Addiko Bank

Annual Report 2018

Addiko Bank a.d. Beograd

Key data

Based on financial statements drawn up in accordance with IFRS

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

Addiko Bank a.d, Beograd

	2018	2017
Profit and Loss Statement (in 000 RSD)	**01.01.-31.12.**	**01.01.-31.12.**
Net interest and fee incime	4,438,148	4,349,749
Net interest income	3,169,165	3,209,060
Net fee and commission income	1,268,983	1,140,689
Other operating income	767,435	1,553,618
Operating expenses	-4,149,380	-4,600,390
Operating result before change in credit loss expenses	**1,056,203**	**1,302,977**
Credit loss expenses on financial assets	284,523	-83,573
Tax on income	-40,768	-1,156
Result after tax	**1,299,958**	**1,218,248**
Balance sheet (in 000 RSD)	**31.12.2018.**	**31.12.2017.**
Loans and advances to customers	73,001,855	61,639,577
Deposits of customers	65,789,053	61,919,011
Equity	21,397,933	21,945,443
Total assets	**100,118,520**	**94,115,810**
Key ratios	**2018.**	**2017.**
Net interest income/Total assets	3.17%	3.41%
Cost to income ratio (CIR)	71.40%	76.06%
Capital adequacy (Tier I ratio)	16.56%	18.69%
Capital adequacy ratio	18.44%	21.84%
FTE	585	595
Branches	38	38

Annual Business Report is prepared in accordance with Article 29 of the Law on Accounting of the Republic of Serbia (Official Gazette of RS no. 62/13) and contains the following:

Letter of the Executive Board

Dear Sir/Madam,

The year 2018 may be assessed as very successful for Addiko Bank. If several previous years could be characterised as turnaround years, the year 2018 could be definitely described as a growth year in every aspect. We continued transforming Addiko Bank from a universal bank to a bank specialised in consumer and SME lending, offering up-to-date user experience based on our strategy of straightforward banking.

Addiko Bank generated significantly larger growth in many indicators compared to the market, meaning the expansion of key segments – retail (21 percent growth) and SME (40 percent growth) loans. Moreover, new placements amounted to over EUR 300 million. In parallel, deposit growth was very intense in 2018, with the deposit base diversification. All of these facts indicate trust of clients in Addiko Bank offer.

The business strategy implemented by Addiko set new standards in the banking market. Clients recognised our focus on their needs, primarily implying saving in time we offer. Account opening in only a few minutes and loan approval in half an hour became a standard of our operation, broadening the business in Serbia. This was a result of streamlining internal processes, implying their digitalisation.

After launching the Addiko brand, the m-banking application was changed, announcing significant strides in the digital transformation segment. We are now already recognised by this feature. Application improvement and instant payment implementation were finalised ahead of the legally prescribed deadline. From that moment, we were prepared for the second stage which will be implemented in Q2 2019.

The year 2018 also featured the initiation of the project of creation of a unique product in the market – mLoan. Addiko will be among the pioneers of enabling clients to take loans without having to visit a bank branch. The process will be completely carried out through the m-banking application.

The unique user experience that was first introduced in the market by us will continue to be a focus of our efforts because we believe it to be our advantage over the competition.

In retrospect of our achievements in several previous years, we can be satisfied with our performance as a team. In 2019, we will continue standardisation, digitalisation of processes and products and improvement of our services because we, Addiko Bank, consider it to be worth offering to our clients.

Sincerely,

Executive Board of Addiko Bank a.d. Beograd

Vojislav Lazarević, Executive Board, Chairperson

Mirko Španović, Deputy of Executive, Board Chairperson

Vladimir Stanisavljević, Executive Board Member

Nebojša Pantelić, Executive Board Member

Annual Business Report Addiko Bank a.d. Beograd

1. About Addiko Bank

Addiko Bank a.d. Beograd ("Addiko Bank") is a member of an international financial group headquartered in Vienna, Austria. Addiko Group operates in five markets: Serbia, Croatia, Bosnia and Herzegovina, Slovenia and Montenegro, having around 860 thousand clients. The strategy of Addiko Group is to concentrate on the markets of the South-Eastern Europe countries, with clients and their needs as the focus. There is also the service of making online deposits in Austria and Germany.

The holding Al Lake (Luxembourg) S.à r.l. is the direct owner of the Addiko Group. Its beneficial owners are the Investment Fund Advent International and the European Bank for Reconstruction and Development (EBRD).

2. General economic environment

The growth of the Serbian GDP accelerated to the highest level (4.3%) last year and at the same time rose stronger than the expectations for the beginning of the year. Accelerating personal spending growth and investments in fixed capital are the main drivers of growth, thanks to the strong growth of disposable income, consumer lending and remittances from abroad, as well as the strengthening of direct foreign investment, public investments and corporate profitability on the other hand. Exports of goods and services continued their strong growth, although they were insufficient to bring about somewhat stronger growth in imports of investment and consumer goods.

In 2018, Serbia re-recorded a budget surplus of about 0.8% GDP (versus the expected deficit of 0.5%) due to the widespread growth in revenues (from taxes) owing to the domestic demand, tax discipline and non-tax income. Public debt continued to decline thanks to the acceleration of the nominal GDP growth, lower interest expenditures and mild appreciation of Serbian dinar.

At the same time, the acceleration of credit growth continued to strengthen lending in the population segment driven by strong demand for cash loans, due to labor market improvements and wage growth. Interest rates remained at record-low levels, both for Serbian dinar loans and currency-indexed ones. Low interest rates and slower approval standards also contributed to the recovery of corporate lending that accelerated the pace due to the strengthening of the investment cycle. In addition, banks continued intensifying their credit portfolios during the year, which, besides a decline in bad loans, had an impact of strengthening competition among banks and intensifying risk appetite, thus freeing up the scope for strengthening the credit activity.

3. Significant events in 2018.

3.1. Organisational structure and Operating Model implementation

The implementation of the Operating Model continued during 2018 with further approvals of non-critical "Central Steering" and "Group Shared Services" received from the local regulator.

This operating model aims to raise levels of productivity and improve efficiency across the organization, while assuring local execution of all critical services. The "Central Steering" and "Group Shared Services" provide each Addiko entity higher degree of specialization and standardisation by sharing best practices and therefore raising the quality of service delivery and steering, while reducing simultaneously the cost of delivery across the Group.

The Operating Model ultimately ensures higher level of service quality across the six countries, increases operational stability and enables full leveraging of investments at the Group level. Furthermore, it offers interesting perspectives for highly-skilled staff and experts.

3.2. Digital transformation & building digital capabilities

Addiko Bank continued its digital efforts by launching two new key digital initiatives, namely a completely new Group-wide e-banking system for the Corporate and SME segments, and a new Group-wide business process management system.

The new e-banking system was launched for Corporate/SME clients in Serbia and it incorporated valuable feedback received from customers. This platform was developed through an agile approach in close cooperation with customers, leveraging the capabilities built in the Group Digital Competence Center (DCC). It enables easier handling of day-to-day tasks, allows customers to monitor their existing trade finance and loan products online and sets the stage for further convenient product initiatives coming to Addiko customers in the future.

In parallel, Addiko Bank also intensified its use of the business process management software which was integrated into the bank's new technology architecture and proved the value of the open API (application programming interfaces) architecture to create an ecosystem with strategic partners. SME/Corporate Relationship Managers in Serbia will be able to digitally apply for a loan or a trade finance product on behalf of their customer, resulting in a very significant decrease of approval time for the clients. In a future release of the software, customers will be able to apply for these products on their own without the need to visit one of Addiko's SME centers.

Addiko Bank Slovenia/Serbia launched two new digital banking applications on the Appian's low-code application platform that will result in significantly faster, more comprehensive and effective digital lending and trade finance processes for its Corporate/SME customers. The applications reduce customer wait times by as much as 50% by cutting 'time-to-yes' for simple loans down from one week to just three days.

Addiko Bank is the first bank within the SEE region to provide such digital banking platform to customers in Slovenia and Serbia, and Addiko is also the first bank in the region to offer a fully digitalized trade finance application process, creating more rewarding experience for customers. Addiko's simplified loan process enables the bank's Corporate and SME customers to apply for a simple commercial loan of up to EUR 250.000 in just three easy steps.

On the other side, by using different digital marketing tactics, direct messaging, e2e processes and incentives, we are moving our markets to digital sales. As a result of that, in 2018, we conducted several lead campaigns, and brought e2e online account opening over the mobile app in Serbia as one of the kind in the region.

Creation of new digital capabilities is one of the strategic focus points of the Group. Addiko invests a significant amount of resources in identifying innovative solutions that aim to solve specific customer problems. In pursuing this approach, Addiko is recognised as the market leader in delivering convenient banking solutions to its customers in the countries of operation.

Digital customer base in Serbia was increased by over 60% during 2018, while the mobile banking became the main channel for our customers.

All of these digital initiatives are crucial in our mission of shifting customers from the physical to the digital environment.

3.3. Focus on improving customer experience

As a part of its continuous focus on improving customer experience, Addiko Bank Serbia transactional net promoter score (NPS) platform started to be tested in 2018. Production is planned for the end of Q1. The possibility to survey customer experience after individual interactions with Addiko allows to measure critical moments of customer journey.

Mystery shopping activities continued for the purpose of improving the quality of service in branch network and increase customer satisfaction.

Certain group customers were surveyed by the Contact Center Department in order to find critical points for specific group users of Addiko Bank services.

3.4. Continuous cost management and efficiency gains

With a continued focus on process optimisation and establishing a lean, efficient, agile and integrated organisation, a further consolidation of the existing IT applications and landscape was conducted during 2018.

As a result of the ongoing cost improvement initiatives, a reduction of the operating expense was achieved, despite additional investments performed to grow the business and enhance the digital capabilities. The Addiko Bank is well positioned for further significant improvement of the overall efficiency and with positive effects on the cost-to-income ratio (CIR).

3.5. Review of the business strategy

After the successful implementation of its original business strategy (established following the change of ownership in July 2015) and extensive repositioning as a "specialist bank" in CSEE, Addiko Bank refined its strategy to differentiate itself from the universal banking models prevalent in the CSEE region by focusing on daily banking activities for which convenience and speed can command higher margins. Such services consist mainly of transactions requiring low or no advisory support, they are suitable to standardisation and delivery over digital channels.

The Addiko Bank focuses on higher risk-adjusted yield businesses as a specialist bank lending to consumer and SME customers in the "real economy" consisting of manufacturing, production, trade, agriculture and tourism businesses, with a proven cash flow producing track record. The underserved markets in CSEE offer attractive growth which will be achieved through convergence with European standards, particularly once digital banking capabilities are expanded in the region.

The Addiko Bank delivers modern customer experience in line with its strategy of providing straightforward banking – "focus on essentials, deliver on efficiency and communicate simplicity". Banking products and services were standardised and refined, especially in the Retail segment and the SME business segment, to improve efficiency, promote simplicity and increase customer convenience, while at the same time reducing risks and maintaining asset quality.

Based on this approach, Addiko Bank reached its goal of transforming the business towards strategic core segments with a focus on growing its consumer business and SME lending activities, as well as payment services (its "focus areas"), offering unsecured personal loan products to consumers and working capital loans to SME customers funded largely by retail deposits. The Addiko Bank's mortgage business, public finance and large corporate lending portfolios (its "non-focus areas") were gradually reduced over time, with repayments by customers exceeding new business generated in those fields, thereby providing liquidity and capital for the gradual growth in its consumer business and SME lending. Any new lending products in non-focus areas are offered on an opportunistic basis only. Furthermore, the Group continued its journey of building a distinctive operating model with digital capabilities.

Building on its successful initial strategy, Addiko will now take further steps to become the go-to-bank for selected products with executional excellence, serving basic banking needs with straightforward, most convenient and fastest customer experience based on clear and transparent communication.

3.6. Branches

At the year-end 2018, Addiko Bank Serbia operated the total of 38 branches. The whole network is divided into three regions, with 17 branches located in the Sales Management Department Region Belgrade, 11 branches located in the Sales Management Department Region Central and Southern Serbia, 10 branches located in the Sales Management Department Region Novi Sad.

3.7. Financial performance in brief

Having delivered on the turnaround in 2017, Addiko continues its path towards achieving appropriate return on equity and shows good progress by increase of customer loans in 2018. (18.4% increase) In the same time the deposit base of clients is higher by 6.3% compared with previous year.

This positive development is the result of Addiko's ongoing focus on changing business composition predominantly from lower-margin mortgage lending and public finance towards higher-added value consumer and SME lending. This is shown by the increased share of these two segments to 54% of the gross performing loan book (YE17: 47%) and the increase of the gross loans book by RSD 10.3 billion. The performance in new disbursements, which outperformed the market growth, in these focus segments over the last 12 months clearly highlights that Addiko delivers on its business strategy, with an increase in the volumes of +51% in the consumer lending and +40% in the SME loans.

The positive development in net interest income is driven mainly by the increase in interest income in retail segment (without mortgage loans) and micro clients (+26%), as well as the constant price control on deposits side overcompensating the run-down of the healthy non-focus portfolio. The key focus was on maintaining positive sales trends while fine-tuning the pricing and securing the required funding for asset growth.

During 2018, Addiko Banka contributed to the constant growth of the deposit base, which grew by 3.9 billion dinars in 2018 through the increase of the client base, new services, and the improvement and acceleration of the work process. At the same time, the growth of assets was supported through the diversification of sources of financing by borrowing from the bank with international financial institutions (EBRD)

Net fee and commission income increased by 11.2% from RSD 1.1 billion in 2017. To RSD 1.3 billion in 2018. as a consequence of higher growth in payment business and consumer lending (excluding mortgage loans) and SME business, which is due to new fee models and new product packages.

Trough efficient assets and liabilities management, as well as monitoring of the currency structure, the Bank ensured alignment of the other operating income with the growth of the focus segments.

Operating expenses amounted to RSD 4.0 billion at YE18, which was a reduction of RSD 95.7 million compared to the comparative period (YE17: RSD 4.1 billion), resulting from the Addiko's Operating Model and tight cost management.

There was a significant improvement in the quality of assets due to the settlement of inherited problem placements through the successful recovery of individual major corporate clients, increased forced collection activities, as well as due to the implemented accounting write-offs. In addition, the emergence of new problematic placements is at a low level, which confirms the focus of the Bank on the long-term growth of credit portfolio through responsible credit policy. Successful resolution of problem loans and positive trends in the movement of loan portfolio re-enacted in the net decrease in provisions despite the introduction of the new accounting standard of IFRS 9.

3.8. Adoption of IFRS 9

The IFRS 9, a new international financial reporting standard related to the classification, measurement and calculation of financial instrument impairment, came into force on 1st January 2018. The IFRS 9 replaces the IAS 39 which was the previous accounting standard used for measurement and classification of financial instruments.

The new standard primarily refers to provisions for credit losses, since it implies the amount of impairment of financial assets measured at amortised value or fair value recognised directly through capital. According to the IFRS 9, impairment requirements are also applied to off-balance sheet items. The change of the impairment model implies the replacement of the historical concept under the IAS 39 (realised credit losses) by the future-oriented concept under the IFRS 9 (expected credit losses).

The new measurement approach implementation resulted in insignificant changes. The first implementation of the IFRS as on 1 January 2018 resulted in the capital decrease of RSD 1,325 million (net deferred tax assets of RSD 159 million).

3.9. New data protection regulation (ZZPL)

The new regulation on personal data (ZZPL), entering into force on 21st November 2018 and applying after nine months from the day of the law entering into force, 21st August 2019, implies strengthening of rights of data subjects and subjecting data controllers and data processors to new requirements when managing and handling personal data. Owing to the importance of this change in regulation, Addiko implemented the ZZPL (aligned with the GDPR) readiness program well in advance.

A big milestone was the appointment of the Data Protection Officer (DPO). The DPO handles and coordinates all data protection activities and reports defined KPIs to the Data Protection Central Steering Function. On 25th May 2018, Addiko reported that it was compliant with the GDPR requirements in all acting countries.

Data protection also had a significant role in the Operating Model in which grounds for intra-Group personal data sharing were laid.

3.10. Changes to the Executive Board

The biggest change took place in the position of the Chairman of the Executive Board. In February 2018, Vojislav Lazarević was appointed Chairman. Also, during 2018, Nebojša Pantelić was appointed member of the Executive Board responsible for retail business.

3.11. Corporate Social Responsibility

In 2018, Addiko Bank continued to apply a single Corporate Social Responsibility Strategy on all markets in which it operates. The primary focus is on young people. Thus, Addiko Bank, in partnership with the Laguna publishing house and within the Addiko Cares program, organized a visit of children's writers to institutions with children with special needs or children without parental care. Four such actions were organized in Niš, Kragujevac, Novi Sad and Belgrade, and each was attended by a number of employees.

