with the net interest and fee income.



II FINANCIAL POSITION AND OPERATING RESULTS

1. MACROECONOMIC ENVIRONMENT

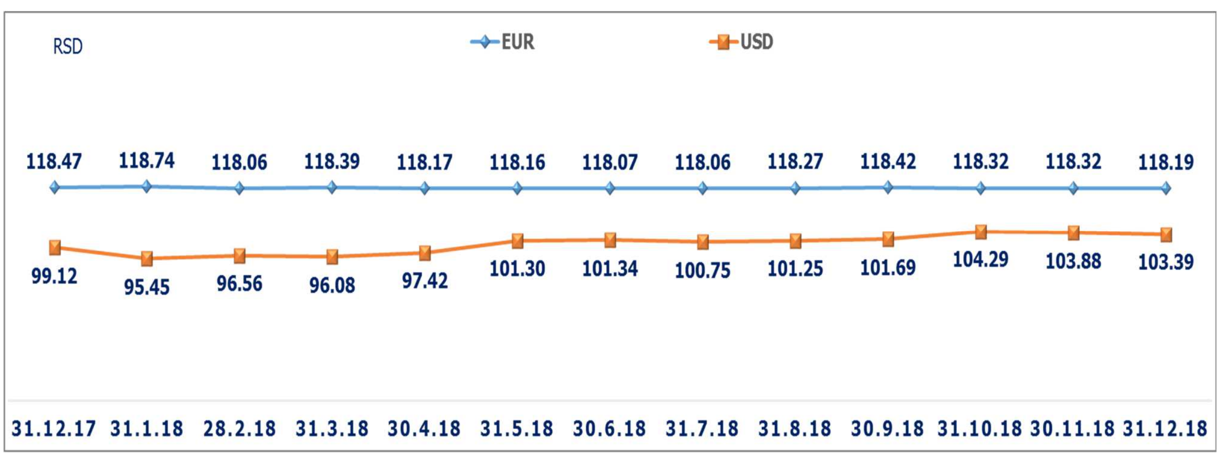
Consumer prices trends in Serbia during 2018



In 2018, consumer prices recorded cumulative growth of 2%. The highest monthly increase was achieved in May, when it equaled 0.6%.

According to the National Bank of Serbia's projection, inflation will remain stable in the upcoming period and continue to move within the target tolerance band, 3±1.5%. The same can be concluded from the results of the inflation expectations survey conducted monthly by the National Bank of Serbia, because both the financial and corporate sectors expect that predictability and price stability will be preserved in the following 12 months, as well as in medium term, which is one of the main conditions necessary for sustainable growth.

FX trend during 2018

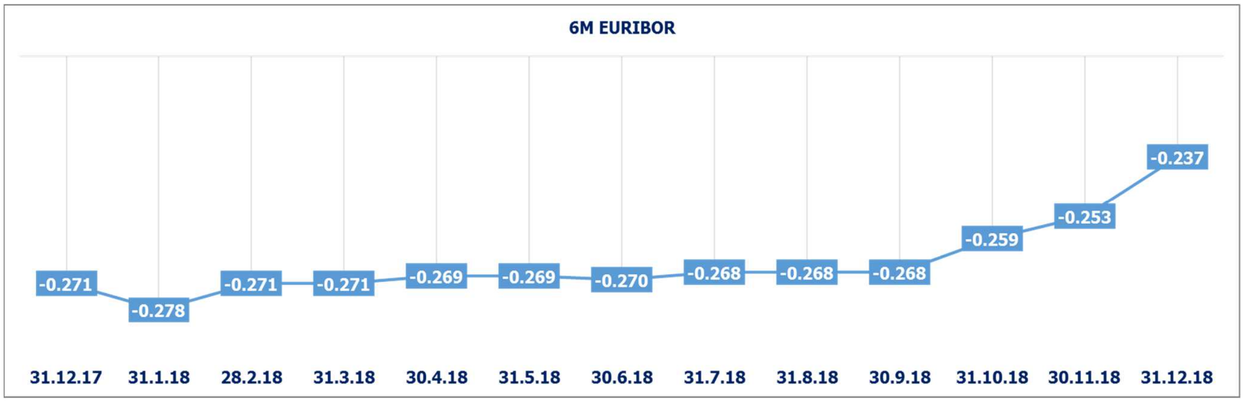


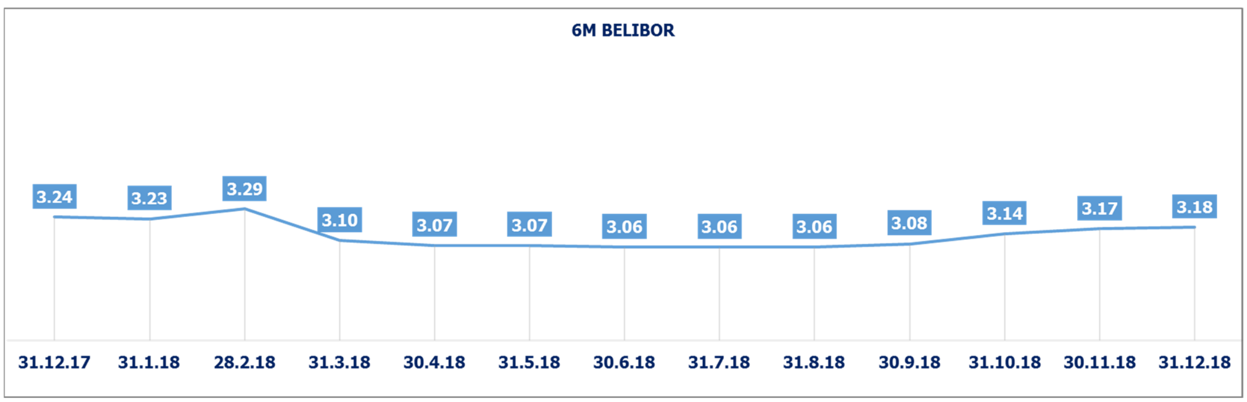
In 2018, Serbian dinar (RSD) strengthened against the Euro (EUR) by 0.23% but depreciated by 4.31% against the United States dollar (USD).

Fluctuations of the National Bank Key Policy Rate

In 2018, the National Bank of Serbia reduced the key policy rate on two occasions, on 14 March and 12 April, by 50 basis points in total, from 3.5% to 3.0%.

Fluctuation of the interest rates on the financial markets





2. ACHIEVEMENT OF THE BASIC OPERATING TARGETS

The targets set out in the Bank's Operating Policy for 2018 were implemented through the following activities:

1. The Bank planned expansion of the branch network by opening 3 new branches, in the region of Belgrade and regions where it had not been present so far. At the end of September, the Bank opened a branch in Belgrade in Bulevar Kralja Aleksandra Street, which is a modern with cutting edge equipment, aiming to enable new and the existing clients efficient transactions in all areas of modern banking. Additionally, in the 2018, the Bank relocated its branches in Kragujevac, Užice, Niš and a sub-branch in Požega to better and more appropriate locations. Moreover, the process of relocation of the branch in Novi Sad started in December, and the branch commenced operations at a new location in February 2019.