Apart from this, the strategic commitment of Addiko Bank, the bank facing digital transformation, is the protection of life, that is, reduction in the printing and use of paper.

4. Financial statements

4.1. Analysis of profit and loss statements

Bilansa uspeha RSD 000

	2018	2017	Change
Interest income	4,152,679	4,161,983	-0.22%
Interest expenses	-983,514	-952,923	3.21%
Net interest income	**3,169,165**	**3,209,060**	**-1.24%**
Fee and commission income	1,401,414	1,265,885	10.71%
Fee and commission expenses	-132,431	-125,196	5.78%
Net fee and commission income	**1,268,983**	**1,140,689**	**11.25%**
Other operating result	647,876	1,078,669	-39.94%
Credit income/loss on financial assets	284,523	-83,573	-440.45%
TOTAL NET OPERATING INCOME	**5,370,547**	**5,344,845**	**0.48%**
Costs of salaries, salary compensations and other personnel expenses	-1,450,282	-1,458,199	-0.54%
Depreciation	-187,935	-207,233	-9.31%
Other income	110,714	382,910	-71.09%
Other expenses	-2,502,318	-2,842,919	-11.98%
PROFIT BEFORE TAX	**1,340,726**	**1,219,404**	**9.95%**
Profit tax	**-1,025**	**-1,156**	**-11.33%**
Loss from deferred tax	-39,743	–	100.00%
PROFIT AFTER TAX	**1,299,958**	**1,218,248**	**6.71%**

Net interest income decreased at the amount of 40 million dinars, so that in 2018, it amounted to 3,169 million dinars, compared to 3,209 million dinars in 2017.

Net fee and commission income increased by 128 million dinars to 1,268 million dinars (in 2017: 1,141 million dinars), with the difference primarily due to higher revenue from fees for maintenance of current account packages, as well as income from guarantees.

Net result of financial instruments decreased from 183 million dinars in 2017. to 171 million dinars in 2018.

Other operating result amounted to 245 million dinars, compared to 499 million dinars in 2017.

Operating result before change in credit loss expenses amounted to 1,056 million dinars (2017: 1,303 million dinars).

The development of credit loss expenses on financial assets (CL) is not comparable to last year's amounts due to the implementation of the IFRS 9. The positive result of 285 million dinars in 2018 shows a release in relation to successfully implemented restructuring measures among larger, individual corporate segment clients.

Profit taxes were 41 million dinars, significantly higher than in the previous reporting period (2017: 1.2 million dinars). This reflects the use of transferred tax losses that also allowed the recognition of deferred tax assets during 2017 and 2018.

4.2. Analysis of the Balance Sheet Statement

Addiko Bank adopted the requirements of the IFRS 9 "Financial Instruments" on 1st January 2018. The requirements of the IFRS 9 for the recording, measurement and depreciation of values were retroactively adjusted to the opening balance on the day of the application.

Addiko Bank did not rule on a comparable period. Therefore, only the balance sheet structure at the end of 2017. was adjusted to new requirements in accordance with IFRS 9, which provided limited comparability.

Bilansa stanja '000 RSD

	2018	2017	Change
Cash reserves	11,174,771	10,575,958	6%
Financial assets held for trading	–	–	0%
Derivatives	25,656	157,022	-84%
Investment securities	11,108,524	16,880,855	-34%
Loans and advances to credit institutions	2,442,156	2,828,041	-14%
Loans and advances to customers	73,001,855	61,639,577	18%
Intangible assets	946,053	680,945	39%
Tangible assets	629,876	615,354	2%
Deferred tax assets	158,974	–	100%
Non-current assets held for sale and assets from discontinued operations	72,446	119,826	-40%
Other assets	558,209	618,232	-10%
Total assets	**100,118,520**	**94,115,810**	**6%**

Total assets of Addiko Bank increased by 6,003 million dinars or 6%, from 94,116 thousand to 100,119 million dinars.

Cash reserve increased by 599 million dinars to 11,175 million dinars (2017: 10,576 million dinars).

Total net receivables (gross receivables excluding provisions for credit risk) decreased to 26 million dinars from 157 million dinars at the end of 2017. Loans and receivables from banks decreased slightly by 386 million to 2,442 million dinars (2017: 2,828 million dinars). In line with the Addiko Bank strategy, within the framework of loans and receivables to customers, the business structure continued to change during the reporting period, with the increased share of higher value added consumer and SME loans.

The investment securities include 2017 positions of financial assets "available for sale" at the amount of 16,881 million dinars, while the item at the amount of 11,109 million dinars was included at the end of 2018.

Fixed assets remained stable and amounted to 630 million dinars, compared to 615 million dinars in 2017.

Intangible assets increased to 946 million dinars compared to 681 million dinars due to further development of new applications for e-banking and investment to improve digital capabilities.

Tax assets were formed at the amount of 159 million dinars in the name of deferred taxes based on the first application of the IFRS 9.

Other assets decreased from RSD 618 million to 558 million dinars.

Fixed assets held for sale and discontinued assets decreased to 72 million dinars.

RSD '000

	2018	2017	Change
Financial liabilities based on derivatives	24,942	32,347	-23%
Deposits of credit institutions	7,589,826	5,382,756	41%
Deposits of customers	65,789,053	61,919,011	6%
Issued bonds, subordinated and supplementary capital	3,911,759	3,774,141	4%
Provisions	369,533	283,395	30%
Current tax liabilities	1,025	1,156	-11%
Deferred tax liabilities	33,785	32,100	5%
Other liabilities	1,000,664	745,461	34%
Equity	21,397,933	21,945,433	-2.5%
Total equity and liabilities	**100,118,520**	**94,115,810**	**6%**

On the liabilities side, financial liabilities at amortized cost increased by RSD 2,207 million from 5,383 to 7,590 million dinars during, primarily due to increase of long term borrowings taken from foreign banks (EBRD)

Deposits increased to 65,789 million dinars at the end of 2018 (2017: 61,919). This development is mainly the result of an increase in corporate deposits and maintenance of a stable level of current deposits of households and an increase in savings deposits in the amount of 4,530 million dinars.

Provisions were increased from 283 million dinars in 2017 and in 2018, they amounted to 370 million dinars.

Capital development refers to the initial effect of the IFRS 9 at the amount of 1,325 million dinars as at 1st January 2018, as well as distribution of profit.

5. Analysis of non-financial key performance indicators

5.1. Human Resources management

The Human Resources strategy underpins the cultural transformation of Addiko Bank. The Operating Model enables employees at all levels to drive for results via team work and cross-boundary collaboration. Building of a strong HR processes in performance, recruitment, talent, learning and leadership development is needed to ensure agility in employee attitudes and capabilities.

The performance and talent management frameworks are key processes used to identify, develop, reward and recognise high performance and talented employees. The two processes support Addiko Bank's journey of building a great place to work, aiming to become an employer of choice, attracting talents and offering opportunities for employees to develop their careers.

In 2018, there were many areas of focus in the Human Resources, with new training programs piloted to develop leadership capabilities. 2018. At yearend 2018, the Addiko Group had 585 FTE's. Several small-scale efficiency and rightsizing programs continued in In the upcoming period, the focus will be on elevating the cultural and business transformation of Addiko Bank, ensuring that "Values and Behaviors" are integrated into daily performance. This will require effective HR metrics in place to ensure that the right employees hold key positions and that the Bank develops critical skills needed to be a bank which is an innovation leader and a digital promoter in the countries where it operates.

6. Internal Control System for accounting procedures

Addiko Bank has an internal control system (ICS) for accounting procedures, defining and implementing adequate structures and processes throughout the organization.

The aim of the Internal Control System of Addiko Group is to ensure effective and efficient operations, adequate identification, measurement and mitigation of risks, prudent conduct of business, reliability of financial and non-financial information reported, both internally and externally, and compliance with laws, regulations, supervisory requirements and the institution's internal rules and decisions.

The Internal Control System (ICS) consists of a set of rules, procedures and organizational structures which aim to:

- ensure that corporate strategy is implemented,
- achieve effective and efficient corporate processes,
- safeguard the value of corporate assets,
- ensure the reliability and integrity of accounting and management data,
- ensure that operations comply with all existing rules and regulations.

The particular objectives with regard to Addiko Bank accounting procedures are that the ICS ensures that all business transactions are recorded immediately, correctly and in a uniform way for accounting purposes. The implementation of the Internal Control System in relation to the financial reporting process is also set out in internal rules and regulations.

The internal control system of Addiko Bank is built on a process-oriented approach. Addiko Bank deploys control activities through process documentation which incorporates the tracking and documentation of each process, including the information about process flow according to the internally set up guidelines for process management.

The overall effectiveness of the internal controls is monitored on an ongoing basis. Internal control weaknesses, whether identified by business line, internal audit or other control functions, are timely applied to the appropriate level of management for further decision-making and are immediately addressed.

The overall efficiency of internal controls is monitored on a permanent basis. Monitoring of key risks is part of daily activities of Addiko Bank, as well as periodic assessments by business lines, internal control functions, risk management, compliance and internal audit.

The Internal Audit performs independent and regular reviews of compliance with legal provisions and internal rules.

The Internal Control System itself is not a static system, but is continuously adapted to the changing environment. The implementation of the Internal Control System is fundamentally based on the integrity and ethical behaviour of employees. The Executive Board and the leadership team actively and consciously embrace their role of leading by example by promoting high ethical and integrity standards and establishing risk and control culture within the organization that emphasizes and demonstrates the importance of internal controls to all levels of personnel.

7. Financial risk management

The risk management system of the Bank is aimed at ensuring minimisation of risks to which the Bank is exposed within its operation by observing and applying risk management principles, policies and procedures, the stability of all aspects of the operation of the Bank and minimum sensitivity to negative internal and external factors and the Bank risk profile, satisfying requirements of prudent banking at all times.

The Bank's risk strategy, which is derived from its business strategy, describes the planned operating structure, strategic development and growth, considering processes, methodologies and organisational structure relevant for managing risk factors. The risk strategy defines a framework for monitoring, control and limitation of risks to which the Bank is exposed within its operation, while ensuring internal capital adequacy, liquidity position and general profitability. Policies and procedures for managing individual risks are based on requirements prescribed by laws and bylaws of the National Bank of Serbia and guidelines, principles and relevant documents of Addiko Group.

The Bank has established the Risk Appetite Framework (RAF) which makes a part of the process of development and implementation of the business and risk strategy. Additionally, the RAF determines the level of risk relative to the risk bearing capacity. The RAF defines the level of risk which is acceptable for the Bank. Measures of the RAF are calibrated in alignment with the Business Plan, Risk Strategy and Recovery Plan, representing a framework for adequate internal risk management and control.

Furthermore, within the strategic risk management, another key process – the Internal Capital Adequacy Assessment Process (ICAAP) is implemented, aiming at determining the level of capital sufficient for covering all material risks to which the Bank is exposed. The ICAAP is a tool for the assessment of internal capital adequacy relative to the Bank's risk profile and the implementation of the Bank's strategy which appropriately preserves an adequate internal capital level.

In the course of 2018, risk management at the Bank (risk identification, measurement/assessment, mitigation and monitoring) was actively carried out by the following:

- Bank bodies and other committees envisaged by the Law on Banks – Board of Directors, Executive Board, Audit Committee, Asset and Liability Management Committee (ALCO) and Credit Committee of the Bank;
- Work bodies of the Executive Board of the Bank – Risk Control Advisory Body, Corporate Advisory Body and Operational Risk Advisory Body;
- Organisational units of the Bank – Risk Control Department, Corporate Risk Management Division, Retail Risk Management and Collection Division, Treasury and Balance Sheet Management Department, Compliance Department and other units when needed.

Key risks of the Bank stem from the operation of the Bank and market conditions, implying the credit risk, liquidity risk, interest rate risk, market risks, operational risk and other risks, such as the risk of investments in legal entities and fixed assets, and country risk.

7.1. Credit risk

The process of credit risk assessment and monitoring at the level of individual client and group of borrowers is based on adopted policies and procedures establishing rules and criteria for approving new placements and defining activities, tasks and responsibilities of persons involved in the credit risk monitoring process.

The process of credit risk identification, assessment, measurement and management is continuous, encompassing the total Bank portfolio exposed to credit risk.

With the implementation of the IFRS 9 on 1st January 2018, the assessment of the impairment of financial assets measured at amortised or fair value through other result implied the expected credit loss (ECL) model instead of the impairment model based on the IAS 39 used before.

The impairment methodology of the Bank under the IFRS 9 was further improved in 2018 by applying new macroeconomic forecasts and a new behavioural model, resulting in the new probability of default (PD) matrices for value adjustment calculation.

In the course of 2018, the Bank was fully complied with the Basel III standards in terms of capital adequacy. As on 31st December 2018, the total capital requirement for credit risk stood at RSD 4.9 billion, the capital adequacy ratio (CAR) stood at 18.44% and whereas the Common Equity Tier 1 ratio (equalling the Tier 1 Capital ratio) stood at 16.56%.

7.2. Liquidity and interest rate risk

The liquidity risk management system of the Bank is based on measures and criteria defined by the National Bank of Serbia, focusing on short-term and structural liquidity, with implementing adequate limit system and early warning policies and procedures aligned with the ICAAP and ILAAP framework and liquidity risk management principles of Addiko Group.

In the course of 2018, the liquidity risk management at the Bank was focused on measurement, monitoring and reporting on forecasts of liquidity inflows and outflows, liquidity reserves in various scenarios of regular operation and potential liquidity crisis and monitoring and regular reporting to the Bank bodies and the ALCO on developments of regulatory liquidity ratios (liquidity ratio, narrow liquidity ratio and liquidity coverage ratio - LCR) and other liquidity ratios under the internal Bank methodology or Basel III standards (Liquidity Value-at-Risk, Net Stable Funding Ratio – NSFR).

All liquidity ratios, both regulatory and internally defined in relation to liquidity risk management, were aligned and above limits in 2018. As on 31st December 2018, liquidity ratios prescribed by the National Bank of Serbia regulations stood as follows: liquidity ratio: 1.75%, narrow liquidity ratio: 1.44% and LCR: 116%.

The interest rate risk management system of the Bank is based on principles prescribed by the National Bank of Serbia and Addiko Group, focusing on analysis, measurement, monitoring and reporting on the interest rate risk from the banking book. In the course of 2018, all interest rate risk ratios of the Bank were aligned and ranged within limits defined by interest rate risk management policies and procedures of the Bank.

7.3. Foreign exchange risk and other market risks

In line with the Decision of the National Bank of Serbia on Capital Adequacy of Banks, the Bank must maintain the foreign exchange risk ratio, implying the relation of the total net open FX position and capital, in the manner that the total net open FX position, including the absolute value of the net open position in gold at the end of each business day, does not exceed 20% of the capital. Throughout 2018, the foreign exchange risk ratio was aligned with the National Bank of Serbia requirements, with the said ratio standing at 2.48% as on 31st December.

Market risk management of the Bank is regulated by adequate policies defining the manner of implementing the criteria and measures prescribed by the National Bank of Serbia and Addiko Group principles for controlling and managing market risks, adopted by the Bank Board of Directors and the proposal of the Executive Board. In the course of 2018, the exposure to price risk on debt securities investments of the Bank was managed and kept aligned continually, the exposure predominantly being generated from investments in the government securities of the Republic of Serbia.

7.4. Risk of exposure

The risk of exposure to one person or a group of related persons was controlled and monitored by forming unified databases on related persons, active monitoring and regulatory reporting. In the course of 2018, there were no breaches of regulatory exposure limits for one person or a group of related persons, which was regularly reported to the Risk Control Advisory Body and Bank bodies.

7.5. Operational risk

Aiming at comprehensive monitoring of the operational risk exposure of the Bank, the operational risk management system is based on standard identification principles of gathering and classifying data on operational risk events and losses, implementation and monitoring of elimination and mitigation measures and regular reporting to the Bank bodies and the Operational Risk Management Advisory Body, focusing on timely analysis of causes and proposal of measures for minimising exposure to operational risk.

In the course of 2018, the Bank also continued assessing operational risks which may occur from introducing new products and from outsourced activities and the risk and control self-assessing in key Bank processes.

The capital requirement for operational risk is calculated by the standardised approach according to which the operational risk capital requirement as on 31st December 2018 amounted to RSD 805 million.