2. The realized value of the average liquidity ratios and the targets are shown in following table:

Indicators	2018	Plan 2018 (minimum)
The average liquidity ratio	1.53	1.2
The average quick liquidity ratio	1.27	0.9
The ratio of liquid assets	28.51%	20%

3. During 2018, the Bank achieved a positive financial result in the amount of RSD 361,725 thousand. The realized values regarding this goal are shown in the following table:

(in RSD thousand)

Indicators	31.12.2018	Plan for 2018	Realization of the plan
Net interest and fee income	2,451,063	2,542,839	96.39%
Operating expenses	2,044,457	2,057,926	99.35%
Profit	361,725	295,679	122.34%

4. The Bank has initiated implementation of a new core banking system. In Q2 2018 the Bank selected the consultant company Ernst&Young for project management services and assistance in vendor selection. All activities are in line with the plan. The Bank is expecting to start the technical implementation in H1 2019.

5. With regard to the project implementation of an in-house solution for payment card processing and printing, the following activities were realized in 2018:

- The processes of establishing a mutual connection between the Bank's system and the card organization system (VISA, MasterCard and Dina) were completed;
- In the process of certification of the systems and hardware components, the project entered its final phase;
- In the area of application development, parameter setting is in pre-production phase and the final testing;
- In the field of harmonization with PCI DSS standards, the final framework for GAP analysis is defined.

The pre-production environment and testing of the final characteristics and components of the system are expected at the beginning of 2019, after which the system will be operational.

6. The main assumption for preparation of the Bank's Business Policy for 2018 was capital increase of EUR 40 million. On 20 February 2018, the Bank increased its share capital, through a new share issue, from RSD 4,248,483 thousand to RSD 6,612,603 thousand (by app. EUR 20 million). The new share issue of RSD 2,360,000 thousand (app. EUR 20 million) was realized on 1 August 2018, when the Bank's capital increased from RSD 6,612,603 thousand to RSD 8,972,603 thousand.

3. BALANCE SHEET

3.1. Assets

As of 31 December 2018, the Bank's total assets amounts to RSD 56,905,090 thousand and recorded a 37.29% increase compared to the end of 2017.

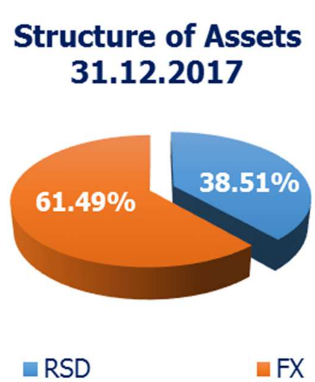
The main driver of this growth was a positive development in lending to corporate and retail clients, where the growth in the observed period amounted to RSD 9,878,719 thousand (34.17%). This was achieved through continuous improvement of loan products so that the Bank can properly respond to the needs of its clients and offer them complete solutions for their financial requirements and further strengthen their trust.

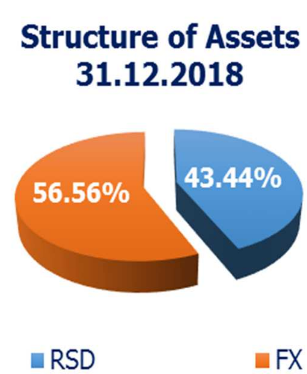
(in RSD thousand)

ASSETS	31.12.2017.	31.12.2018.	Plan 2018	% of change
Cash, cash equivalents and assets held with the central bank	4,839,851	7,643,117	5,318,757	57.92%
Financial assets	4,857,500	6,720,145	5,791,535	38.35%
Loans to banks and other financial organizations*	1,522,008	2,276,152	2,381,621	49.55%
Loans to clients*	28,907,976	38,786,695	35,458,380	34.17%
Intangible assets, property, plant and equipment and investment property	1,044,516	1,248,062	1,639,005	19.49%
Other assets	277,326	230,919	234,380	-16.73%
Total assets	**41,449,177**	**56,905,090**	**50,823,678**	**37.29%**

*The positions of "Loans to clients" and "Loans to banks and other financial organizations" differ from the line items "Loans and receivables due from customers" and "Loans and receivables due from banks and other financial Institution" presented in the official Balance sheet form for the amount of receivables for accrued interest, fee and accrued interest receivable and accrued income for EIR compensation, shown within the line item of "Other assets" and "Other assets" include the item of "Deferred tax assets" from the official Balance sheet form.

The following graphs present the currency structure of assets as at 31 December 2017 and 31 December 2018, where a slight increase in the share of RSD assets in total assets is observable, from 38.51% to 43.44%:





3.1.1 Loans to clients

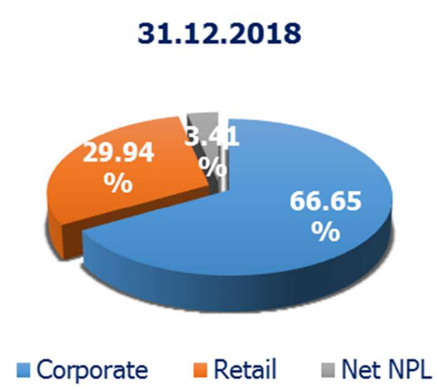
Since its arrival to the Serbian market, the focus of Halkbank a.d. Beograd has been on the maximum satisfaction of clients, development of innovative products and services, and improvement and digitization of the processes in order to strengthen the efficiency of operations. This approach and strategic orientation enabled the Bank to realize the plans for 2018 in crediting both the corporate and retail sectors, with a continuing positive growth trend from 2017.

The structure of the loans to clients as of 31 December 2017 and 31 December 2018 is shown in the following table:

(in RSD thousand)

	31.12.2017.	31.12.2018.	Plan 2018	% of change
Loans to clients - net	**28,907,976**	**38,786,695**	**35,458,380**	**34.17%**
Corporate clients without NPL	18,620,433	25,850,569	21,866,001	38.83%
Retail clients without NPL	8,202,223	11,614,258	11,464,876	41.60%
NPL (net)	2,085,320	1,321,868	2,127,503	-36.61%

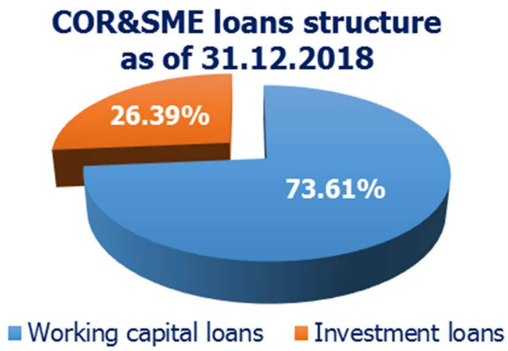
The Bank's net loan portfolio increased during 2018 by 34.17%. Corporate loans increased by RSD 7,230,136 thousand, retail loans increased by RSD 3,412,035 thousand, while the net NPL decreased by RSD 763,452 thousand.

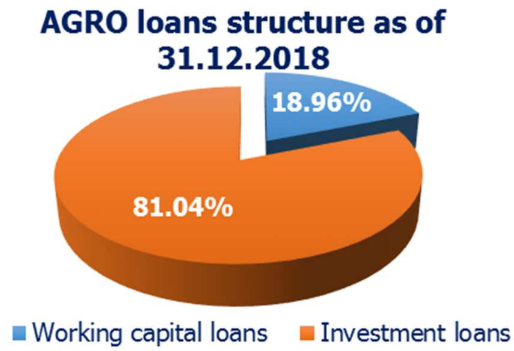


In 2018 the Bank disbursed loans to corporate, SME and retail clients in the amount of RSD 30,325 million.

Gross loans - Corporate

Gross corporate loans, including gross NPL, as of 31 December 2018 amounted to RSD 28,455,074 thousand with a growth of 22.40% comparing to the end of 2017. In the following graphs the structure of these loans is presented:





The most important activities of Corporate and SME Marketing Division in 2018 were as follows:

- The Bank disbursed RSD 23,394 million in Corporate and SME through 4,115 loans.

- In 2018 COSME program (*Competitiveness of Small and Medium-sized Enterprises*) was the main focus and core product which covers working capital and investment loans secured with COSME guarantee. The Bank disbursed 1,119 COSME loans in the amount of RSD 5,456 million in 2018.

- Once again, the Bank took an active role in the program of the Government of the Republic of Serbia – "Program for Supporting Small Enterprises in the Purchase of Equipment in 2018". Five banks took part in this Program. The Bank has granted RSD 503 million through 83 investment loans.

- In November of 2017, the Bank signed the Intermediary Finance Agreement for realization of APEX loan for SME and other priorities with the European Investment Bank. A portion of these funds is dedicated to financing SME project for employing young people, under the age of 30. Realization of loans from this credit line started in 2018 and until 31 December 2018 the Bank approved 30 loans totaling RSD 1,607 million, out of which the amount of RSD 1,206 million was drawn.

- The Bank commenced crediting agro business clients in Q2 2018. All products and procedures were prepared and the Bank executed the contract with the Ministry of Agriculture for subsidized loans for working capital and agro equipment. The Bank disbursed RSD 281 million through agro segment loans in 2018.

Gross loans - Retail

Gross retail loans as of 31 December 2018 amounted to RSD 11,751,582 thousand and had the following structure:

(in RSD thousand)

Loan type	31.12.2017.	31.12.2018.	% change
Cash loans	4,529,143	6,632,890	46.45%
Housing loans	2,989,251	4,275,124	43.02%
Consumer loans	588,305	595,635	1.25%
Allowed account overdrafts	125,995	138,541	9.96%
Other	89,044	109,392	22.85%
Total	**8,321,738**	**11,751,582**	**41.22%**

The Retail Marketing and ADC Division realized numerous activities in 2018 in order to improve products and services available to the Bank's retail clients:

- New loans totaling of RSD 6,588 million resulted in an increase of the Bank's market share, from 1.03% at the end of 2017 to 1.30% at the end of 2018. The loan portfolio recorded a growth of 41%, while the number of credit clients increased by 15%.
- The most significant result was achieved by realization of two cash and refinancing loans campaigns, one of which was supported by a TV commercial. In 2018 the Bank disbursed RSD 4,754 million through cash loans to the employed and pensioners, which is 1.70% of the total amount of disbursed cash loans in the market during the year.
- The active approach to the market and improvement of the loan processing resulted in significant increases in the number and volume of housing loans. Thus, in 2018 the Bank placed RSD 1,585 million through 255 loans, which is 2.02% of the total amount of disbursed housing loans in banking market during the year. This result was significantly better than the Bank's result in achieved in 2017, when RSD 733 million was realized through 132 housing loans.
- As described in Basic Operating Targets, significant activities were carried out in the implementation of the project of in-house solution for processing and printing of payment cards. The prerequisites and conditions were created for completion of the project in H1 2019, when the issuance of new types of cards can start, as well as development of the receipt network.

3.2. Liabilities

Total liabilities as of 31 December 2018 amounted to RSD 56,905,090 thousand with the following structure:

(in RSD thousand)

Liabilities	31.12.2017.	31.12.2018.	Plan 2018	% of change
Deposits from banks and other financial organizations	3,190,355	3,724,393	2,245,697	16.74%
Deposits from other clients	23,449,090	32,239,586	29,666,845	37.49%
Funds borrowed	7,585,899	8,833,825	7,800,844	16.45%
Other liabilities	1,104,126	955,601	158,972	-13.45%
Total liabilities	**35,329,470**	**45,753,405**	**39,872,357**	**29.50%**
Share capital	4,248,483	8,972,603	8,966,242	111.20%
Current year's profit	194,631	361,725	295,487	85.85%
Retained earnings from previous years	-	52,373	-	
Reserves	1,676,593	1,764,984	1,689,592	5.27%
Total equity	**6,119,707**	**11,151,685**	**10,951,321**	**82.23%**
Total liabilities and equity	**41,449,177**	**56,905,090**	**50,823,678**	**37.29%**

*The positions "Deposits from other clients" and "Deposits from banks and other financial organizations" differ from positions "Deposits and other liabilities due to clients" and "Deposits and other liabilities due to banks, other financial institutions and central bank" presented in the official Balance sheet form for the amount of liabilities for interest, fees, accrued liabilities for accrued interest and other financial liabilities towards clients, shown within the "Other liabilities" position. Additionally, the line item of "Funds borrowed" is excluded from the aforesaid line items as well. The item of "Other liabilities" includes "Provisions" from the official Balance sheet form.

The most significant changes in the Bank's liabilities during 2018 were related to the increase in the Bank's share capital made by the parent bank in the amount of RSD 4,724,120 thousand, as well as to the increase in client deposits in the amount of RSD 8,790,496 thousand.

The following graphs present the currency structure of liabilities as at 31 December 2017 and 31 December 2018:

3.2.1 Deposits from banks, other financial organizations and central bank

The structure of deposits from banks, other financial organizations and central bank and comparative analysis as of 31 December 2017 and 31 December 2018 is presented in the following table:

(in RSD thousand)

Deposits from banks and other financial organizations	31.12.2017.	31.12.2018.	% of change
Transaction deposits	14,956	15,633	4.53%
Other deposits	3,175,399	3,708,760	16.80%
Total	**3,190,355**	**3,724,393**	**16.74%**

The other deposits include deposits of insurance companies and "money market" deposits of domestic and foreign banks.

3.2.2 Deposits from other clients

The structure of deposits from other clients and comparative analysis by segments as of 31 December 2017 and 31 December 2018 is presented in the following tables and graphs:

(in RSD thousand)

Deposits from other clients	31.12.2017.	31.12.2018.	Plan 2018	% of change
Transaction deposits	10,134,074	14,215,085	13,355,990	40.27%
Other deposits	13,315,016	18,024,501	16,310,855	35.37%
Total	**23,449,090**	**32,239,586**	**29,666,845**	**37.49%**

Total increase of deposits from other clients in 2018 amounted to 37.49%.