7.6. Risk management system adequacy

In 2018, the risk management system of the Bank was adequate, in view of the following:

- Due to an adequate approach to new placement approval and improvements in management and resolving of non-performing placements, the share of non-performing exposure in total exposure was considerably decreased, being substantially below the planned level;
- The IFRS 9 used for calculation of financial asset impairment was successfully implemented, resulting in:
    - Increase of exposure in assets side due to transferring suspended interest to on-balance exposure,

  - Introduction of Stages 1 and 2 resulting from the division of the performing portfolio, with parallel introduction of the term expected credit loss (ECL),
  - Implementation of new macroeconomic forecasts,
  - Updating of risk parameters PD (Probability of Default) and LGD (Loss Given Default) as models for calculating adjustments of on-balance sheet assets and off-balance sheet items;
- Regulatory and internal ratios of exposure to material risks were maintained within prescribed limits, regularly monitored and reported to management and operational bodies of the Bank, including ratios envisaged by the current Recovery Plan;
- The utilisation of defined exposure limits for different types of risks was regularly monitored with timely defining measures for preventing limit breaches;
- The ICAAP was regularly implemented with maintaining alignment of all calculated values with internal limitations;
- Recommendations of the National Bank of Serbia within the SREP were received and considered within the development of the risk management system.

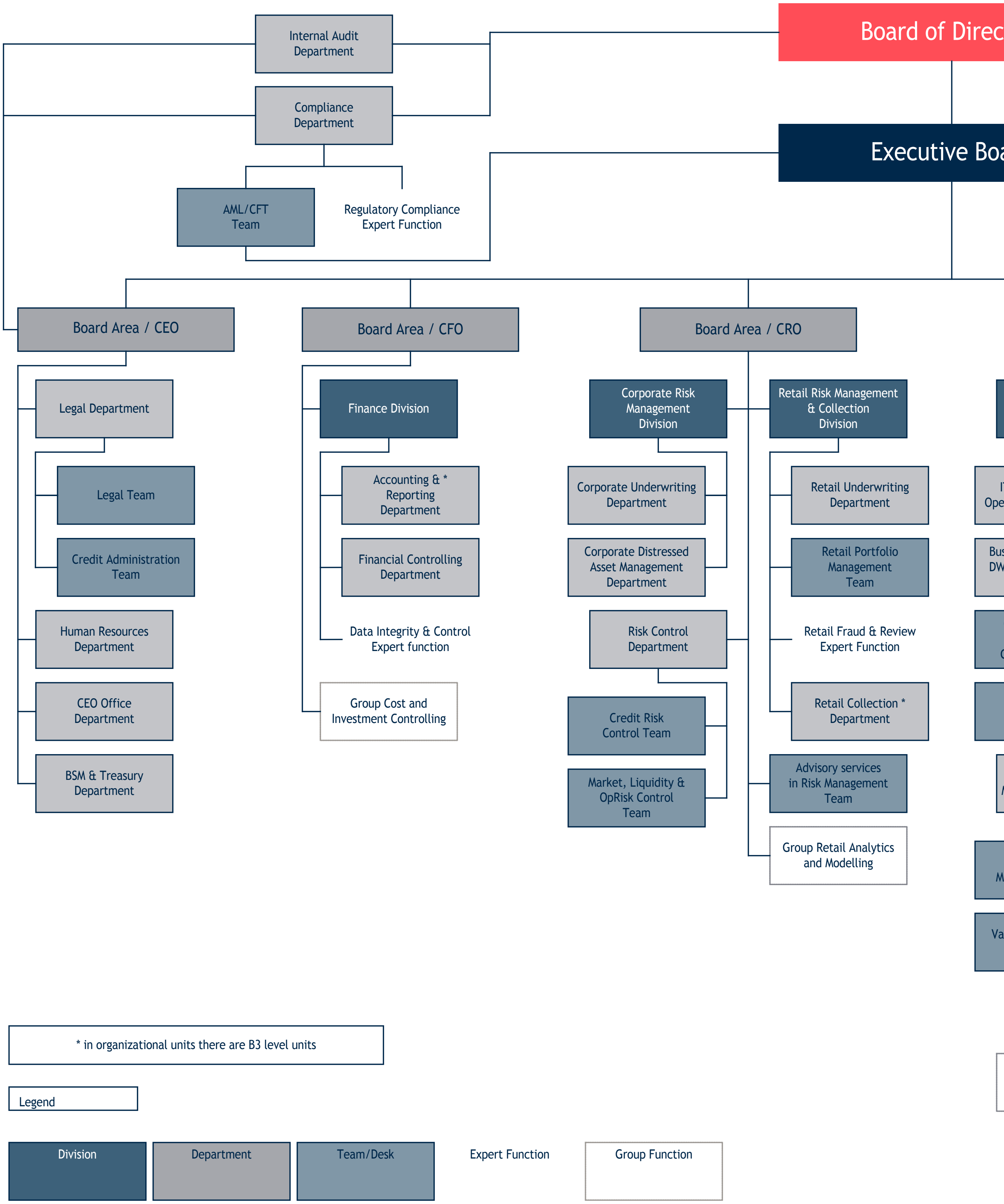
8. Outlook

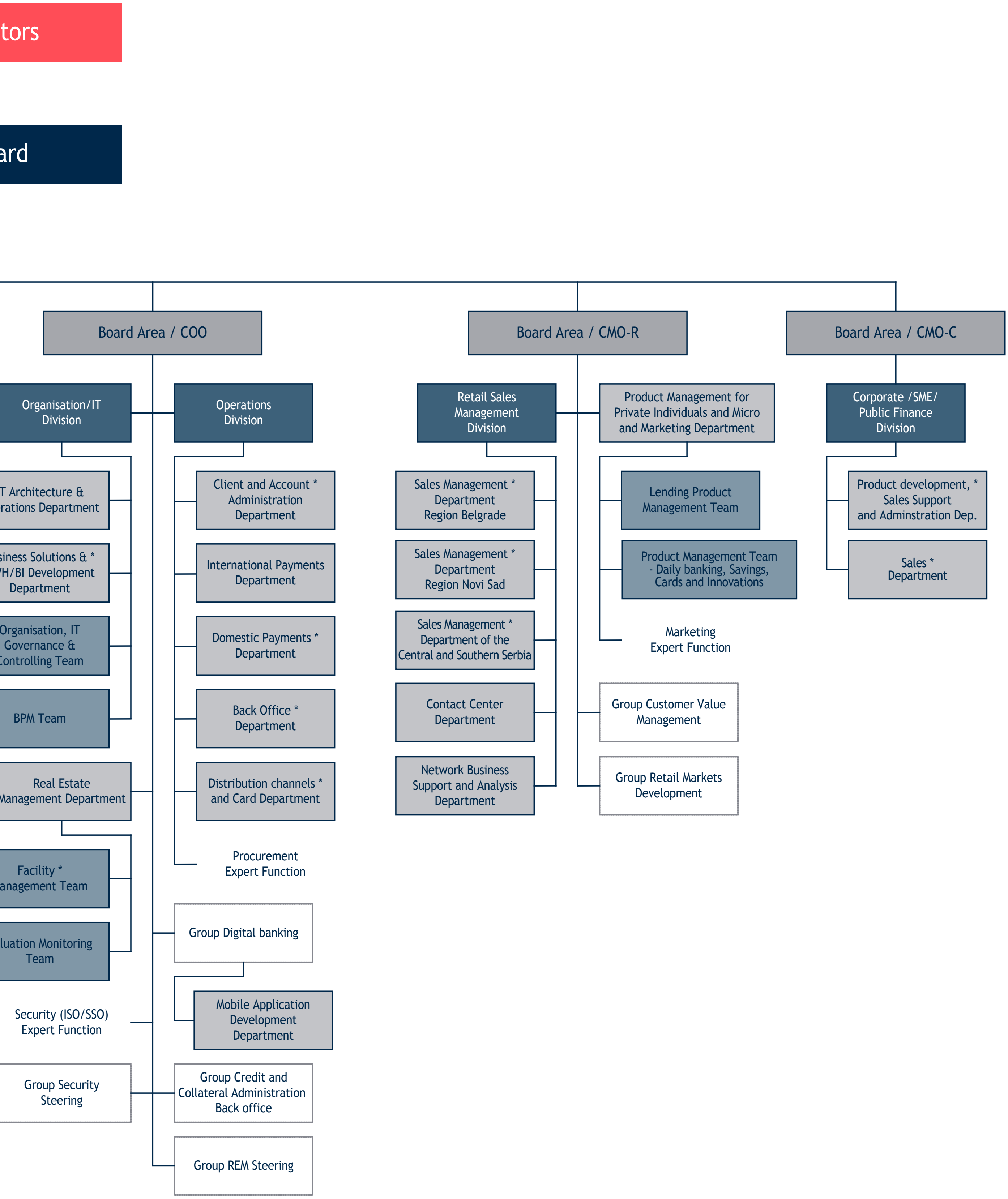
In 2019, we see a still relatively strong GDP growth at around 3.5% due to strong growth in personal consumption and investments, fiscal relaxation and tax reform. Such dynamics of the economic activity will probably be accompanied by further improvements in labour market opportunities, lower unemployment rates, wage increases and low inflation, which all contribute to a further relatively strong growth in personal consumption.

We expect that the growth in private consumption and strong consumer sentiment will support the continuation of consumer lending, while strong investment activity will have a beneficial effect on further recovery in lending activity in the enterprise segment. Nevertheless, credit growth will continue at a slower pace, especially if we take into account new regulatory measures introduced since the beginning of the year, aimed at preventing excessive long-term consumer debt risks.

9. Organizational Chart

The Bank's organizational chart as of December 31, 2018 is presented on the following page:




tors
ard
Board Area / COO
Board Area / CMO-R
Board Area / CMO-C
Organisation/IT Division
Operations Division
Retail Sales Management Division
Product Management for Private Individuals and Micro and Marketing Department
Corporate /SME/ Public Finance Division
T Architecture & rations Department
iness Solutions & * /H/BI Development Department
Organisation, IT Governance & Controlling Team
BPM Team
Real Estate Management Department
Facility * anagement Team
luation Monitoring Team
Security (ISO/SSO) Expert Function
Group Security Steering
Client and Account * Administration Department
International Payments Department
Domestic Payments * Department
Back Office * Department
Distribution channels * and Card Department
Procurement Expert Function
Group Digital banking
Mobile Application Development Department
Group Credit and Collateral Administration Back office
Group REM Steering
Sales Management * Department Region Belgrade
Sales Management * Department Region Novi Sad
Sales Management * Department of the Central and Southern Serbia
Contact Center Department
Network Business Support and Analysis Department
Lending Product Management Team
Product Management Team - Daily banking, Savings, Cards and Innovations
Marketing Expert Function
Group Customer Value Management
Group Retail Markets Development
Product development, * Sales Support and Adminstration Dep.
Sales * Department

Contents

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This is a translation of the Auditors' Report issued in the Serbian language
In case of any discrepancy between the Serbian and /English versions, the Serbian version shall prevail

INDEPENDENT AUDITORS' REPORT

To the Shareholder of Addiko Bank A.D., Beograd

We have audited the accompanying financial statements of Addiko Bank A.D., Beograd (hereinafter: the "Bank") enclosed on pages 2 to 120, 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 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 Addiko Bank 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 25, 2019

Nada Sudić
Certified Auditor

Financial Statements

Balance Sheet

As at 31 December 2018 RSD '000

	Note	2018	2017
Assets			
Cash and balances held with the Central Bank	3.6, 16	11,174,771	10,575,958
Receivables under derivatives	3.6, 17	25,656	157,022
Securities	3.6, 18	11,108,524	16,880,855
Loans and receivables due from banks and other financial institutions	3.6, 19	2,442,156	2,828,041
Loans and receivables due from customers	3.6, 20	73,001,855	61,639,577
Intangible assets	3.9, 21	946,053	680,945
Property, plant and equipment	3.9, 22	629,876	615,354
Deferred tax assets	3.16, 15	158,974	–
Non-current assets held for sale and discontinued operations	3.12, 23	72,446	119,826
Other assets	24	558,209	618,232
Total Assets		**100,118,520**	**94,115,810**
Liabilities			
Liabilities under derivatives	3.6, 17	24,942	32,347
Deposits and other financial liabilities due to banks, other financial institutions and the Central Bank	3.6, 25	7,589,826	5,382,756
Deposits and other financial liabilities due to customers	3.6, 26	65,789,053	61,919,011
Subordinate liabilities	27	3,911,759	3,774,141
Provisions	3.13, 3.14, 28	369,533	283,395
Current tax liabilities	3.16, 15	1,025	**1,156**
Deferred tax liabilities	3.16, 15	33,785	32,100
Other liabilities	29	1,000,664	745,461
Total Liabilities		**78,720,587**	**72,170,367**
Share Capital	3.15, 30	20,545,294	20,545,294
Profit	30	1,299,958	1,218,248
Loss	30	(1,126,066)	–
Reserves	3.15, 30	678,747	181,901
Total Equity		**21,397,933**	**21,945,443**
Total Liabilities and Equity		**100,118,520**	**94,115,810**

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

These financial statements were adopted by the Executive Board of Addiko Bank A.D. Beograd, on 25 March 2019.

Signed on behalf of Addiko Bank A.D, Beograd by:

Gordana Ivanković
Head of the Accounting and Reporting Department

Vladimir Stanisavljević
Member of the Executive Board

Vojislav Lazarević
President of the Executive Board

Addiko Bank a.d.
1
Beograd

Income Statement

Year Ended 31 December 2018 RSD ’000

	Napomena	2018	2017
Interest income	3.2, 5	4,152,679	4,161,983
Interest expenses	3.2, 5	(983,514)	(952,923)
Net interest income		**3,169,165**	**3,209,060**
Fee and commission income	3.3, 6	1,401,414	1,265,885
Fee and commission expenses	3.3, 6	(132,431)	(125,196)
Net fee and commission income		**1,268,983**	**1,140,689**
Net gains on changes in the fair value of financial instruments	3.6, 7	241,398	487,784
Net gains from the derecognition of financial instruments measured at fair value	3.6, 7	170,624	183,428
Net exchange losses and negative currency clause effects	3.5, 8	(8,845)	(92,039)
Net reversal of/(losses) on impairment of financial assets not measured at fair value through profit or loss (FVtPL)	3.6, 11	284,523	(83,573)
Other operating income	9	244,699	499,496
Total Operating Income, Net		**5,370,547**	**5,344,845**
Salary expenses, salary compensations and other personal expenses	12	(1,450,282)	(1,458,199)
Amortisation/depreciation costs	13	(187,935)	(207,233)
Other income	10	110,714	382,910
Other expenses	14	(2,502,318)	(2,842,919)
Profit Before Taxes		**1,340,726**	**1,219,404**
Current income tax expense	3.16, 15	(1,025)	(1,156)
Loss from deferred taxes	3.16, 15	**(39,743)**	–
Profit After Taxes		**1,299,958**	**1,218,248**

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

These financial statements were adopted by the Executive Board of Addiko Bank A.D. Beograd, on 25 March 2019.

Signed on behalf of Addiko Bank A.D, Beograd by:

Gordana Ivanković Head of the Accounting and Reporting Department	Vladimir Stanisavljević Member of the Executive Board	Vojislav Lazarević President of the Executive Board

Addiko Bank a.d.
1
Beograd

Statement Of Other Comprehensive Income

Year Ended 31 December 2018 — RSD ’000

	2018	2017
Profit for the year	**1,299,958**	**1,218,248**
Other comprehensive income for the year		
Components of other comprehensive income that may be reclassified to profit or loss:		
Positive effects of value adjustments of debt securities measured at fair value through other comprehensive income (FVtOCI)	11,231	16,264
Losses on taxes relating to other comprehensive income	(1,684)	(2,440)
Total positive other comprehensive income for the year	**9,547**	**13,824**
Total positive comprehensive income for the year	**1,309,505**	**1,232,072**

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

These financial statements were adopted by the Executive Board of Addiko Bank A.D. Beograd, on 25 March 2019.