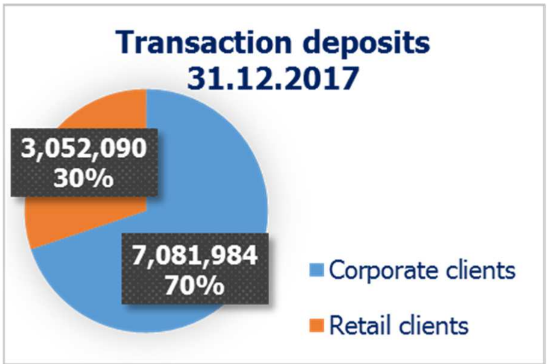
(in RSD thousand)

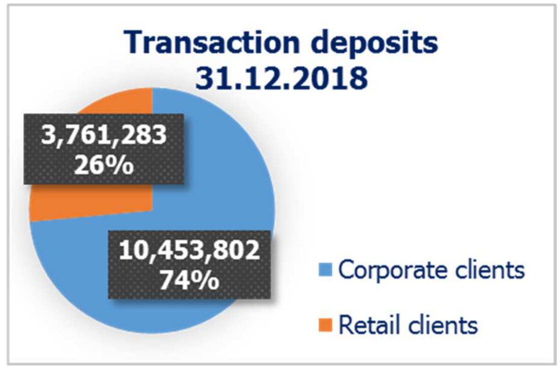
Deposits from other clients	31.12.2017.	31.12.2018.	Plan 2018	% of change
Corporate clients	11,217,654	16,792,417	14,537,936	49.70%
Retail clients	12,231,436	15,447,169	15,128,909	26.29%
Total	**23,449,090**	**32,239,586**	**29,666,845**	**37.49%**

By constant monitoring of the market trends, individual and proactive approach to clients, the Bank increased the level of deposits from corporate clients by 49.70%, and the level of deposits from retail clients by 26.29%.

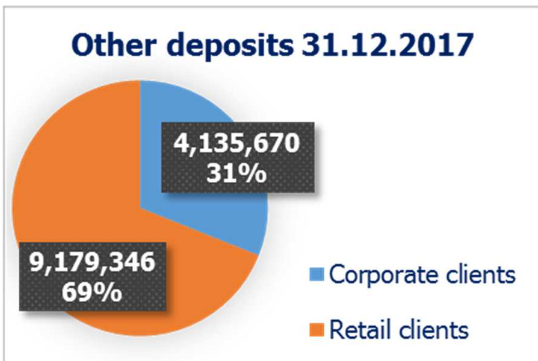
The structure deposits from other clients is presented in the following graphs:

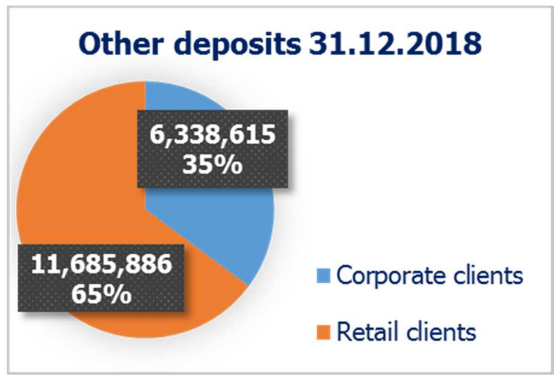
(in RSD thousand)





(in RSD thousand)





2.3 Funds borrowed

(in RSD thousand)

Borrowed loans in foreign currencies	31.12.2017.	31.12.2018.	% of change
- EIB	3,719,147	5,725,497	53.95%
- European Fund for Southeast Europe	1,184,727	1,181,946	-0.23%
- EAR long-term revolving line	1,085,062	865,516	-20.23%
- GGF	699,580	590,973	-15.52%
- Demir-Halk Bank (Nederland) N.V.	592,364	295,487	-50.12%
- KfW	215,405	107,450	-50.12%
- Government of the Republic of Italy	89,614	66,956	-25.28%
Total	**7,585,899**	**8,833,825**	**16.45%**

In 2018, the Bank made regular and timely repayment of the long-term loan principle amounts to IFIs on in the aggregate amount of EUR 15,969 thousand. In the same period, the Bank withdrew EUR 26,678 thousand of IFI's funds, from which EUR 23,983 thousand refers to EIB credit line while amount of EUR 2,695 thousand refers to EAR long-term revolving line of credit.

3.2.3 Equity

The Bank's equity as of 31 December 2018 amounted to RSD 11,151,685 thousand and comprised of the following:

(in RSD thousand)

Equity	31.12.2017.	31.12.2018.	% of change
Share capital – ordinary shares	1,819,820	5,658,940	210.96%
Share capital – preference cumulative shares	1,340	1,340	0.00%
Share capital - preference non-cumulative shares	600,000	600,000	0.00%
Share premium	1,827,323	2,712,323	48.43%
Revaluation reserves	364,162	452,553	24.27%
Reserves from profit	1,312,431	1,312,431	0.00%
Retained earnings from previous years before the first application of IFRS 9	0	194,631	-
Decrease in retained earnings from previous years from the first application of IFRS 9 as of 1-Jan-2018	0	-142,258	-
Profit of the current year	194,631	361,725	85.85%
Total	**6,119,707**	**11,151,685**	**82.23%**

The first capital increase was conducted on 20 February 2018 through a new issue (31st) of 236,412 ordinary (common stock) shares with the par value of RSD 10,000 per share. Thereby the Bank's share capital was increased from RSD 4,248,483 thousand to RSD 6,612,603 thousand (approximately EUR 20 million). The new issue of shares (32nd) of RSD 2,360,000 thousand (147,500 ordinary shares with nominal value of RSD 10,000 per share and share premium of RSD 885,000) was realized on 1 August 2018, which raised the share capital from RSD 6,612,603 thousand to RSD 8,972,603 thousand.

The Bank implemented IFRS 9 as from 1 January 2018, followed by adoption of new accounting policies in Q1 2018. The Bank's business model for measurement of the assets, loans and receivables and documentary operations, except debt securities is the amortized cost model ("hold to collect contractual cash flows" and "solely payments of principal and interest" the so-called HTC and SPPI model). All contract clauses passed the SPPI test and all loans were measured at amortized cost. The negative effects of the first-time adoption of IFRS 9 were booked in the 2018 in the amount of RSD 142,258 thousand (EUR 1,204 thousand) against retained earnings from 2017 in accordance with the relevant Decision of the Bank's Assembly.

The information about the number of shareholders and the basic information on shares is presented in the following table:

Information on shares	31.12.2017.	31.12.2018.
Number of shareholders	6	1
Number of shares	242,116	626,028
Nominal value per share in RSD	10,000	10,000
Net book value per share in RSD	25,275.93	17,813.40

On 27 November 2018 the squeeze out process of share purchase form minority shareholders was ended. In this way, Turkiye Halk Bankasi A.S. became the sole shareholder of the Bank.

On 22 June 2018 the Bank adopted the Decision on exclusion of shares from the Belgrade Stock Exchange and after conducting this procedure, it ceased to be an open joint stock company pursuant to the Law on Capital Market.

4. OFF-BALANCE SHEET ITEMS

During 2018, the Bank issued performance and payment guarantees and letters of credit for its customers. The structure of off-balance sheet items as of 31 December 2017 and 31 December 2018 is presented in the following table:

(in RSD thousand)

Off-balance sheet items	31.12.2017.	31.12.2018.	% of change
Contingent liabilities (guarantees, acceptances and irrevocable liabilities)	6,400,560	9,692,565	51.43%
Operations for and on behalf of third parties	278,305	271,834	-2.33%
Derivatives (SWAP)	36,024	1,579,341	4284.26%
Other off-balance sheet items	45,919,922	47,548,920	3.55%
Total	**52,634,811**	**59,092,660**	**12.27%**

The following table compares the structure of the item of guarantees, acceptances and irrevocable liabilities as of 31 December 2017 and 31 December 2018:

(in RSD thousand)

Contingent liabilities (guarantees, acceptances and irrevocable liabilities)	31.12.2017.	31.12.2018.	% of change
Performance guarantees	3,313,643	5,337,428	61.07%
Payment guarantees	1,384,362	2,116,315	52.87%
Unused limits which cannot be revoked	1,259,108	1,813,172	44.00%
Issued foreign currency letters of credit with Banks' confirmation	385,037	384,132	-0.24%
Issued unsecured letters of credit	58,410	41,518	-28.92%
Total	**6,400,560**	**9,692,565**	**51.43%**

The item of "Other off-balance sheet items" is broken down in the table below:

(in RSD thousand)

Other off-balance sheet items	31.12.2017.	31.12.2018.	% of change
Received fixed assets (buildings, cars, land etc.) as collateral in favor of the Bank	32,438,723	30,019,818	-7.46%
Receivables for suspended interest	4,542,059	4,713,469	3.77%
The unused amount of combined (revolving loans plus off-balance) framework	2,245,606	3,569,773	58.97%
Write-off of receivables – direct write-off of receivables in accordance with IAS 39	2,149,401	3,208,517	49.27%
The unused amount of revolving loans	1,564,945	2,432,907	55.46%
Received guarantees and other collaterals as collateral in favor of the Bank	1,402,964	1,966,033	40.13%
Other off-balance sheet items	1,493,514	1,443,424	-3.55%
The unused amount of off-balance framework	82,710	194,979	135.74%
Total	**45,919,922**	**47,548,920**	**3.55%**

5. STATEMENT OF PROFIT AND LOSS FOR THE PERIOD

The Income Statement for the period from 1 January to 31 December 2018 is presented in compliance with the Law on Accounting, IFRS and NBS regulations.

The Bank ended FY 2018 with a profit of RSD 361,725 thousand.

(in RSD thousand)

Income Statement	31.12.2017.	31.12.2018.	Plan 2018	% of change
Interest income	1,754,993	2,068,379	2,105,234	17.86%
Interest expense	265,688	315,868	272,025	18.89%
Net interest income	**1,489,305**	**1,752,511**	**1,833,210**	**17.67%**
Fee and commission income	710,404	843,582	851,556	18.75%
Fee and commission expense	106,059	145,030	141,926	36.74%
Net fee and commission income	**604,345**	**698,552**	**709,630**	**15.59%**
Net trading income	35,518	13,866	11,827	-60.96%
Other operating income	21,116	16,380	23,654	--22.43%
Net income/(losses) on impairment of financial assets	-269,765	-75,127	-224,716	-72.15%
Total net operating income	**1,880,519**	**2,406,182**	**2,353,605**	**27.95%**
Salaries, salary compensation and other personal expenses	648,765	802,875	780,593	23.75%
Depreciation costs	151,567	150,143	189,235	-0.94%
Other expenses	885,556	1,091,439	1,088,099	23.25%
Total operating expenses	**1,685,888**	**2,044,457**	**2,057,926**	**21.27%**
NET PROFIT BEFORE TAX	**194,631**	**361,725**	**295,679**	**85.85%**

*The item of "Other operating income" includes the items "Other operating income" and “Other income” from official Statement of profit and loss.

In 2018, the Bank increased its net interest income by 17.67%, or by RSD 263,206 thousand, comparing to 2017, while the net income from fees and commission rose by 15.59% year on year or by RSD 94,207 thousand. Total operating expenses were higher by 21.27%, or by RSD 358,569 thousand comparing to 2017.

The structure of interest income is presented in the following table:

(in RSD thousand)

Interest income	31.12.2017	31.12.2018	% of change
Corporate clients	909,642	989,956	8.83%
Retail clients	602,376	773,992	28.49%
Securities	212,996	268,481	26.05%
Other	29,979	35,949	19.91%
Total	**1,754,993**	**2,068,379**	**17.86%**

The structure of fee and commission income is presented in the following table:

(in RSD thousand)

Fee and commission income	31.12.2017	31.12.2018	% of change
Fees from payment operations	438,884	483,145	10.08%
Fees from guarantees	83,397	111,321	33.48%
Fees from FX changes	91,831	103,389	12.59%
Fees from checks and payment cards	37,971	63,446	67.09%
Fees from loan processing	34,723	45,041	29.72%
Fees from SWAP	9,211	25,611	178.05%
Other fees	14,387	11,629	-19.17%
Total	**710,404**	**843,582**	**18.75%**

The structure of interest expense is presented in the following table:

(in RSD thousand)

Interest expense	31.12.2017	31.12.2018	% of change
Deposits – retail	84,468	86,131	1.97%
Deposits – corporate	72,406	85,098	17.53%
Banks deposits	20,659	42,525	105.84%
Borrowings FI's	88,155	102,114	15.83%
Total	**265,688**	**315,868**	**18.89%**

The structure of fee and commission expense is presented in the following table:

(in RSD thousand)

Fee and commission expenses	31.12.2017	31.12.2018	% of change
Payment operations	70,784	86,295	21.91%
VisaCard and MasterCard	22,486	43,740	94.52%
Credit biro	12,101	13,862	14.55%
Credit lines	688	1,133	64.68%
Total	**106,059**	**145,030**	**36.74%**

6. CASH FLOWS

Cash flows from operating activities during 2017 and 2018 are presented in the table below:

(in RSD thousand)

Cash inflows from operating activities	I - XII 2017	I - XII 2018	Change
Interest	1,615,643	2,018,094	402,451
Fees	712,474	858,916	146,442
Other operating income	5,538	3,849	-1,689
Dividend and share in profit	759	886	127
Total cash inflows	**2,334,414**	**2,881,745**	**547,331**
Cash outflows from operating activities			
Interest	245,085	291,577	46,492
Fees	121,289	141,536	20,247
Salaries	651,930	751,379	99,449
Tax and contribution	142,180	185,280	43,100
Other operating expenses	747,029	926,684	179,655
Total cash outflows	**1,907,513**	**2,296,456**	**388,943**
Net cash inflows from operating activities	**426,901**	**585,289**	**158,388**

Cash inflows from operating activities in 2018 increased for RSD 547,331 thousand comparing to the same period in 2017.