Signed on behalf of Addiko Bank A.D. Beograd by:

Gordana Ivanković
Head of the Accounting and Reporting Department

Vladimir Stanisavljević
Member of the Executive Board

Vojislav Lazarević
President of the Executive Board

Statement of Changes in Equity

Year Ended 31 December 2018 RSD '000

	Share capital	Share premium	Reserves from profit	Revaluation reserves	Profit/(Loss)	Total
Opening balance as at 1 January 2017	**17,517,484**	**4,306,318**	**–**	**168,077**	**(1,278,508)**	**20,713,371**
Profit for the year	–	–	–	–	1,218,248	1,218,248
Positive effects of fair value adjustments of financial assets available for sale	–	–	–	13,824	–	13,824
profit distribution, loss absorption	–	(1,278,508)	–	–	1,278,508	–
Balance as at 31 December 2017	**17,517,484**	**3,027,810**	**–**	**181,901**	**1,218,248**	**21,945,443**
Opening balance as at 1 January 2018	**17,517,484**	**3,027,810**	**–**	**181,901**	**1,218,248**	**21,945,443**
Loss from the first-time adoption of IFRS 9					(1,324,783)	(1,324,783)
Opening balance as at 1 January 2018, restated	**17,517,484**	**3,027,810**	**–**	**181,901**	**(106,535)**	**20,620,660**
Decrease in loss from tax prepayment					198,717	198,717
Profit for the year	–	–			1,299,958	1,299,958
Positive effects of fair value adjustments of financial assets	–	–	–	9,547	–	9,547
Dividend paid	–	–			(730,949)	(730,949)
Profit distribution - allocation to reserves			487,299	–	(487,299)	–
Balance as at 31 December 2018	**17,517,484**	**3,027,810**	**487,299**	**191,448**	173,892	**21,397,933**

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

These financial statements were adopted by the Executive Board of Addiko Bank A.D. Beograd, on 25 March 2019.

Signed on behalf of Addiko Bank A.D. Beograd by:

Gordana Ivanković
Head of the Accounting and Reporting Department

Vladimir Stanisavljević
Member of the Executive Board

Vojislav Lazarević
President of the Executive Board

Addiko Bank a.d.
1
Beograd

Cash Flow Statement

Year Ended 31 December 2018 RSD '000

	2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash inflows from operating activities	**6,681,201**	**6,481,529**
Interest inflows	4,830,209	4,760,866
Fee and commission inflows	1,414,867	1,073,589
Inflows from other operating income	436,125	647,074
Cash outflows from operating activities	**(4,543,393)**	**(5,312,620)**
Interest payments	(848,225)	(1,023,358)
Fee and commission payments	(132,289)	(125,069)
Payments to, and on behalf of employees	(1,429,407)	(1,429,226)
Taxes, contributions and other duties paid	(469,789)	(171,820)
Payments for other operating expenses	(1,663,683)	(2,563,147)
Net cash inflows from operating activities prior to increases/decreases in loans and deposits	**2,137,808**	**1,168,909**
Decrease in loans and increase in deposits received and other liabilities	**10,275,605**	**830,809**
Decrease in financial assets initially recognised at fair value, financial assets held for trading and other securities not held for investments	4,742,857	324,171
Decrease in receivables under financial derivatives designated as hedging instruments and changes in fair value of hedged items	236,351	506,638
Increase in deposits and other liabilities due to banks, other financial institutions, the central bank and customers	5,296,397	–
Increase in loans and decrease in deposits received and other liabilities	**(11,768,374)**	**(5,980,037)**
Increase in loans and receivables due from banks, other financial institutions, the central bank and customers	(11,768,374)	(1,884,468)
Decrease in deposits and other liabilities due to banks, other financial institutions, the central bank and customers	–	(4,095,569)
Net cash generated by/(used in) operating activities before income tax	**645,039**	**(3,980,319)**
Income tax paid	–	–
Dividends paid	(730,949)	–
Net cash generated by/(used in) operating activities	**(85,910)**	**(3,980,319)**
Cash Flows From Investing Activities		
Proceeds from the sales of intangible assets, property, plant and equipment	21,714	113,217
Cash used for the purchases of intangible assets, property, plant and equipment	(479,579)	(309,488)
Net cash used in investing activities	**(457,865)**	**(196,271)**
Cash Flows From Financing Activities		
Cash inflows from borrowings	250,889	2,481,242
Net cash (used in)/generated by financing activities	**250,889**	**2,481,242**
Total Cash Inflows	17,229,409	9,906,797
Total Cash Outflows	(17,522,295)	(11,602,145)
Net Cash Decrease	**(292,886)**	**(1,695,348)**
Cash and Cash Equivalents, Beginning Of Year	5,889,922	6,413,163
Foreign Exchange Gains	656,330	1,416,644
Foreign Exchange Losses	(369,687)	(244,537)
Cash and Cash Equivalents, End Of Year	**5,883,679**	**5,889,922**

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

These financial statements were adopted by the Executive Board of Addiko Bank A.D. Beograd, on 25 March 2019.

Signed on behalf of Addiko Bank A.D. Beograd by:

Gordana Ivanković
Head of the Accounting and Reporting Department

Vladimir Stanisavljević
Member of the Executive Board

Vojislav Lazarević
President of the Executive Board

Addiko Bank a.d. 1 *Beograd*

Notes to the Financial Statements

1. General Information About the Bank

Based on the license issued by the National Bank of Yugoslavia no. O 38 dated 27 February 1991 and the Decision on the Establishment of Depozitno-kreditna banka d.d. Beograd no. 1/5 dated 14 May 1991, Depozitno-kreditna banka a.d. Beograd, Novi Beograd, Goce Delčeva 44, was registered with the District Commercial Court of Belgrade, under Decision no. Fi-5709/91 dated 22 May 1991 (registry card no. 1-18332-00).

For harmonization of the Bank's bylaws and enactments with the Law on Banks and Other Financial Organizations (Official Gazette of SRY No. 32/93) the founders of Depozitno-kreditna banka a.d. Beograd executed the Articles of Association of Depozitno - kreditna banka a.d. Beograd no. 563 dated 20 April 1995.

Under the Decision of the Commercial Court in Belgrade No. XII-Fi. 10865/02 dated 27 September 2002, based on the share sale and purchase transaction performed with the existing shareholders of Depozitno-kreditna banka a.d. Beograd, the majority ownership of Hypo Alpe-Adria-Bank AG Klagenfurt over the Bank was registered, while the Bank's name was changed to Hypo Alpe-Adria-Bank a.d. Beograd and the change registered under the same court's Decision no IX Fi. 12210/02 dated 28 October 2002

Upon the takeover of shares of Hypo Alpe-Adria-Bank a.d. Beograd by Hypo Alpe-Adria-Bank International AG Klagenfurt approved under the Decision of the Securities Commission No. 4/0-32-3303/4-10 dated 14 July 2010, and the realisation of the procedure of enforced sale of shares, fully in line with the Law, Hypo Alpe-Adria-Bank a.d. Beograd had two shareholders: Hypo Alpe-Adria-Bank International AG Klagenfurt and Industrija kotrljajućih ležaja a.d. Beograd (subsequently: Industrija kotrljajućih ležaja a.d. Beograd – in bankruptcy).

At its session held on 24 March 2011, the Shareholder Assembly of Hypo Alpe-Adria-Bank a.d. Beograd enacted the Decision on Amendments and Supplements to the Articles of Association of Hypo Alpe-Adria-Bank a.d. Beograd No. 08461/11, whereby the Bank changed its organisational form and became a closed shareholding company. This change of legal form was registered with the Serbian Business Registers Agency under Decision No. BD 39396/11 dated 5 April 2011.

Pursuant to the National Bank of Serbia's Decision no. 10407 dated 22 November, 2013 on the issue of prior approval to the acquirer Hypo SEE Holding AG for the acquisition of direct ownership, vesting it with 99.999% of voting rights in Hypo Alpe Adria-Bank a.d. Beograd, on 27 March 2014, in the Central Securities Depository and Clearing House, the shares of the issuer Hypo Alpe-Adria-Bank a.d. Beograd were transferred from the account of Hypo Alpe-Adria-Bank International AG Klagenfurt to the account of the acquirer Hypo SEE Holding AG Klagenfurt, corporate ID No. FN 350921, Alpen-Adria-Platz 1, Klagenfurt.

On 30 October 2014 Hypo SEE Holding AG changed its name to Hypo Group Alpe Adria AG. The sole (100%) owner of Hypo Group Alpe Adria AG Klagenfurt is Al Lake Luxembourg S.A.R.L. registered with the Commercial Entity Register of Luxembourg under No. B191802, at the address of 47 Grand Rue, L-1661 Luxembourg.

Al Lake Luxembourg S.A.R.L. is owned by Al Lake Management S.A.R.L. Luxembourg. Owners of Al Lake Management S.A.R.L. Luxembourg are funds managed by Advent International Corporation domiciled in the United States of America and by the European Bank for Reconstruction and Development (EBRD).

On 8 July 2016, under Decision of the Commercial Court in Vienna, Hypo Group Alpe Adria AG (HGAA) changed its legal name to Addiko Bank AG (ABH), headquartered at the address of Wipplingerstrasse 34/4 Vienna, Austria.

On 8 July 2016, under Decision of the Serbian Business Registers Agency no. BD 55080/2016 Hypo Alpe-Adria-Bank a.d. Beograd changed its legal name to Addiko Bank a.d. Beograd.

Addiko Bank AG publishes its consolidated financial statements on web page www.addiko.com.

Throughout 2018, the Bank operated via its Head Office and 38 branch offices.

The Bank performs the following activities:

1. Deposit activities,
2. Credit (lending activities)
3. Foreign exchange operations and exchange transactions,
4. Payment transactions,
5. Issuing payment cards,
6. Activities involving securities in accordance with the effective regulations,
7. Issuance of guarantees, acceptances and other types of sureties (guarantee operations),
8. Purchase, sale and collection of receivables (factoring and forfeiting)
9. Insurance agency activities upon obtaining approval of the National Bank of Serbia,
10. Technical and financial control of construction and reconstruction of facilities relating project financing,
11. Valuation of real estate by certified appraisers for the purposes of the Bank and its clients related to the loans extended, and
12. Provision of services to other members of the Group and other entities in the areas related to the Bank's business activities.

The Bank's organisational units are not legal entities and have no independent transaction accounts but operate via the Bank's unique account. They are entitled to the execution of contracts within their scope of operations and within authorisations granted to them by the Bank's relevant bylaws.

As at 31 December 2018 the Bank had 585 employees (as at 31 December 2017 the Bank had 595 employees).

The Bank’s activity code is 6419 – other monetary intermediation.

The Bank’s corporate ID number is 07726716.

The Bank’s tax ID number is 100228215.

2. Basis of Preparation and Presentation of the Financial Statements and Accounting Method

2.1. Basis of Preparation and Presentation of the Financial Statements

The Bank’s separate financial statements (hereinafter: the financial statements) for 2018 have been prepared in accordance with the International Financial Reporting Standards (IFRS).

Legal entities and entrepreneurs incorporated in Serbia are required to maintain their books of account, to recognise 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 under the Decision on the Forms and Contents of the Items in the Forms of the Financial Statements of Banks (Official Gazette of RS nos. 71/2014 and 135/2014).

IFRS 9 Financial Instruments has come into effect for annual periods beginning on or after 1 January 2018, and has replaced the previously effective IAS 39.

Significant effects arising from the implementation of IFRS 9 are disclosed in Note 2.6 First-Time Adoption of IFRS 9, as well as in Note 4.1.1 Credit Risk

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

- Financial assets measured at fair value through other comprehensive income - debt securities,
- Financial assets measured at fair value through profit or loss - derivatives.

Historical cost is based on the fair valued of contributions initially 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 other valuation techniques. 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 realisable value in IAS 2 or value in use in IAS 36.

In addition, for financial reporting purposes, fair value measurements are categorised 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. The dinar (RSD) is the official currency of the Republic of Serbia.

Going Concern

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

2.2. New Amendments to the Existing Standards 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 1 January 2018);

IFRS 9 has replaced the previously effective accounting standard - IAS 39. Significant effects arising from the implementation of IFRS have been disclosed in Note 2.6 First-Time Adoption of IRFS 9, and in Note 4.1.1 Credit Risk.

The application of the following standards, IFRIC interpretations and amendments to the existing standards mandatory for the first time for the financial year beginning as of 1 January 2018, did not result in substantial changes to the Bank's accounting policies and did not have an impact on the Bank's accompanying financial statements:

- IFRS 15 "Revenue from Contracts with Customers" (effective for annual periods beginning on or after 1 January 2018);

This standard replaces the existing guidelines referring to the recognition of income, including IAS 18 "Revenue" and IAS 11 "Construction Contracts" and the relating interpretations. IFRS 15 provides a single, comprehensive five-step model to be applied to all contracts with clients. The Bank conducted an analysis of its revenue from the aspect of the new requirements of IFRS 15, with particular focus on fee and commission income. Based on the said analysis, it was concluded that the application of IFRS 15 requirements does not require change in timing of recognition or amounts of the income recognized.

- Amendments to IFRS 2 "Share-based Payment" – Classifying and Measuring Share-Based Transactions (effective for annual periods beginning on or after 1 January 2018);
- Amendments to IFRS 4 "Insurance Contracts" - regarding the implementation of IFRS 9 "Financial Instruments" with IFRS 4 "Insurance Contracts" (effective for annual periods beginning on or after 1 January 2018 or the date of first-time application of IFRS 9 "Financial Instruments");
- Amendments to IAS 40 "Investment Property" - Transfers of Investment Property (effective for annual periods beginning on or after 1 January 2018);
- Amendments to IFRS 1 and IAS 28 as a result of annual improvements project, Improvements to IFRS 2014 - 2016 Cycle, which is the result of the annual improvement to the IFRS (IFRS 1, IFRS 12 and IAS 28) aiming to remove inconsistencies and clarify wording (amendments to IFRS 1 and IAS 28 effective for annual periods beginning on or after 1 January 2018);
- IFRIC 22 "Foreign Currency Transactions and Advance Consideration" (effective for annual periods beginning on or after 1 January 2018).

2.3. New Standards and Amendments to the Existing Standards 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 1 January 2019).

IFRS 16 defines the recognition, measurement, presentation and disclosure of leasing. The standard provides a single lessee accounting model, requiring lessees to recognise assets and liabilities for all leases unless the lease term is 12 months or less or the underlying asset has a low value. Lessors continue to classify leases as operating or finance, in accordance with the guidelines on accounting for leases specified by IFRS 16 replacing the existing guidelines for IAS 17 "Leases",

- IFRS 17 "Insurance Contracts" (effective for annual periods beginning on or after 1 January 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 1 January 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 1 January 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 1 January 2019),

- Amendments to various standards as a result of Improvements to IFRS (2015 - 2017 Cycle), which is the result of annual improvement to the IFRS (IFRS 3, IFRS 11, IAS 12 and IAS 23) aiming to remove inconsistencies and clarify wording (amendments should be effective for annual periods beginning on or after 1 January 2019).
- Amendments to References to the Conceptual Framework for Financial Reporting (effective for annual periods beginning on or after 1 January 2020),
- IFRIC 23 “Uncertainty over Income Tax Treatments” (effective for annual periods beginning on or after 1 January 2019).

The Bank's management is currently reviewing the impact of the mentioned standards and interpretations on the Bank's financial statements, as well as the dates of their entry into force.

The Bank’s Management believes that the most significant impact on the financial statements in the coming reporting period will be in terms of IFRS 16 Leases, which is effective for annual periods beginning on or after 1 January 2019 (with early adoption permitted) and which the Bank will apply from 1 January 2019.

Impact of IFRS 16 Application on the Bank’s Financial Statements

IFRS 16 “Leases” was issued by IASB in January 2016. IFRS 16 “Leases” will be effective from 1 January 2019, replacing the previously effective IAS 17 “Leases”, IFRIC 4 “Determining Whether an Arrangement Contains a Lease”, SIC-15 “Operating Leases – Incentives” and SIC-27 Evaluating the Substance of Transactions Involving the Legal Form of a Lease.

General Information

The standard establishes the main principles of recognition, presentation and the disclosure of lease contracts for the counterparties, i.e., the lessee and lessor. The central idea of this new standard is that the lessee will recognise all leases and the corresponding rights and liabilities in the balance sheet. The main objective of IFRS 16 is to avoid the presentation of leases outside of the statement of financial position (balance sheet). IFRS 16 eliminates the classification of leases as either operating leases or finance leases. Instead, right-of-use assets and lease liabilities are recognised for all leases to-date. Right-of-use (ROU) assets are initially measured at cost, which includes the initial amount of lease liabilities adjusted for any prepayment of the lease made prior to the commencement date, including all initial direct costs and estimated costs of dismantling, removal or restoration of the fixed asset, less any lease incentives received from the lessor. Right-of-use assets are subsequently amortised on a straight-line basis. Lease liabilities are initially measured at the present value of the lease payments made throughout the lease term, discounted at implicit interest rates, or, should it be impossible to determine the rate in this manner, it is then calculated by applying the Bank’s incremental borrowing rate. In this regard and generally speaking, all lease liabilities are recognised in line with the ‘right-of-use’ approach in the balance sheet. The only exceptions are short-term leases of 12 months or less and small-value asset leases. According to the IASB, small-value leases are those where the underlying asset’s value is USD 5,000 or less. In such cases, it will be possible to continue recognition within administrative costs (lease). With regard to the lessors, the provisions of IAS 17 have mostly remained unaltered in the new IFRS 16. Lessor accounting therefore continues to depend on which party has the material capacity and risks associated with ownership over the leased assets.