Cash outflows from operating activities increased for RSD 388,943 thousand comparing to 2017.

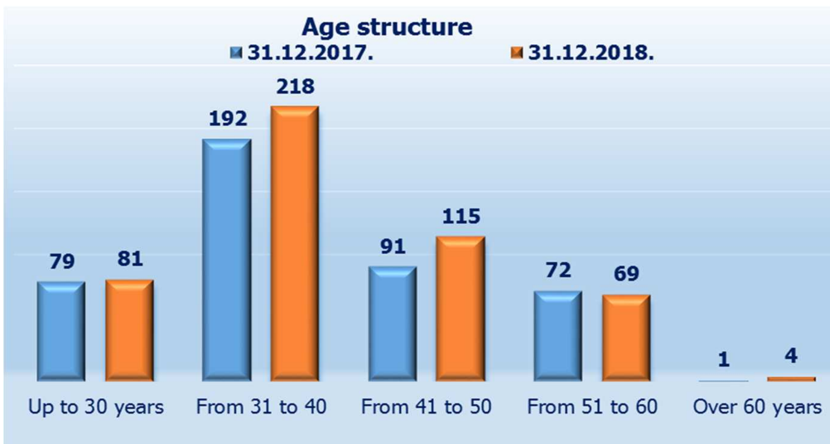
Net cash inflows from operating activities in 2018 amounted to RSD 585,289 thousand, recording an increase of RSD 158,388 thousand comparing to same period in 2017.

7. HUMAN RESOURCES

Employees present one of the most important resources on which the Bank's overall activities are based. At the end of 2018 the Bank had 487 employees and the following structure:

Number of employees	31.12.2017.	31.12.2018.	Plan 2018
Headquarters	187	203	206
Branches	248	284	268
Total	**435**	**487**	**474**

The following graphs show the qualification and age structures of employees as of 31 December 2017 and 31 December 2018:



In the qualification structure of employees at the end of 2018, the share of employees with higher education was 70.02%, while the participation of younger than 40 years was 61.40%. The Bank intensively invests in improving the skills and knowledge of employees through external and internal trainings and participation in educational panels. Particular attention is paid to the Bank's internal communication to all employees in order to be familiar with the strategic goals and results, and the most important challenges and activities.

Expenses for salaries, salary compensations and other personal expenses in 2018 amounted to RSD 802,875 thousand and accounted for 102.85% of the planned budget for 2018.

8. INVESTMENT PLAN

During 2018, the total investments in fixed assets, investment property and intangible assets amounted to RSD 362,828 thousand.

Movements on these balance sheet items are presented in the following table:

(in RSD thousand)

Investments	Buildings	Equipment	Investment property	Intangible assets	Total	Plan for 2018
Balance 01.01.2018	**475,163**	**342,679**	**127,727**	**98,947**	**1,044,516**	**1,044,516**
Total increase:	**23**	**159,070**		**203,735**	**362,828**	**785,994**
IT		55,626		203,735	259,361	663,899
Adaption of business premises	23	67,031			67,054	79,900
Other		36,413			36,413	42,195
Total decrease:	**29,428**	**99,033**	**3,844**	**29,544**	**161,849**	**191,506**
Depreciation	17,722	99,033	3,844	29,544	150,143	189,235
Sell	11,706				11,706	0
FX effects					0	2,271
Revaluation - net	**2,567**				**2,567**	
Balance 31.12.2018	**448,325**	**402,716**	**123,883**	**273,138**	**1,248,062**	**1,639,005**

The investments of the Bank were made in accordance with the adopted budget, except in respect of IT investments, where replacement of the Bank’s "core" system was planned in the amount of EUR 3 million, but was not realized in 2018. The activities on this project started with selection of the external consultant and will be continued in 2019.

9. COMPLIANCE OF OPERATIONS WITH NBS REGULATIONS AND IFI AGREEMENTS

As of 31 December 2018 all the operating ratios of the Bank were within the limits prescribed by the Law on Banks and NBS regulations.

Ratio	The values prescribed by the NBS regulations	Values as at December 31 2018
Regulatory Capital	Min 10,000,000 €	87,827,287 €
Capital adequacy ratio	min 8%	27.82%
Foreign exchange risk ratio	max 20%	0.63%
Liquidity ratio	Min 1	1.69
Quick liquidity ratio	Min 0.7	1.42
Exposure to one person or group of related persons	max 25%	12.34%
Sum of large exposures	max 400%	12.34%
Investment in non-financial sector	max 10%	0%
Investments in fixed assets and investment property	max 60%	9.39%

The Bank's business policy for 2018 as one of the main goals in the risk management process defines maintenance capital adequacy ratio above 17%. As of 31 December 2018 the capital adequacy ratio was above the stated target (27.82%).

By the Decision on the Minimum Requirement for Capital and Eligible Liabilities of a Bank, the National Bank of Serbia defined the ratio of capital and eligible liabilities to total liabilities to be minimum 6.20%. The ratio of the capital and eligible liabilities to total liabilities of the Bank equaled 25.95% as of 30 June 2018, which is significantly above the defined limit.

Compliance with the covenants from the agreements concluded with the international financial institutions (IFIs)

Pursuant to the defined limits in the agreements concluded with the International Financial Institutions (IFIs) - German Development Bank (KfW), Green for Growth Fund (GGF), and European Fund for Southeast Europe (EFSE), the Bank is required to comply with certain financial covenants until the final repayment of the loans. As of 31 December 2018, the Bank was in full compliance with all the contractually defined covenants.

III INVESTMENTS FOR THE PURPOSE OF ENVIRONMENTAL PROTECTION

The Bank is particularly cautious to invest only in the projects that do not cause any environmental and social harm. Environmental and social (E&S) protection includes, besides ecological aspects, the issues of the local community and employee protection.

The aim of managing E&S risk is identification, assessment and control of the risks that may cause E&S harm and it is carried out in accordance with the E&S Risk Management Policy and the E&S Risk Management Procedure.

The following bodies are responsible for managing the E&S risk in the Bank:

- Board of Directors that establishes and at least once a year reviews E&S Risk Management Policy and identifies the need for any amendments,
- Executive Board that establishes and implements the E&S Risk Management Procedure,
- Credit Committees that make decisions on loan disbursement on the basis of the E&S information available and the opinion of the Corporate and SME Marketing Division,
- The Corporate and SME Marketing Division that assesses the impact of the activity and the project during the process of appraising customers' creditworthiness,
- The Risk Management Department that monitors loans at the portfolio level by categories of E&S risks through the preparing and analysis of reports.

When processing individual clients' applications, E&S risk is classified for the basic activity of the client and the activity which is subject to financing.