Recognition of ‘right-of-use’ assets on the assets side and corresponding lease liabilities on the liabilities side, results in an increase in the total assets/liabilities. Due to the fact that only liabilities are increased on the liabilities side, and all other items remain the same, the equity ratio decreases. There will also be an impact on the income statement. The total cost charged over the lease term will remain the same, however, the time period and allocation to the separate items of the income statement, are adjusted. In line with IAS 17, costs related to operating leases are generally recognised on a straight-line basis under operating costs in the actual amount of executed payments. In line with IFRS 16 - as was in effect for finance lease – costs are distributed between interest and amortisation costs. Interest expenses are calculated using the effective interest rate and as they decrease over the lease term, but amortisation is generally conducted on a straight-line basis, which consequently results in the digressive development of costs with the shift of the costs toward the earlier periods of a lease. Interest expenses are presented in the 'net Interest Income'. Additionally, considering that the annual right-of-use asset amortisation in line with IFRS 16 is less than the leasing rate and that all other items remain the same, the operating result before changes in provisions for credit losses will increase. The statement of cash flows will shift from the cash flows from operating activities to the cash flows from financial activities. Despite the fact that it is still possible to continue to present interest payments within the cash flows from operating activities, it is mandatory to show lease liabilities within the cash flows from financing activities.

Leases with the Bank as the Lessor

Due to the Bank's strategic decision to focus on the main banking operations, the leasing portfolio has been reduced and for this reason, IFRS 16 will not have a material impact on the Bank's accounting as a lessor. The same provisions as those of IAS 17 will continue to be applied in order to determine whether the lease is an operating or a finance lease. If an operating lease is in question, the asset remains on the Bank's balance sheet, and income generated from leasing is presented in the income statement. If a finance lease is in question, the lease income is recognised at the net investment value.

Leases with the Bank as the Lessee

The Bank has completed the initial assessment of the potential impact on its financial statements, including an estimate of whether it will apply any of the lease renewal options and to what extent the Bank chooses practical expedients and exemptions from recognition. This mainly refers to land and buildings rented by the Bank. Generally, the Bank applies its incremental borrowing rate as a discount rate.

Transition

The Bank will apply IFRS 16 from 1 January 2019, using the modified retrospective transition approach (cumulative catch up approach). Thereby, the cumulative effect of IFRS 16 first-time adoption will be recognised as an adjustment to the opening balance of retained earnings as at 1 January 2019, without having to adjust the comparative information. Under the contracts where the Bank is the lessee, the leased asset, i.e., the right-of-use asset will be recognised on the balance sheet in the amount equal to the relating lease liability (subsequently, the right-of-use assets will be adjusted for calculations and prepayments). The Bank will apply IFRS 16 to all contracts concluded prior to 1 January 2019, identified as leases in line with IAS 17 and IFRIC 4. The Bank will not apply IRFS 16 to contracts referring to intangible assets. The Bank will apply exceptions to short-term leases and low-value leases, whereby the right-of-use assets are not recognised. For lease contracts previously classified as operating leases according to IAS 17, the applicable discount rate will be the lessee's incremental borrowing rate as at the first-time adoption date.

The effects of the first-time adoption of IFRS 16 based on preliminary calculations are shown below:

RSD '000

	1 January 2019	31 December 2019
Leased assets (ROU)	493,470	–
Lease liabilities	493,470	–
Expected effects through profit or loss		
Increase of depreciation costs	–	186,590
Increase in interest expenses	–	392
Expected effects through cash flows		
Net cash inflows from operating activities	–	–
Net cash outflows from operating activities	–	16,904

2.4. Comparative Information

Comparative information in the accompanying financial statements comprise data from the Bank's financial statements for 2017, audited by the auditing company Deloitte.

The Bank made no adjustments to the opening balance of retained earnings for 2017 since no adjustments were required under the Auditor's Report 2017.

The accounting policies and estimates referring to the recognition and measurement of assets and liabilities, used in preparation of these financial statements are consistent with the accounting policies and estimates applied in the preparation of the Bank's annual financial statements for 2017, except for the changes in the accounting policies resulting from the application of IFRS 9. The Bank applied the exemptions whereby it is allowed not to adjust comparative data for previous years in terms of changes to the classification and measurement of financial assets and financial liabilities, as well as impairment in this respect. Differences between the carrying amounts of financial assets and financial liabilities resulting from the application of IFRS 9 and those from the period prior to IFRS 9 application, are recognised within equity, i.e., retained earnings, as at 1 January 2018 as an opening balance adjustment. Consequently, the comparative data presented for 2017 do not reflect the requirements of IFRS 9 and are not comparable to data presented for 2018 (Notes 2.6 and 4.1.1).

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. IFRS 9

In July 2014, IASB published the final version of IFRS 9 "Financial Instruments", the application of which is mandatory for reporting periods beginning on or after 1 January 2018. The requirements of IFRS 9 differ significantly from IAS 39 "Financial Instruments: Recognition and Measurement". The new standard introduces fundamental changes to financial asset accounting and to certain aspects of financial liabilities accounting.

Classification and Measurement of Financial Assets and Financial Liabilities

Based on the entity's business model and cash flow features, IFRS 9 defines three basic categories for the classification of financial assets at the date of initial recognition:

- Financial assets are measured at amortised cost (AC) only if the aim of the business model is to hold the asset in order to collect contractual cash flows, and the contractual cash flows are solely payments of principle and interest on the principal outstanding (SPPI criterion);
- A financial asset is measured at fair value through other comprehensive income (FVtOCI) if the asset is held in a business model in which assets are managed both in order to collect contractual cash flows and to sell contractual cash flows, and contractual cash flows are solely payments of principal and interest on the principal outstanding (simple loan feature);
- Financial assets that do not meet these criteria are measured at fair value through profit or loss (FVtPL). In addition, embedded derivatives will no longer be separated from the host contract. Such a financial instrument is assessed in its entirety and measured at FVtPL.

Financial instruments are initially recognised at fair value increased by transaction costs that may be directly attributable to these assets (IFRS 9.5.1). Loans and advances are recognised when cash is advanced to borrowers. The fair value of a financial instrument at initial recognition is most often the transaction price, i.e., the fair value of the consideration given or received (IFRS 9.B5.1.2A and IFRS 13). However, if the given or received consideration differs from that which is recognised as a financial instrument, the Bank will measure the instrument at fair value. For example, the fair value of non-interest bearing, long-term loans or receivables may be measured at the present value of all future cash proceeds discounted by applying the prevailing market interest rates applicable to similar instruments with similar borrower credit capabilities. Each subsequent borrowed amount is an expense or decrease of income, unless qualifying for recognition as another type of asset.

For equity investments that are not held for trading, the Bank may irrevocably elect to classify the instruments at FVtOCI at initial recognition, with all subsequent changes in fair value being recognised in other comprehensive income (OCI). This classification may be applied to each separate investment. Throughout 2018, the Bank did not have such instruments in its portfolio.

The classification and measurement requirements for financial liabilities are only slightly changed compared to IAS 39. Changes to the fair value of liabilities resulting from changes in the liability's own credit risk are recognised in other comprehensive income, while the remaining amount of the change in fair value will be shown through profit or loss.

Business Model Assessment

All financial assets should be classified into one of the business models provided below. Also, at initial recognition, it must be determined whether or not SPPI contractual cash flows exist for each asset (SPPI test). Thereafter, the financial assets are classified into one of the following business model categories:

- Holding financial assets to collect contractual cash flows ("hold-to-collect" model);
- Holding financial assets to collect contractual cash flows and for sale ("hold-to-collect-and-sell" model); and
- Other business models - financial assets held for trading or assets that do not meet one of the above said criteria.

In a rare case that an entity may change the model it applies to the management of certain financial assets, reclassification of all assets to which the adjustment applies would be required.

Contractual Cash Flow Characteristics

To assess whether contractual cash flows are solely payments of principal and interest (SPPI), the 'principal' is defined as the fair value of the financial asset at initial recognition. 'Interest' is defined as a charge for the time value of money (TVM), for credit risk associated with the principal amount outstanding during a particular period of time and for other basic lending risks and costs (e.g., liquidity risk and administrative costs), as well as a profit margin.

In assessing whether the contractual cash flows are solely payments of principal and interest (SPPI), the Bank considered the contractual terms of the instruments and analysed the existing portfolio based on an SPPI criteria checklist. This includes assessing whether the financial asset contains a contractual term that could change the timing or amount of contractual cash flows so that it would not meet this condition, considering the following: contingent events that would change the amount and timing of cash flows, leverage features, prepayment and extension terms, terms that limit the Bank's claim to cash flows from specified assets and features that modify consideration for the time value of money.

Special attention during the analysis was paid to the unilateral changes in margins and interest rates, prepayments clauses, other contingent payments, project financing and benchmark tests. Compliance with the SPPI test was assessed in the following manner:

- In assessing unilateral changes to margins and interest rates, the Bank concluded that the transfer of costs associated with the underlying loan contract, clauses drafted in order to maintain a stable profit margin, and adjustments to the interest rate reflected deterioration of the credit rating; however, these are not harmful in terms of SPPI tests.
- Clauses referring to early loan repayment are not harmful, as long as the prepaid amount reflects the unpaid principal, interest and compensation for the early repayment of the loan. Such consideration must be less than the loss incurred from the interest margin and loss incurred from interest.
- Other contingent payments are typically clauses referring to other business transactions. Consideration for failure to fulfil the obligations represents increased costs of risk monitoring or compensation for profit losses tied to a causal event.
- Project financing is assessed in terms of whether or not a correlation exists with the performance of the project in question. Should no such link exist but the borrower possesses sufficient capital for the project necessary to absorb losses before the said losses affect the borrower's ability to repay the loan, the said project may pass the SPPI test.
- Loans with variable interest rates may include mismatch of interest features. In order to assess whether or not the time value of money (TVM) has been significantly modified, a quantitative benchmark test should be conducted.

When performing a benchmark test and prior to initial recognition, the contractual non-discounted cash flows of the financial instrument are compared to the cash flows per the benchmark which would have arisen if the TVM had not been modified. The effect of modifying TVM is considered in each reporting period and cumulatively throughout the financial instrument's lifetime. The benchmark test is based on a range of reasonable scenarios. An acceptable comparative financial instrument is one of equal credit quality and with the same contractual terms, except those for modification.

Should the entity come to the realisation that the contractual (non-discounted) cash flows may significantly vary (threshold of 10%) from the (non-discounted) cash flows per the benchmark test, the financial asset does not fulfil the criteria defined in IFRS 9, Article 4.1.2 (b) or 4.1.2A (b) and cannot be therefore measured at amortised cost or at fair value through other comprehensive income.

Upon transition to IFRS 9, there were no financial instruments with identified interest mismatch, which would lead to the measurement of the said financial instruments at fair value through profit or loss (FVtPL). Considering that the Bank's internal policies on new product approval define the obligation of SPPI test compliance, a significant number of financial instruments with the aforementioned features is not expected.

Classification and Measurement of Financial Assets and Financial Liabilities

Impairment – Financial Assets and Calculation of Expected Credit Losses

IFRS 9 replaces the ‘incurred loss’ model in IAS 39 with a forward-looking ‘expected credit losses’ (ECL) model.

In applying the ECL model which also takes into account information on future events, Addiko Bank recognises expected losses at each reporting date in order to reflect changes in the credit risk of a given financial asset. Impairment of financial assets through the ECL model is based on historical, present and forecast future events and therefore takes into account various scenarios that envisage events which may result in future credit losses.

According to IFRS 9, lifetime expected credit losses are calculated as the expected present value of credit losses incurred should borrowers fail to fulfil their obligations within the specified timeframe for the entire lifetime of the financial instrument with parallel consideration of the probability of default (PD) as well as credit loss – loss given default (LGD).

Details on impairment methods under IFRS 9 may be found in Note 4.1.1 Credit Risk.

Derecognition and Contract Modification

IFRS 9 includes the conditions found in IAS 39 relating to derecognition of financial assets and financial liabilities without any substantial changes. This requirement has not had a material impact on the Bank.

Financial assets are derecognised when:

The contractual rights to the cash flows from the asset have expired; or when the Bank has transferred its right to cash flows from assets or has assumed payment obligations of the cash flows in full without significant default on behalf of a third party within ‘pass-through’ contracts; and/or

(i) the Bank has transferred substantially all risks and benefits associated with the ownership over the asset,
(ii) the Bank has neither transferred nor retained substantially all risks and benefits associated with the ownership over the asset, but has transferred control over the asset.

Contractual adjustments arising from renegotiations with borrowers may result in two types of changes to the initial contractual cash flows.

Significant Modifications Resulting in Derecognition of a Financial Asset

Should the contractual cash flows be significantly modified, this results in the derecognition (due to the expiry of contractual rights to the cash flows) of the said financial asset in line with IFRS 9. A new financial asset with adjusted terms is recognised and the difference between the amortised cost of the financial asset which is derecognised and the fair value of the new financial asset are presented in the income statement. If the borrower is not in default, or if the significant modification does not result in the default status, then a new asset will be classified in Stage 1. If the borrower is in default, or if the significant modification results in the default status, then the new asset will be treated as a purchased or originated credit impaired financial asset (POCI). For POCI financial assets impairment allowance is not recognised, and lifetime expected credit losses (ECL) are included in the credit-adjusted effective interest rate at initial recognition. Thereafter, the amount of the change in the lifetime expected credit loss since the initial recognition of POCI financial assets should be recognised as a gain or loss from impairment in the income statement.

Should the criteria for derecognition apply to borrowers who are facing financial difficulties classified in Stage 3, the assessment of changes in the expected cash flows is conducted instead of an assessment of contractual cash flows. The revised terms of the contract may reflect the borrower’s ability to repay the initial cash flows, as already expressed in the impairment assessment.

The following criteria are recognised as significant modifications:

Quantitative - significant adjustments to the contractual cash flows when the present value of the cash flows according to the new terms is discounted by applying the original effective interest rate and varies from the discounted carrying value of the original financial instrument by at least 10%.

Qualitative:
- change of borrower,
- change of currency,
- change of financing purpose,
- SPPI critical features have been removed or included in a new loan contract.

Insignificant Modifications Not Resulting in the Derecognition of a Financial Asset

If the agreed cash flows of a financial asset are modified in a way that does not result in derecognition of such financial asset, in line with IFRS 9, it is necessary to recalculate the gross carrying amount of the financial asset based on the modified contractual cash flows using the original effective interest rate for discounting. Gains or losses arising from the modification are recognised in the income statement.

Impact of the Initial Application of IFRS 9

The new standard will affect the classification and measurement of financial instruments from 1 January 2018 as follows:

- based on assessments conducted up to date, most of the loan portfolio classified as loans and receivables according to IAS 39 will still be measured at amortised cost (AC) by the Bank in line with IFRS 9;
- financial assets measured as held for trading in line with IAS 39, are measured at fair value through profit or loss (FVtPL) in line with IFRS 9;
- financial assets measured as available for sale in line with IAS 39, are measured at fair value through other comprehensive income (FVtOCI) in line with IFRS 9.

Investment securities, previously classified and measures as financial assets available for sale under IAS 39, amounting to RSD 589,429 thousand, the fair value adjustments of which were recognised through OCI in line with IAS 39, have been reclassified to the category measured at FVtPL, according to IFRS 9.

In terms of the classification and recognition of financial liabilities, there has been no significant impact on the Bank's financial statements arising from the new provisions of IFRS 9. According to IFRS 9.7.2.15 there is an option to choose an accounting policy whereby the previous periods are adjusted or to recognise the impact of the initial application of IFRS 9 within the opening balance of equity as at 1 January 2018.

Transition

Changes to the accounting policies resulting from the application of IFRS 9, have been applied. The Bank has applied the exception which allows it not to recognise the impact over previous periods, with relation to the altered classification and measurement (including impairment). Changes to the exposure of financial assets and liabilities resulting from the application of IFRS 9, have been recognised through retained earnings as at 1 January 2018.

Disclosure of the Financial Impact of IFRS 9

Changes between categories of financial asset measurement and exposure according to IAS 39 and IFRS 9 as at 1 January 2018:

Financial assets RSD '000

	IAS 39	IFRS 9
Cash assets and deposit accounts held with central banks	10.575.958	10.575.958
Loans and receivables due from banks	2.828.041	2.831.405
Loans and receivables due from customers	61.639.577	60.377.565
Securities	16.880.855	16.880.855
Other assets	**476.834**	**475.824**

The loan portfolio previously classified as loans and receivables according to IAS 39 was now classified in the business model of holding the assets for the purpose of collecting contractual cash flows (hold-to-collect), which resulted in no impact, since these loans are measured at amortised cost according to IFRS 9.

There have been no changes to the classification and measurement of financial liabilities due to the application of IFRS 9.

Application of the new approach to recognition has resulted in significant changes. The effect of the first-time application of IFRS 9 as at 1 January 2018 was a decrease in equity amounting to RSD 1,324,783 thousand. The effect on the CET1 ratio was a decrease of 1.56%. The amount of impairment of receivables measured at amortised cost increased by RSD 1,259,658 thousand in the balance sheet, while the change to equity resulting from the measurement of securities at FVtOCI amounted to RSD 55,895 thousand. The effect of transferring suspended interest from off-balance sheet records to the balance sheet, in the amount of RSD 1,715,195 thousand, had no impact on increasing the balance sheet exposure as this portion of receivables is fully (100%) impaired.

RSD '000

ITEM	IAS 39					Effect		
						Transfer of suspended interest to the balance sheet		Receivables measured at amortised cost (AC)
ASSETS	Portfolio	Measure-ment Method	New classification under IFRS 9	The net value as at 31 December 2017 - IAS 39	The net value as at 1 January 2018 - IFRS 9 balance as at 1 January 2018	Gross exposure	Allowance for impairment	Allowance for impairment
Cash and balances held with the Central Bank	Loans and receivables	Amortised Cost	Amortised Cost	10.575.958	10.575.958	–	–	–
Receivables under derivatives	Assets held for trading	FVTPL	FVTPL	157.022	157.022	–	–	–
Securities at fair value through profit or loss	FVTPL	FVTPL	FVTPL	101.474	101.474	–	–	–
Securities valued through other equity	AFS	Fair value through equity	FVOCI	16.189.952	16.134.057	–	–	(55.895)
Investment units valued through other equity	AFS	Fair value through equity	FVTPL	589.429	589.429	–	–	–
Loans and receivables due from banks and other financial institutions				2.828.041	2.831.405	–	–	3.364
Loans and receivables due from customers	Loans and receivables	Amortised Cost	Amortised Cost	61.639.577	60.377.565	1.715.195	(1.715.195)	(1.262.012)
Other assets	Amortised Cost	Amortised Cost	Amortised Cost	476.834	475.824	–	–	(1.010)
Total Financial Assets				**92.558.287**	**91.242.734**	**1.715.195**	**(1.715.195)**	**(1.315.553)**
Off-balance item classified, net	Amortised Cost	Amortised Cost	Amortised Cost	14.295.294	14.286.064	–	–	(9.230)
Total Exposure				**106.853.581**	**105.528.798**	**1.715.195**	**(1.715.195)**	**(1.324.783)**

2.7. Use of Estimates

Preparation of the financial statements in accordance with IFRS requires the Bank's management to make the best possible estimates and reasonable assumptions that affect the application of the accounting policies and the reported amounts of assets and liabilities, as well as income and expenses. Actual amounts of assets and liabilities may vary from these estimates.

Impairment of Financial Assets

The Accounting Policy Applicable from 1 January 2018

At each reporting date, the Bank assesses and recognises provisions for expected credit losses on financial assets which are measured at amortised cost or in terms of debt instruments recorded at fair value through other comprehensive income as well as credit commitments and issued guarantees. The carrying value of financial instruments measured at amortised cost is decreased by the amount of provision for expected credit losses, while the calculated expected credit losses on financial assets measured at fair value through other comprehensive income is recorded in equity.

Assumptions and assessments applied by the Bank as inputs in the expected credit losses valuation model, and the assessment of significant increase of credit risk, are disclosed in Note 4.1.1 Credit Risk.

The Accounting Policy Applicable until 1 January 2018

At each reporting date, the Bank assesses whether there is objective evidence that the value of a financial asset or group of financial assets is impaired. A financial asset or group of financial assets is impaired and impairment losses are recognised only if there is objective evidence of impairment, as a result of one or more events that occurred after initial recognition of the asset (a loss event), and when that loss event affects the estimated future cash flows of the financial asset or group of financial assets that can be reliably assessed. When assessing losses incurred by credit impairment, the Bank conducts an overview of the loan portfolio no less than once quarterly, aiming to assess impairment.

In the process of determining whether or not it is necessary to enter losses incurred by impairment into the income statement, the Bank judges whether there is reliable evidence demonstrating measurable decreases in assessed future cash flows from the loan portfolio prior to decrease which may be identified in the individual loans of the portfolio.

This evidence may include available data indicative of unfavourable changes in terms of the borrower's capability to execute their obligations towards the Bank in a timely manner.

The Bank's management makes assessments based on the historical experience of realised losses incurred per loans in the previous period for all assets with credit risk characteristics and objective evidence of impairment similar to the loan portfolio that existed at the time of planning the future cash flows. The methodology and assumptions used to assess amounts and periods of future cash flows are subject to regular review aiming to reduce the differences between the estimated and realised losses.

The methodology and assumptions used to assess amounts and periods of future cash flows are subject to regular analysis aiming to reduce the differences between estimated and realised losses.

Useful Life of Intangible Assets, Property, Plant and Equipment

Determining the useful life of intangible assets and property, plant and equipment ('fixed assets') is based on the Bank's historical experience with similar assets, technological development and changes affected by a large number of economic or industry factors. Adequacy of a certain useful life is reviewed annually, or whenever there is an indication that there has been a significant change in the underlying factors determining the said useful life.

Due to the significance of the fixed assets within the Bank's total assets, any change to the aforesaid assumptions may have a significant effect on the Bank's financial position and its performance.

Deferred Tax Assets

Deferred income taxes are provided under the balance sheet liability method for all temporary differences arising between the tax bases of assets and liabilities and their carrying values in the Bank's financial statements. The currently effective tax rate at the reporting date equalled 15% (2017: 15%).

Current Taxes

The Bank is subject to income taxation in the Republic of Serbia. The Bank is under obligation to pay income tax in the form of monthly advance payments during the year, the amount of which is determined based on the income tax return submitted for the previous year. The final taxable income to which the prescribed corporate income tax rate of 15% is applied (2017: 15%), is arrived at through preparation of the Bank's tax statement. In situations where the final tax liability differs from the initially recognised tax liability, this difference affects the tax liability in the period in which the difference was identified.

Retirement Benefits and Other Employee Termination Benefits

The costs of the defined post-employment benefits to employees and/or retirement benefits upon fulfilling the legal retirement criteria are determined based on the actuarial assessment. An actuarial assessment includes an assessment of the discount rate, future salary trends, mortality rates and employee turnover rate. Due to the long-term nature of these plans, significant uncertainties influence these assessments. Additional information in this respect are disclosed in Note 28 to the financial statements.

Fair Value of Financial Assets and Liabilities

Fair value of financial instruments traded on an active market at the reporting date are based on the quoted market bid (financial assets) or asking prices (financial liabilities). If a market for a financial asset is not active, the Bank determines the asset's fair value using valuation techniques. These include comparison with most recent similar transactions performed at arms' length, analysis of discounted cash flows and other valuation techniques used by the market participants. Models of estimates reflect current market conditions at the assessment date, and do not necessarily reflect the market conditions before or after the measurement date. At the reporting date, the Bank's management reviewed the models in order to ensure that they adequately reflect the current market conditions, including relative market liquidity and interest margins.

Additional information in this respect are disclosed in Note 4.3 to the financial statements.

3. Summary of Significant Accounting Policies

3.1. Recognition of Income and Expenses

The Bank recognises income when it can be measured reliably, when it is probable that the future economic benefits will flow to the Bank and when special criteria for each of the Bank's activities are met, as set out below.

3.2. Interest Income and Expenses

Accounting Policies Applicable from 1 January 2018
The Bank earns income and incurs interest expenses through its operations with the National Bank of Serbia, domestic and foreign banks and legal entities (corporate customers) and private individuals (retail customers).

Interest income and expenses including default interest and other income and other expenses from interest bearing assets, i.e., liabilities, are recognized as per 'matching principle' (on an accrual basis) under obligatory terms defined by a contract concluded between the Bank and a client. Interest income and expenses are determined on an accrual basis using the effective interest rate, which is defined upon initial recognition of a financial asset/liability.

For all financial assets measured at amortised cost, financial assets measured at fair value through other comprehensive income, and financial assets not held for trading and measured at fair value through profit or loss, interest income and interest expenses are recorded based on the effective interest rate.

Amortised cost is the amount at which a financial asset or financial liability is measured at initial recognition, less the payment of the principle amount, plus/minus cumulative amortisation using the effective interest method and any difference between the initial amount and amount at maturity. For financial assets, the amount is adjusted for any loss. The gross carrying amount of the financial assets is the amortised value of the financial assets prior to adjustment for any losses. For purchased or originated credit impaired (POCI) financial assets, the credit-adjusted effective interest rate is used to reduce the estimated future cash flows, including expected credit losses on the amortised cost of debt instruments at initial recognition.

The effective interest rate method of calculation is applied for the precise discounting of the estimated future cash inflows and outflows over the expected lifetime of the financial asset, or a shorter period if applicable, to the gross carrying amount of the financial asset, unless the instrument is a POCI asset or a financial liability at amortised cost. The calculation includes transaction costs and paid considerations which are an integral part of the effective interest rates (unless the financial asset is measured at fair value through profit or loss), premium or rebate. Expected credit losses are disregarded.

For financial assets which are subsequently credit impaired, interest income is recognised using the effective interest rate on the amortised cost of the asset (the net carrying value). If, in the following reporting period, the credit risk of an impaired financial asset improves so that the financial asset is no longer credit-impaired, interest income is recognised by applying the effective interest rate to the gross carrying amount of the financial asset (except for POCI assets, whereby the interest income is not based on the gross value, even if the asset's credit risk improves).

Interest income on assets held for trading, and the interest components of derivatives are shown within the line item of 'interest income'. Changes in the fair value only arising from assets and liabilities held for trading are shown within the 'net gains/losses from changes in the fair value of financial instruments'.

Negative interest from financial assets and financial liabilities is shown in the line item of 'net interest income'. The Bank earned negative interest on deposits due to customers at the rates from 0.7% to -2.4% and paid negative interest on deposits placed at the rates from 0% to -2.03%.

The Bank realises income/expenses from fees for servicing approved (received) loans.

Such fee income is deferred by applying the effective interest rate throughout the loan period and is recognised within 'interest income'.

Accounting Policies Applicable until 1 January 2018

The Bank earns income and incurs interest expenses through its operations with the National Bank of Serbia, domestic and foreign banks and legal entities (corporate customers) and private individuals (retail customers).

Interest income and expenses including default interest and other income and other expenses from interest bearing assets, i.e., liabilities, is recognized as per 'matching principle' (on an accrual basis) under obligatory terms defined by a contract concluded between the Bank and a client. Interest income and expenses are determined on an accrual basis using the effective interest rate, which is defined upon initial recognition of a financial asset/liability.

For all interest-bearing instruments other than those classified as available for sale or recorded at fair value through profit or loss, interest income and expenses are recognised within the income statement using the effective interest rate, which is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or a shorter period, where appropriate, to the net carrying amount of the financial asset or financial liability.

When calculating the effective interest rate, the Bank estimates cash flows, taking into consideration all contractual terms related to the financial instrument (e.g. advance payments) but not considering future credit losses. The calculation includes all fees and commissions paid or received between two contracting parties, which forms an integral part of the effective interest rate, transaction costs and all other premiums and discounts. Interest is recognized as it accrues on a time proportion (pro rata temporis) basis, so that the interest amount depends on the time elapsed.

In case of impairment of a financial asset, the Bank reduces the receivable's carrying amount to the recoverable amount, which represents the estimated future cash flow discounted at the original effective interest rate of the financial instrument, and continues to unwind the discount as interest income.

From the moment of impairment of a financial asset, the contracted interest is no longer recognised in the balance sheet and income statement. Interest income from impaired loans and receivables is recognized using the effective interest rate method on the amortised cost of the financial asset. The only interest income recognized for all impaired loans and receivables is thus the effect arising from the future cash flows discounting – the so-called unwinding effect.

The legal framework allows for the banks to opt for the manner of recognizing the contracted gross interest on impaired loans, so they are allowed to recognise it through other off-balance sheet items or in the subledgers for internal purposes and for the needs of statistical monitoring of these amounts. Within its accounting policy, the Bank has decided that for impaired loans, it will recognise the contracted gross interest calculated according to the repayment schedule within other off-balance sheet items.

The Bank realises income/expenses from fees for servicing approved (received) loans.

Such fee income is deferred by applying the effective interest rate throughout the loan period and it is recognized within interest income.

3.3. Fee and Commission Income and Expenses

Fee and commission income and expenses (except those which are an integral part of the effective interest rate applicable to a financial asset or liability) are included in the effective interest rate and are calculated in line with IFRS 15 – "Revenue from Contracts with Customers" - and are recorded under the item 'net fee and commissions income'.

Fees for rendered services during a specified time period are calculated for the said period. These fees include loan fees which are not an integral part of the effective interest rate of a financial instrument, guarantee fees, asset management commissions, custody and other fees and commissions relating to management and consultant services, and fees for insurance brokerage activities in FX transactions. In contrast, fees earned from providing transaction services to third parties, such as organising the acquisition of shares or other securities or the purchase/sale of entities, are recognised upon completion of each such transaction.

3.4. Dividend Income

Dividend income is recognised when the Bank's entitlement to receive dividend is established.

Dividends are recognised in profit and loss only in the following instances:

- if an entity's right to the payment of dividend has been established,
- if it is likely that an entity will achieve economic benefits connected with dividend, and
- if the amount of dividend can be measured reliably.

3.5. Foreign Exchange Translation

Items included in the Bank's financial statements are measured using the currency of the primary economic environment in which the Bank operates (functional currency). As stated in Note 2.1, the Bank's financial statements are stated in thousands of dinars (RSD). Dinar is the Bank's functional and presentation currency.

Transactions denominated in foreign currencies are translated into dinars at the official middle exchange rates determined at the interbank foreign exchange market and effective at the date of each transaction or the measurement date, if the items are remeasured.

Monetary assets and liabilities denominated in foreign currencies at the reporting date are translated into dinars at the official middle exchange rates determined at the interbank foreign exchange market prevailing as of that date (Note 36).

Foreign exchange positive or negative effects arising upon such transactions and the translation of monetary assets and liabilities denominated in foreign currencies at year-end are credited or charged to the income statement as foreign exchange gains or losses (Note 8).

Gains or losses realised/incurred upon translation of financial assets and liabilities with a currency clause index are recorded within the income statements as foreign exchange gains or losses and positive or negative currency clause effects (Note 8).

3.6. Financial Instruments

3.6.1. Accounting Policies Applicable from 1 January 2018

3.6.1.1. Recognition

A financial instrument is any contract which results in financial assets of one contracting party and financial liabilities or equity instruments of the counterparty.

3.6.1.2. Classification

On initial recognition, a financial asset is classified based on one of the following measurement techniques:

1) measurement at amortised cost (AC),
2) fair value through other comprehensive income (FVtOCI) or
3) fair value through profit or loss (FVtPL).

A financial asset is measured at amortised cost if it is not designated as FVtPL and meets the following criteria:

- the objective of the business model is holding the assets for the purpose of collecting the contractual cash flows, and

- the contractual provisions of a financial assets give rise to the cash flows that are solely payments of principal and interest on outstanding principal on specified future dates.

A debt instrument is measured at FVtOCI only if it meets both of the following criteria and if it is not designated as FVtPL:

- the objective of the business model is holding the assets for the purpose of collecting the contractual cash flows and for sale, and
- the contractual provisions of a financial assets give rise to the cash flows that are solely payments of principal and interest on outstanding principal on specified future dates.

Debt instruments held for the purpose of collecting the contractual cash flows and sale consist of treasury bills and bonds of the Republic of Serbia.

Upon initial recognition of equity instruments not held for trading, the Bank may irrevocably elect to present subsequent adjustments of their fair value through other comprehensive income (OCI), at the level of a specific equity instrument.

Assets measured at fair value through profit or loss (FVtPL) are financial assets not measured at amortised cost nor are they debt instruments measured at FVtOCI, which in particularly include:

- other business models;
- financial assets for which contractual provisions do not meet the criteria resulting in cash flows, which represent solely the payments of principal and interest on outstanding principal at specified future dates;
- financial assets measured at fair value through profit or loss (FVtPL) upon initial recognition;
- equity instruments; and
- derivatives.