There are the following E&S risk categories:
- High – Exclusion List;
- High – Category A;
- High;
- Medium and
- Low

Environmental risk

Overview of the Bank's exposures by environmental and social risk categories

(in RSD thousand)

Risk category	Number of clients		Amount of placements (balance and off-balance)		Increase/ decrease
	31.12.2017.	31.12.2018.	31.12.2017.	31.12.2018.	
High – Exclusion List	-	2	-	238,534	238,534
High – Category A	8	8	70,640	72,576	1,936
High	244	292	7,682,454	7,895,397	212,943
Medium	1,048	1,359	11,748,016	16,655,673	4,907,657
Low	1,975	2,287	13,960,351	19,560,691	5,600,340
Total	**3,275**	**3,948**	**33,461,461**	**44,422,871**	**10,961,410**

*For the purpose of analysis of environmental risk, the Bank includes only relevant part of portfolio.

IV SIGNIFICANT EVENTS AFTER THE END OF THE BUSINESS YEAR

After the reporting period, there have been no events with a material impact on the financial statements of the Bank as of and for the year ended 31December 2018.

On 1 January 2019, the Bank implemented the new accounting standard IFRS 16 - Leases.

V ANTICIPATED FUTURE DEVELOPMENTS

The business policy and strategy for the period from 2018 to 2022 defined the basic business goals and main guidelines for the development of Halkbank a.d. Belgrade on the Serbian market.

By increasing its share capital in 2018 in the amount of EUR 40 million, the Bank will have an excellent base for rapid growth in the future in order to achieve the assets size of EUR 1 billion by the end of 2022.

As one of the main goals, it is planned to expand the branch network to more than 50 branches, opening 4 to 5 new branches annually, with a high potential for raising market share in Belgrade and other regions where the Bank does not currently have branches. The Bank will be oriented towards SME clients, with a strong focus on the retail segment. Loans will grow above 20% on the annual basis, while client deposits will grow 30% on the annual basis.

All listed activities will lead to increase in market share in the banking sector to 3%, based on the size of total assets, with sustainable growth, good liquidity and capital adequacy position.

VI RESEARCH AND DEVELOPMENT ACTIVITIES

The Bank carries out a regular financial market research, analyses customers' financial needs and investigates a degree of satisfaction of the users of financial services.

The Marketing Division constantly develops new products and services, and based on the information and conclusions that it obtains through market research activities and customers' needs, strives to develop and offer modified existing products, as well as completely new products and services.

VII INFORMATION ON PURCHASE OF OWN SHARES

The Bank did not acquire its own shares during 2018.

VIII EXISTENCE OF AFFILIATES

As of 31 December 2017 the Bank operated in business network of 24 branches, 9 sub-branches and 4 cash desks. As at 31 December 2018 the Bank was comprised of 8 branches in Belgrade, 2 branches in Čačak and branches located in the towns of Jagodina, Gornji Milanovac, Kraljevo, Užice, Kragujevac, Kruševac, Aranđelovac, Valjevo, Šabac, Niš, Novi Sad, Pančevo, Novi Pazar and Subotica and 9 sub-branches in Čačak, Paraćin, Požega, Topola, Ivanjica, Vrnjačka Banja, Leskovac, Mladenovac and Tutin.

IX RISK MANAGEMENT ADEQUACY

The Bank's targets in risk management are identification, measuring, mitigating and monitoring all types of risks and thus minimizing the Bank's exposure to such risks.

Credit Risk

The Bank measures and monitors the credit risk level through assessing the clients' solvency and controlling the loan portfolio through the calculation of loan loss reserves pursuant to the NBS regulations and impairment provisions pursuant to IFRS rules.

Structure of gross risk-weighted assets in terms of classification categories

(in RSD thousand)

Classification category	Classified amount as at 31.12.17	% of the share in gross risk-weighted assets		Classified amount as at 31.12.18	% of the share in gross risk-weighted assets	
A	23,601,471	54.12%	82.7%	29,638,883	50.67%	85.00%
B	12,454,845	28.56%		20,083,191	34.33%	
V	2,070,139	4.75%	4.7%	5,574,816	9.53%	9.53%
G	1,273,389	2.92%	12.6%	483,354	0.83%	5.47%
D	4,207,751	9.65%		2,715,735	4.64%	
Total	**43,607,595**	**100.00%**		**58,495,979**	**100.00%**	

Total classified assets increased in 2018 compared to the end of 2017 by 34.46%.

Compared to 31 December 2017, the structure of the Bank's portfolio improved by increase of share of receivables classified in A and B in total classified assets by 2.30 p.p. and decrease of receivables classified in categories G and D are reduced by 7.13 percentage points.

Portfolio quality as of 31 December 2018 was in the low risk level, taking into account that less than 10% of portfolio was classified in categories G and D and was improved compared to 31 December 2017, when the quality of the Bank's portfolio was within the medium risk, due to the collection of non-performing exposures and write-off of receivables that were 100% impaired.

Loan loss reserves and required reserves pursuant to the NBS Decision on Classification of Balance Sheet and Off-Balance Items of Banks

(in RSD thousand)

	31.12.2017	31.12.2018	Change
Loan loss reserve for potential losses	4,872,042	3,544,296	-1,327,746
Required reserves for estimated losses without coefficient	2,300,006	2,201,860	-98,146
Required reserve for estimated losses with coefficient	713,002	0	-713,002

The required reserve for estimated losses by using coefficient will not calculated as a capital deductible item as from 30 June 2018, due to the fact that NPL ratio was below 10% as from that date.

Collection and coverage of NPLs

NPL based on the methodology of reporting to the National Bank of Serbia is shown in the following table:

(in RSD thousand)

	31.12.2017	31.12.2018	Change
NPL portfolio	4,504,911	2,569,350	-1,935,561

NPL as of 31 December 2018 was reduced by RSD 1,935,561 thousand compared to 31 December 2017 as a result of NPL collection and accounting write-off conducted for 100% impaired non-performing receivables. In 2018, the Bank collected EUR 7.9 million of NPL, while accounting write-off of 100% impaired non-performing receivables in the first three quarters of 2018 amounted to EUR 12.9 million. By accounting write-off of receivables and transfer to off-balance sheet items, the Bank does not waive collection of the non-performing exposures or exercise of its legal rights arising from such loans.

Share of gross NPLs in total gross Bank's loans

Ratio	31.12.2017	31.12.2018	Change
Share of NPLs in total loans	14.40%	6.42%	-7.98 p.p.

The credit risk management policy defines the limit for the level of non-performing loans (NPL ratio) as a ratio of gross NPLs and gross loans at the level of 10%. As of 31 December 2018 the Bank’s NPL ratio was below the defined limit.

NPL coverage

Ratio	31.12.2017	31.12.2018
Ratio of NPL coverage with impairment provisions for loans	55.48%	54.54%
Ratio of NPL coverage with NPL impairment provisions	53.69%	47.97%
Cost of risk	0.86%	0.19%

Credit Risk Management Policy defines the limit of the cost of risk coefficient as ratio of cost of impairment (as per income statement) and loans in amount of 2%. As of 31 December 2018 the Bank was in compliance with the prescribed value.