Financial assets measured at fair value through profit or loss upon initial recognition include the following sub-categories:

- financial assets held for trading;
- financial assets designated as measured through profit and loss upon initial recognition; and
- financial assets for which measurement at fair value through profit and loss is mandatory.

Financial assets held for trading consist of the following items:

- acquired or generated mainly for short-term sale or repurchase;
- upon initial recognition, a portion is the portfolio of set financial instruments which are managed jointly and for which there is evidence of a recently acquired short-term gains; or
- in case of a derivative instrument (except a derivative instrument which is a financial surety contract or designated/actual hedging instrument).

At initial recognition the Bank may irrevocably elect to measure financial assets at fair value through profit and loss (fair value option) if this removes or significantly reduces inconsistencies in measuring or recognising (sometimes referred to as an ‘accounting mismatch’) which would otherwise occur due to the measurement of assets and recognising gains and losses relative to such assets on various bases.

Financial assets for which measurement at fair value through profit and loss is mandatory consist of financial assets which do not meet the SPPI criterion.

Gains and losses arising from financial assets measured at fair value is recognised in the income statement except in the following cases:

- for investment in an equity instrument and if the option to present gains and losses arising from such an investment in other comprehensive income has been chosen; and
- for financial assets measured at fair value through other comprehensive income.

In case of a modification of the business model for managing financial assets, such financial assets will be reclassified. Reclassification is conducted prospectively, from the reclassification date, i.e., as at the first date of the subsequent accounting period, without adjustments to the previously recognised profit/loss and interest.

Derecognition and Contract Modification

IFRS 9 incorporates the requirements of IAS 39 for the derecognition of financial assets and financial liabilities without substantive amendments. The impact of these modifications on the Bank is immaterial.

If contractual cash flows of financial assets are renegotiated or substantially modified, this will result in derecognition (due to the expiration the contractual rights to the cash flows from the financial asset) of the financial asset, in line with IFRS 9. The new financial asset is recognised, under the modified conditions, while the difference between the amortised cost of the financial asset which is derecognised and fair value of the new asset is presented through profit and loss as a modification gain/loss.

If the modification is not substantial, changes to the contractual provisions do not result in derecognition of the financial asset. The details of these modifications are described in Note 2.6. The analysis of contracts and changes, which are an integral part of the modifications, has shown that the Bank did not have any financial effects of the modifications, either material or immaterial.

3.6.1.3. Impairment - Financial Instruments

The Bank's assets exposed to credit risk, for the purposes of this decision, consist of loans, interest, fees, deposits placed with other banks and advances and other balance sheet items per which the Bank is exposed to credit risk as well as the off-balance sheet exposure items: issued guarantees, other sureties, unsecured letters of credit and approved but undrawn loans as well as other off-balance sheet items which represent contingent liabilities of the Bank.

The methodology applied to credit risk monitoring is in line with the Bank's internal procedures governing the credit risk. This internal methodology for credit risk monitoring is a basis for credit risk identifying measuring, monitoring and controlling in line with the Decision on Minimum Standards for Credit Risk Management in Banks.

Allowance for impairment and provisions for impairment for expected credit losses are recognised for the following exposures:

- financial assets measured at amortised cost (AC), and
- financial assets measured at fair value through other comprehensive income (FVtOCI).

The Bank reports allowance for impairment of exposures at amortised cost in the profit and loss within the expenses of the period for which the expected loss is determined as well as on the balance sheet, recorded under allowance for impairment of balance sheet exposures. Amounts recognised as expected credit losses, arising from off-balance sheet liabilities, are recognised as expenses for the period in which the loss has been identified, and on the balance sheet under provisions. The manner of calculating impairment of financial assets is described within the Credit Risk Methodology (under the section Credit Risk, paragraph 4.1.1).

Allowance for impairment of financial assets measured at fair value through other comprehensive income is carried out by applying the expected credit loss model whereby allowance for impairment is recognised in the profit or loss, as well as in other comprehensive income, without decreasing the value of the asset itself within the balance sheet.

IFRS 9 replaces the 'incurred loss' model in IAS 39 with a forward-looking 'expected credit losses' (ECL) model.

In applying the ECL model which also takes into account information on future events, Addiko Bank recognises expected losses for each reporting date in order to reflect on the credit risk adjustments of a given financial asset. Impairment of financial assets through the ECL model is based on historical, present and forecast of future events and therefore takes into account various scenarios that envisage events which may result in future credit loss.

According to IFRS 9, lifetime expected credit losses are calculated as the expected present value of credit losses incurred should borrowers fail to fulfil their obligations within the specified timeframe over the entire lifetime of the financial instrument with parallel consideration of the probability of default (PD) as well as loss given default (LGD).

3.6.1.4 Calculation of Expected Credit Losses

Expected loss is defined as the difference between the cash flows that are due to the Bank in accordance with the contractual terms of a financial instrument and the cash flows that the Bank expects to receive (considering probabilities of default and expected recoveries). Although this requirement is introduced by IFRS 9, the standard does not prescribe detailed methods and techniques to be applied.

When establishing cash flows the Bank expects to receive, the Bank applies the marginal loss approach, whereby the total expected loss is calculated as the sum of marginal losses incurred at any moment, starting from the reporting date. Marginal losses arise from individual parameters which are used to estimate exposures and losses in the event of default and conditional probability of default for each period. Lifetime expected credit losses are calculated separately for different scenarios taking into account current and forecast forward-looking information. The total expected credit losses under individual scenarios are eventually probability-weighted. The Bank considers three scenarios: the base line, optimistic and pessimistic scenarios and some less favourable scenarios are at times simulated in order to understand the dynamics and potential portfolio-specific risks.

3.6.2. Accounting Policies Applicable until 1 January 2018

Until 31 December 2017, IAS 39 "Financial Instruments: Recognition and Measurement" was a standard applicable to financial instruments. On 1 January 2018, it was replaced by IFRS 9 – "Financial Instruments". Taking into account that IFRS 9 is not applied retrospectively, the provisions of IAS 39 apply to the comparative period.

In line with IAS 39, all financial assets and liabilities must be recognised in the statement of financial position (balance sheet). Financial instruments are recognised at fair value at the time of their acquisition. Financial assets and liabilities not measured at fair value through profit and loss also include transaction fees which may be attributed to the acquiring of assets or assuming obligation. The Bank will recognise an increase and decrease in derivatives and financial instruments with maturities customary on the local market as, at the date of trading.

3.6.2.1. Recognition

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

Financial assets and financial liabilities are recognised in the Bank's balance sheet on the date upon which the Bank becomes counterparty to the contractual provisions of a specific financial instrument. All 'regular-way' purchases and sales of financial assets are recognised on the settlement date, i.e., the date the assets are delivered to the counterparty.

3.6.2.2. Derecognition of Financial Assets and Liabilities

Financial assets

The Bank derecognises a financial asset (or part of an asset or a group of financial assets) if:

- the contractual rights to the cash flows from the financial asset have expired; or
- the Bank has transferred the right to the cash flows from the financial asset or assumed an obligation to make the payment of the cash received in respect of the assets in full amount, without materially significant delay in payment to a third party under the executed contract on such transfer; and
- the Bank has either transferred all the risks and rewards associated with the asset or has neither transferred nor retained all the risks and rewards of ownership over the asset but has transferred control over the asset.

When the Bank transfers the rights to the cash flows from a financial asset or executes a contract on such transfer, and thereby the Bank neither transfers nor retains all the risks and rewards of ownership and has not transferred control over the asset, the asset is recognised to the extent of the Bank's continuing involvement in the asset. Any further involvement of the Bank in the transferred asset, in the form of a guarantee for the asset transferred, is measured at the lower of the asset's original carrying value and the maximum amount of the consideration the Bank would need to pay.

Financial Liabilities

A financial liability is derecognised when its contractual obligation is discharged, cancelled or expired. Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of the existing liability are substantially modified, such an exchange or modification is treated as derecognition of the original liability and the simultaneous recognition of a new liability, with the difference between the respective carrying amounts recognised in the income statement.

3.6.2.3. Classification of Financial Instruments

The Bank's management determines the classification of its financial instruments at initial recognition. Classification of financial instruments upon initial recognition depends on the purposes for which financial instruments have been acquired and their characteristics.

The Bank's has classified financial assets into the following categories: financial liabilities at fair value through profit or loss, loans and receivables, financial assets held to maturity and financial assets available for sale.

The Bank's has classified financial liabilities into the following categories: financial liabilities at fair value through profit or loss, financial labilities held to maturity (deposits due to banks and customers, subordinated liabilities).

Subsequent measurement of financial assets depends on their classification as follows:

a) Financial Assets at Fair Value through Profit or Loss

This category includes two sub-categories of financial assets: financial assets held for trading and those designated at fair value through profit or loss.

Financial assets are classified as held for trading if they have been acquired for sale purposes or re-purchase within a short period, for the purpose of generating profit from short-term price fluctuations. These assets are recorded in the balance sheet at fair value. Financial assets held for trading also include financial derivatives.

All realized or unrealised gains and losses arising from changes in the market value of these assets, i.e. adjusted to fair value, are recorded on the income side, i.e. against the expense side.

The Bank is in possession financial derivatives that do not meet the criteria for hedge accounting. At year-end the Bank had receivables and liabilities per short-term foreign currency swaps (FX-swaps).

Derivatives, including FX contracts, FX swaps and other derived financial instruments, are initially recognised at fair value within the off-balance sheet items on the contract execution date and are subsequently remeasured at fair value.

Derivatives are initially recognised at the moment when derivative contract has been agreed with the counterparty (date of agreement). The notional amount of principal to which the respective derivative is agreed is recorded as an off-balance sheet item, while the initial positive or negative fair value of the derivative is carried within assets or liabilities. The initial recognition of fair value is executed only if the market price of the same or similar derivative can be found in the organised derivatives market, and if it differs from the price at which that derivative has been agreed by the Bank.

Information on the fair value is acquired at the market and includes information on recent market transactions or it is determined by the method of discounted cash flows.

All derivatives are recognised as assets when the fair value is positive, i.e. as liabilities when negative. The best source of estimation of the fair value of derivatives on initial recognition is transaction price (i.e. fair value of fee given or received).

(b) Loans and Receivables

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

Loans and receivables approved by the Bank to other banks and customers are recorded within the statement of financial position from the moment of loan funds disbursement to the borrower. All loans and receivables are initially recognised at fair value. As of the reporting date loans are stated at amortised cost using the contractually defined interest rate, less allowance for impairment per impairment and direct write off.

Interest income and receivables in respect of these instruments are recognised under interest income. Fees which are part of effective yield on these instruments are deferred and credited to the income statement as interest income over the lifetime of a financial instrument.

The Bank includes a currency clause index in the loan contracts executed with its clients. RSD loans with contracted risk hedges by indexing RSD loans to EUR, CHF or USD exchange rates are revalued in accordance with the particular contract executed for each loan facility. The difference between the carrying amount of the outstanding principal and the amount calculated by applying the foreign currency clause is included within loans and receivables. The currency clause index represents an embedded derivative that is not accounted for separately from the host contract, since the economic characteristics and risks of the embedded derivative are closely related to those of the host contract. Gains or losses arising from the currency clause application are recorded in the income statement as positive or negative currency clause effects.

Loans and receivables are presented in the Bank's statement of financial position (balance sheet) under two items – as 'loans and receivables due from banks and other financial institutions' and 'loans and receivables due from customers'.

Financial Assets Held to Maturity

Financial assets held-to-maturity are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Bank's management has the positive intention and ability to hold to maturity. If the Bank were to sell other than a significant amount of held-to-maturity financial assets, the whole category would be reclassified to assets available for sale.

After initial recognition, financial assets held-to-maturity are subsequently measured at amortised cost using the effective interest rate method, less any allowance for impairment or losses under impairments. Amortised cost is calculated by taking into account any discount or premium on acquisition, over the period to maturity. The amount of impairment loss for securities held to maturity is calculated as the difference between the securities' carrying amount and the carrying values of expected future cash flows discounted at the investment's original effective interest rate.

Financial Assets Available for Sale

Financial assets intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices are classified as 'available-for-sale financial assets'.

Available-for-sale financial assets refer to Treasury bills of the Republic of Serbia.

After initial recognition, available-for-sale financial assets are shown at fair value. The fair value of Treasury bills is calculated based on discounted nominal value of notes by the interest rate published on the website of the Treasury Department of the Ministry of Finance.

In case of available-for-sale financial instruments, the Bank assesses on an individual basis whether there is objective evidence of impairment, based on the same criteria as those applied to the financial assets carried at amortised cost. Also, impairment already recognized represents cumulative loss valued as difference between amortised cost and current fair value, net of any impairment loss previously recognised in the income statement.

3.6.2.4. Impairment of Financial Assets and Risk Provisions

In accordance with its internally adopted policy, at each reporting date the Bank assesses 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 deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events occurring after the initial recognition of the asset and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated.

Evidence of impairment may include indications that a borrower or a group of borrowers is facing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they will enter bankruptcy or other financial reorganisation and where observable data indicate that there is a measurable decrease in the estimated future cash flows, such as changes in arrears in liability settlement or economic conditions that correlate with defaults.

In assessing impairment of loans and receivables due from banks and clients, the Bank assesses individually whether objective evidence of impairment exists for financial assets which are individually significant, or collectively for financial assets that are not individually significant. If the Bank determines that no objective evidence of impairment exists for an individually assessed financial asset, it includes such assets in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is, or continues, to be recognised are not included in a collective assessment of impairment.

If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the assets' carrying value and the present value of the future cash flows (without taking into account expected credit losses not yet incurred). The asset's carrying value is reduced via the impairment allowance account and losses arising from impairment of loans and receivables, as well as other financial assets, are recorded through profit or loss as losses on impairment of financial assets and credit risk-weighted off-balance sheet items (Note 10).

Loans and the related impairment allowances are fully derecognized when there is no realistic prospect of future recovery and all collaterals have been realised or foreclosed by the Bank. If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment has been recognised, the previously recognised impairment loss is reversed by adjusting the allowance account, while the amount of the reversal is recognized in the income statement as gain on the reversal of impairment of financial assets and credit risk-weighted off-balance sheet items (Note 10).

The present value of expected future cash flows is arrived at by discounting the cash flows at the financial asset's original effective interest rate. If a loan has a variable interest rate, the current variable portion of the interest rate is applied. The calculation of the carrying value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from collateral foreclosure net of costs of collateral sale irrespective of the probability of the process of collateral realisation.

For the purpose of collective impairment assessment, financial assets are grouped on the basis of the Bank's internal classification system that takes into account credit risk characteristics. Future cash flows of a group of financial assets that are collectively assessed for impairment are estimated on the basis of historical loss experience for assets with credit risk characteristics similar to those in the group. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the years on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist at the balance sheet date. The Bank reviews the methodology and assumptions used for estimating future cash flows on an ongoing basis in order to reduce any differences between loss estimates and actual loss experience.

Write-offs for past-due loans and receivables, partial or in full, may be performed during the year if inability of their collection is certain, i.e., for which impairment is recognised and documented. Write-off is made based on court ruling or the relevant decisions of the Bank’s competent bodies.

3.6.2.5. Rescheduled Loans

In each individual case, the Bank decides on the collection strategy for clients facing financial difficulties. Where possible, the Bank seeks to reschedule or restructure loans rather than foreclose collaterals. This may involve alteration of the initially agreed loan terms such as extending the payment terms, extending the grace period, replacing several loans with a single new loan with extended repayment period or any combination thereof. Once the terms have been renegotiated, the loan is no longer considered due and payable. The Bank's management continuously monitors rescheduled/restructured loans to ensure that all criteria are met, as well as that future payments are made. The Bank continues to assess loans for impairment using the loan's original effective interest rate.

3.6.2.6. Off-Setting of Financial Instruments

Financial assets and liabilities are offset, and the difference between their sums is recognised in the balance sheet, when there is a legally enforceable right to offset the recognised amounts, and when there is an intention to commit settlement on a net basis, or to simultaneously realise both the asset and the liability.

3.6.3. Cash and Balances Held with the Central Bank

Cash and cash balances held with the central bank include cash funds in the local (RSD) and foreign currencies, i.e., cash balances on gyro and current accounts, vault cash and other cash funds in the local (RSD) and foreign currencies, gold and other precious metals, liquid asset surpluses deposited with the National Bank of Serbia and foreign currency required reserve funds held on the special accounts with the National Bank of Serbia. Cash and cash balances held with the central Bank are carried at amortised cost in the balance sheet. These funds are held for the settlement of current cash liabilities rather than investment or other purposes.

The structure of cash and cash balances held with the central bank is provided in Note 15.