The Strategy for NPL Management and Collection defines basic ratios and their values for ensuring satisfactory coverage of NPLs, as well as the level of loan loss reserves that enables minimizing negative effects of any deterioration of asset quality on the Bank's capital adequacy. In accordance with this Strategy, the Bank’s target is to maintain NPL coverage ratio by impairment provisions of total loans above 55%. As of 31 December 2018 the Bank’s achieved value was slightly below the defined one for this indicator as a direct consequence of write-offs of 100% impaired receivables.

In Credit Risk Management Policy, the Bank defined the highest acceptable level of non-performing exposures (NPE) in relation to total balance sheet and off-balance sheet assets that are classified at a level that is less than 10%. The share of bad non-performing exposures (NPE) as of 31 December 2018 in total classified assets amounted to 4.70% and was significantly below the defined limit. This share decreased compared to 31 December 2017 for 6.79 p.p. due to the reduction of non-performing loans and simultaneous increase of the loan portfolio.

Liquidity Risk

Liquidity Ratio and Quick Liquidity Ratio prescribed by NBS in the period from 1 January to 31 December 2018

	Liquidity Ratio	Quick Liquidity Ratio
Value as of December 31st	1.69	1.42
Average	1.53	1.27
Maximum	2.02	1.70
Minimum	1.28	1.02
Daily NBS limit	Min 0.8	Min 0.5
NBS limit on monthly level	Min 1	Min 0.7

Liquidity ratios of the Bank during the period from 1 January to 31 December 2018 were in accordance with the prescribed limits by the Decision on Risk Management by Banks. In order to manage the liquidity risk adequately, the Bank monitors internally established indicators of structural liquidity, besides the limits prescribed by the NBS.

Additional liquidity ratios in the period from 01.01-31.12.2018 – internally established

	Min.	Max.	Average	Limit
Liquid assets ratio	23.04%	29.26%	26.42%	Min 20.00%
Net loans to total deposits ratio	105.63%	112.68%	110.50%	Max 200.00%
Customers' deposits to total deposits ratio	83.89%	89.64%	85.91%	Min 75.00%
Deposit concentration ratio	20.53%	25.16%	23.25%	Max 30.00%

The Bank was within internally prescribed liquidity limits during the period from 01.01-31.12.2018.

Foreign exchange risk

FX Risk ratio in the period from 01.01 - 31.12.2018

Value as of December 31st	0.63%
Average	1.37%
Maximum	5.68%
Minimum	0.18%
Limit NBS	Max 20%

Foreign currency risk measured by FX Risk ratio was located in the low risk category during 2018.

Interest rate risk

The impact of changes in interest rates on the economic value of the Bank is monitored through total net weighted position of the banking book.

Total net weighted position of the Bank as of 31 December 2018

	(in RSD thousand)
Total net weighted position	105,379
Equity	10,380,711
Total net weighted position and equity ratio	1.01%
Internally prescribed maximum	20%

Operational risk

In the period from 1 January to 31 December 2018 in terms of operational risk, 129 events were recorded in the operational risk database.

92 of all events of operational risk that were reported referred to cash shortages or surpluses and were successfully resolved (58 events of cash shortages and 34 events of cash surpluses).

Number of events	**129**
Cash shortage	58
Cash surplus	34
Other	37
Gross loss in RSD thousand	40,196
Net loss in RSD thousand	6,506

The Bank also performs an assessment of the risk of outsourcing, based on the contracts concluded with third parties, which have clearly defined rights and obligations of the parties. When introducing new products, processes and systems or new business activities, the Bank also performs assessment and identification of operational risks.

Exposure risk

The Bank's exposure to persons related to the Bank and its large exposures as of 31 December of 2018

	(in RSD 000)	% of equity	Limit NBS
Persons related to the Bank	1,281,466	12.34%	-
Large exposures	1,281,466	12.34%	Max 400%

Concentration risk

The Bank monitors the concentration risk through a concentration ratio that was defined as the ratio of the 20 largest gross exposures at the level of the client or the group of related parties and total regulatory capital.

The policy of credit risk management has determined that the concentration ratio should be maintained at a level below 300.00%.

	31.12.2017	31.12.2018	Prescribed value
Concentration ratio of 20 largest clients/groups of related parties	145.95%	89.69%	Max 300% of regulatory capital

Additionally, in order to manage the concentration risk, by the Credit Risk Management Policy and Procedure for the Credit Risk Management at the portfolio level, exposure limits are established to specific geographical areas and to a specific sector / business activity, which provide diversification of the portfolio. The Credit Risk Management Policy has defined a maximum exposure limit of 30% share in classified asset for a specific geographical area and sector / business activity.

Investment Risk

The Bank did not have investments in non-financial sector as of 31 December 2018. The total investments in entities that are not in financial sector and in fixed assets and investment property were in the category of low risk (below 45% of capital).

Bank's investments into non-financial sector and fixed assets as of 31 December 2018

	Investments into non-financial sectors	Investments into fixed assets	Total
Amount (000 RSD)	0	974,925	974,925
Share in equity	0%	9.39%	9.39%
Limit NBS	Max 10%	-	Max 60%

Country risk - the risk of the country of origin of the party the Bank is exposed to

The Bank establishes a system of country classification regarding the level of country risk and is committed to a system of risk classification by applying categories assigned by international rating agencies (Moody's, Standard&Poors and Fitch).

During 2018, the Bank had exposures to clients, which operate in countries that are classified as low-risk and medium-risk countries, according to the classification of official international credit rating agencies and the Bank’s Procedure.

The Bank’s exposure towards countries, which are in the category of low risk, is without limits. The countries in this category as of 31 December 2018 were Germany, Belgium, Austria and USA. Countries in the category of medium risk were Turkey, Macedonia, Croatia and Albania. Exposure to the countries in the category of medium risk was significantly below the adopted internal limits during the year ended 31 December 2018.

Review of the countries of clients whose exposure is involved in country risk as of 31 December 2018

Country	Risk category	Limit	Share in Bank capital
Germany	low	without limit	3.75%
Belgium	low	without limit	0.12%
Austria	low	without limit	2.38%
USA	low	without limit	0.79%
Turkey	medium	100% regulatory capital	23.75%
Macedonia	medium	100% regulatory capital	3.23%
Croatia	medium	10% regulatory capital	0.04%
Albania	medium	25% regulatory capital	1.14%

X CORPORATE GOVERNANCE RULES

Corporate governance rules of Halkbank a.d. Beograd are governed and set forth by the following by-laws:

- Statute;
- Articles of Incorporation;
- Corporate Governance Code;
- Business Code of Supervisory Board Members;
- Code of Conduct and Ethical Principles;
- Anti-Corruption Policy and
- General Operating Conditions.

HALKBANK AD BEOGRAD

Head of Financial Management and Planning Division
Vesna Petrović

Member of Executive Board
Radojica Popović

Chairman of Executive Board
Kenan Bozkurt