3.6.4. Receivables and Liabilities under Derivative Financial Instruments (Derivatives)

The Bank maintains in its portfolio financial derivatives which whose underlying market variable is exchange rate. The derivatives used by the Bank are FX swaps and FX forwards.

For accounting purposes, derivatives are classified as held-for-trading financial instruments, i.e. they are recorded in the balance sheet at fair value.

Derivatives are initially recognised at the moment when derivative contract has been agreed with the counterparty (date of agreement). The notional amount of principal to which the respective derivative is agreed is recorded as an off-balance sheet item, while the initial positive or negative fair value of the derivative is carried within assets or liabilities. The initial recognition of fair value is executed only if the market price of the same or similar derivative can be found on the organised derivatives market, and if it differs from the price at which that derivative has been agreed by the Bank.

Derivatives which the Bank agrees with clients who operate in Serbia accordingly do not have the initially recognised fair value since there is no active derivatives market in the country. Once an active derivatives market is developed, i.e. when comparative data from the market become available, the Bank will record in the balance sheet (asset or liability) and income statement (initially positive or negative fair value) the difference between the market cost of transaction and the derivative's initial fair value, as established per measurement methodology.

In accordance with the Bank's current accounting policy, the fair value of financial instruments held for trading is adjusted on a daily basis and the effects of derivatives' fair value adjustments are recorded in the balance sheet as an increase in fair value or decrease in fair value. The positive fair value of derivatives is presented as a receivable under derivative and the negative fair value is presented as a liability under derivative.

Derecognition of the derivative occurs at the moment when contractual rights expire and liabilities which arise from derivatives (exchange of cash flows), i.e. as at date of execution. The ultimate effect of adjusting the fair value of FX financial derivatives (which are currently the only type that the Bank agrees) is at that point recorded in the realised FX gains/losses account, while all other previous records of the fair value and its adjustments (positive and negative fair values recorded on a monthly basis) are reversed.

Due to the fact there is no active derivatives market on the Serbian financial market and consequently it is not possible to objectively establish the value of derivatives (quoted prices), the Bank applies the discounted future cash flows methodology to the calculation of cash flows arising from derivatives. Said calculation method is generally accepted by all participants in derivative transactions in the countries with organised derivative trading markets and such calculated fair value represents a reliable assessment of a particular derivative's price which would be achieved in transactions carried out on a developed derivatives market.

3.6.5. Securities

3.6.5.1. Securities Recognised through Other Comprehensive Income

The Bank has in its portfolio debt securities recognised through other comprehensive income. Gains or losses recognised through OCI, except interest income, expected credit losses and FX gains/losses are recognised through the profit or loss.

Once debt securities recognised through other comprehensive income are derecognised, accumulated gains or losses, previously recognised through other comprehensive income, are reclassified from the equity item to the balance sheet.

3.6.5.2. DuDebt Securities Measured at Fair Value through Profit or Loss

For debt securities measured at fair value through profit and loss, gains and losses arising from adjustments to the market value are recognised through profit and loss and are not subject to impairment.

At initial recognition, debt securities are measured at fair value increased by transaction costs, except in case of securities held for trading. For accounting purposes, the securities were subsequently recognised based on their classification, as follows: financial assets held to maturity, financial assets available for sale and financial assets at fair value through profit and loss.

Interest income arising from treasury bills and bonds of the Republic of Serbia are calculated and accrued on a daily basis and recognised through profit and loss.

3.6.6. Loans and Receivables Due from Banks and Other Financial Institutions and Loans and Receivables Due from Customers (Loans and Receivables)

The loans and receivables item includes:

- Loans and receivables measured at amortised cost. Such loans and receivables are initially recognised at fair value, increased by direct transaction costs, while they are subsequently measured at amortised cost, by applying the effective interest method.
- Loans and receivables measured at fair value through profit and loss, in accordance with the business model and the features of the cash flows

As at 31 December 2018, the Bank did not have in its loan portfolio loans and receivables that meet the criteria of measurement at fair value through profit and loss.

Loans and receivables approved by the Bank are recorded in the balance sheet commencing from the date of disbursement to the client. All loans and receivables are initially recognised at fair value. As at the balance sheet date, loans are stated at amortised cost using the effective interest rate less impairment allowance and any amounts written off.

IFRS 9 envisages that all receivables for which there is no reasonable expectation of recovery are excluded from the Bank's balances and that they should be written off from the balance sheet assets and recorded within the off-balance sheet items pending the recovery procedure, in line with the National Bank of Serbia's Decision on the Accounting Write-off of Bank Balance Sheet Assets.

The criteria for derecognition of financial assets are defined by the Bank's internal bylaws.

3.6.7. Deposits and Other Financial Liabilities Due to Banks, Other Financial Institutions and the Central Bank and Deposits and Other Liabilities Due to Customers

Deposits and other financial liabilities due to banks, other financial institutions and the central bank and deposits and other financial liabilities due to other customers are initially recognised at fair value, decreased by incurred transaction costs, except for financial liabilities recognised at fair value through profit and loss. At initial recognition, the said financial liabilities are recognised at amortised cost, by applying the effective interest rate.

Within this item, the liabilities per borrowings are initially recognised at fair value decreased by incurred transaction costs and are subsequently recognised at amortised cost.

Borrowings are classified as current liabilities, unless the Bank has the unconditional right to settle such liabilities within at least 12 months following the balance sheet date.

3.7. Other Liabilities

Trade payables and other current operating liabilities are stated at nominal value.

3.8. Reserves for Estimated Losses on Bank Balance Sheet Assets and Off-Balance Sheet Items

The required reserve for estimated losses on balance sheet assets and off-balance sheet items is calculated in accordance with the relevant internal bylaws and the National Bank of Serbia's Decision on the Classification of Bank Balance Sheet Assets and Off-balance Sheet Items (Official Gazette of RS nos. 94/2011, 57/2012, 123/2012, 43/2013, 113/2013, 35/2014, 38/2015, 61/2016, 69/2016, 91/2016, 101/2017 and 114/2017).

In assessing credit risk in line with the Methodology, the Bank considers the borrower's financial position in terms of: profit stability, maturity matching of certain asset and liability features, adequacy of cash flows, indebtedness, leverage, liquidity ratios, interest liability coverage and profitability.

In addition to the financial indicators, an important element of the assessment of the borrower's risk category is timeliness in material liability settlement toward the Bank for the past 12 months and at the reporting date. Material liability amount equals to 1% of the individual receivable due from the borrower, however not below RSD 10,000 for corporate clients and RSD 1,000 for entrepreneurs, agricultural producers and private individuals, respectively.

The basic borrower classification is independent of the collateral obtained.

Due to collateral quality assessment, a receivable due from the borrower may be classified in a category different from the basic borrower classification. According to their quality, collaterals are divided into first-class and adequate collaterals.

First-class collaterals trigger category A classification of receivables, while adequate collaterals place receivables into a category more favourable (one up) than the category as per basic classification of borrowers.

The Bank classifies aggregate receivables due from a borrower into categories A, B, V, G and D based on the timeliness/delay in liability settlement criterion, as well as based on the assessment of the borrower's creditworthiness and collateral quality.

In accordance with the classification of receivables and pursuant to the aforesaid NBS Decision, the amount of the required reserve for estimated losses under different categories is calculated by applying the following percentages: A (0%), B (2%), V (15%), G (30%) and D (100%).

The Bank is obligated to determine the amount of the required reserve for estimated losses, which is calculated as the sum of all the positive differences between the reserve for estimated losses computed in accordance with NBS Decision and the determined impairment allowances for balance sheet assets and provisions per off-balance sheet items at the individual borrower level. The required reserve from profits for estimated losses represents a deductible item in calculation of the capital adequacy ratio.

3.9. Intangible Assets Property, Plant and Equipment and Investment Property

a) Intangible Assets

Intangible assets consist of software, licenses and investments in progress. Intangible assets are stated at cost less accumulated amortisation and aggregate impairment losses, if any.

Separately acquired trademarks and licenses are stated at historical cost. Trademarks and licenses have finite useful lives and are carried at cost less accumulated amortisation. Amortisation is calculated using the straight-line method to allocate and write down the cost of trademarks and licenses over their estimated useful lives.

Intangible assets are regularly written down during the year (and these amounts are charged to operating expenses) through the calculation of amortisation over their estimated useful life – 7 years for the Bank's core information system and 5 years for other software. The residual value and useful lives are reviewed, and adjusted when necessary, at each reporting date.

Expenditures relating to the development or maintenance of the software applications are recognised as expenses, as incurred.

Intangible assets also include investments in software which are not amortised since they are still not in use.

The Bank capitalised the internally developed software, in line with IAS 38, the amount of capitalisation being RSD 24,937 thousand. According to IAS 38.12, an intangible asset should be recognised only if it is probable that future economic benefits which are attributable to the asset will flow to the entity and if the cost of the asset can be measured reliably.

The types of cost that may be capitalised in accordance with IAS 38:

- salaries, wages and other employment related costs in the process of bringing the assets in the operating condition;
- professional fees directly incurred in the process of bringing the assets in the operating condition; and
- costs of testing the proper functioning of the assets.

Said costs represent an example of typical costs that may be capitalised but the range of costs to be capitalised can also include costs meeting the following criteria:

- they are directly attributable to the relevant asset; and
- they are incurred with relation to the preparation of the asset for its intended use.

The capitalisation of costs which are included in the cost of software will no longer be applied once the relevant asset is in the appropriate condition to be used for intended purpose. This means that once the software achieves sufficient and intend level of functionally and it can readily be used - cost capitalisation will no longer be applied.

b) Property, Plant and Equipment

Property, plant and equipment are stated at cost less accumulated depreciation and aggregate impairment losses, if any. Cost includes expenditures that are directly attributable to the acquired asset.

Subsequent costs are included in the asset's carrying amount or are recognised 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. The carrying value of the replaced asset is derecognised. All other repairs and maintenance costs are charged to the income statement of the financial period in which they are incurred.

Derecognition of property, plant and equipment occurs when they are sold or when the Bank no longer expects future economic benefit from their use. All gains and losses arising on derecognition of assets (calculated as the difference between the net sales proceeds and the carrying value of the asset) are recognised in profit and loss for the year of derecognition.

Land is not depreciated. Depreciation of assets is calculated using the straight-line method to allocate the cost of assets to their residual values over their estimated useful lives, as follows:

Assets	Depreciation rate (%) in 2018	Depreciation rate (%) in 2017
Buildings	1.87% - 2.24%	1.87% - 2.24%
Computer equipment	25.00%	25.00%
Furniture	11.00%	11.00%
Vehicles	15.50%	15.50%
Other equipment	10% - 33.33%	10% - 33.33%

When determining the basis for depreciation, the cost or revalued amount is not decreased by the amount of the residual value since after the expiry of the useful life of a fixed asset it is assessed as equal to zero.

Calculation of depreciation of property, plant and equipment commences at the beginning of the month following the month of the asset's placement into use. Investments in progress are not depreciated. Depreciation charge is recognised within expenses for the period when incurred.

The residual values and useful lives of assets are reviewed, and adjusted if appropriate, at each reporting date. If higher than its estimated recoverable amount, an asset's carrying amount is written down immediately to its recoverable value.

Gains and losses arising on disposal or sales of property and equipment are credited or charged to the income statement as a part of other operating income or other operating expenses.

Depreciation for tax purposes is calculated in accordance with the Corporate Income Tax Law of the Republic of Serbia and the Rules on the Manner of Classification of Fixed Assets into Groups and Manner of Determining Depreciation for Tax Purposes, resulting in deferred taxes (Note 14).

c) Investment Propert

Investment property is a type of property held to earn rentals or for capital appreciation or both.

Investment property is recognised at cost less accumulated depreciation.

Calculation of depreciation of investment property commences at the beginning of the month following the month of the asset's placement into use. Depreciation charge is recognised within expenses for the period when incurred.

Investment property is depreciated at the rate of 2.5% p.a. using the straight-line depreciation method. The residual values and useful lives of assets are reviewed, and adjusted as appropriate, at each reporting date.

Subsequent costs are capitalised only when it is probable that future economic benefits associated with them will flow to the Bank and the cost can be measured reliably. All other repairs and maintenance costs are expensed when incurred.

d) Impairment of Non-Financial Assets
Non-financial assets that have an indefinite useful life are not subject to amortisation and are tested for impairment on an annual basis.

Assets that are subject to depreciation/amortisation are assessed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised in the amount by which the asset's carrying amount exceeds its recoverable amount.

The recoverable amount is the higher of an asset's fair value less costs to sell and value in use.

For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows. Non-financial assets that have suffered impairment are reviewed for possible reversal of the impairment at each reporting date.

In 2018, no indications of impairment of the Bank's non-financial assets were identified.

Fair value measurement and impairment of the Bank's intangible assets are disclosed in Note 21.

3.10. Leases

a) Operating Lease - the Bank as Lessee
A lease where all the risks and rewards incidental to ownership are retained by the lessor, i.e., not transferred to the lessee, is classified as an operating lease.

Payments made under operating leases are charged to other operating expenses in the income statement (when they occur) on a straight line basis over the period of the lease.

In 2018 and 2017 respectively, the Bank leased (rented) commercial premises in which it performed its business activities.

b) Finance Lease - the Bank as Lessee
Finance leases, which transfer to the Bank substantially all risks and rewards incidental to ownership of the leased item, are capitalized at the inception of the lease at the lower of the fair value of the leased asset or the present value of the minimum lease payments and included in property and equipment with the corresponding liability to the lessor included in other liabilities.

Lease payments are apportioned between the cost of financing and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability. The cost of financing is charged directly in the income statement as an interest expense.

In 2018, the Bank had no finance lease agreements.

c) Operating Lease - the Bank as Lessor
A lease is an agreement whereby the lessor conveys to the lessee, in return for a payment, or series of payments, the right to use an asset for an agreed period of time. When assets are leased out under operating leasing, the assets are shown in the balance sheet depending on the type of asset. Lease income is recognized on a straight-line basis during the lease period.

The Bank leases parts of its business premises, and thus earns rental income, as stated in Note 9.

3.11. Assets Acquired in Lieu of Debt Collection

According to the Bank's policy, the Bank assesses whether an asset acquired in lieu of debt collection is suitable for the Bank's internal business operations or it is to be sold. Assets determined as appropriate for the Bank's own use are classified within the relevant asset line item and measured at the lower of the asset's cost and the carrying value of the underlying receivable.

3.12. Non-Current Assets Held for Sale

Non-current assets (or disposal groups) held for sale are classified as assets held for sale when their carrying amount is recovered predominantly through a sale transaction and the sale is considered highly probable. They are stated at the lower of carrying amount and fair value less costs to sell if their carrying amount is to be recovered principally through a sale transaction rather than through continued use. This condition is considered fulfilled if the sale is highly probable and when such an asset (or a disposal group) is available for immediate sale in its current condition. Management must be committed to the action plan for the sale in order for the asset to fulfil the recognition criteria and the sale is expected to be completed within a year from the initial classification.

3.13. Provisions, Contingent Liabilities and Contingent Assets

Provision is a liability uncertain in terms of both maturity and amount. Provisions are recognised:

- when the Bank has a present obligation (legal or constructive) as a result of a past event;
- when it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and
- when a reliable estimate can be made of the amount of the obligation.

The amount recognized as provision represents the best estimate of the expense needed to settle the present obligation at the reporting date.

Provisions are monitored per type and can be used only for the expenses for which they were initially recognized.

Provisions are not recognized for future operating losses in instances of a number of similar liabilities, probability that their settlement will require an outflow of resources is determined at the level of the liability category as a whole. Provisions are recognized even if the probability for any of the liabilities within the same category is remote.

Contingent liabilities are not recognized in the financial statements. They are disclosed in notes to the financial statements (Note 35).

Contingent liabilities are assessed on an ongoing basis to determine the probability of an outflow of economic resources. Where a probable resource outflow will be required in the future for items previously recognised as contingent liabilities, provisions are recognised in the financial statements for the period in which a change occurred to the probability of event occurrence.

Provisions for contingent liabilities are separately calculated for:

- approved yet undrawn loans,
- payment and performance guarantees issued,
- unsecured letters of credit, and
- other forms of sureties where payments may be required.

Credit risk exposure – exposure at default (EAD) for contingent liabilities is equal to the portion of the risk exposure that is expected to be used at the time of default.

The Bank does not recognise contingent assets in the financial statements. Contingent assets are disclosed in the notes to the financial statements when the inflow of economic benefit is probable.

3.14. Employee Benefits

(a) Employee Social Security Taxes and Contributions
In line with the regulatory requirements of the Republic of Serbia, the Bank is obligated to pay contributions to tax authorities and to various state social security funds. These obligations involve the payment of taxes and contributions on behalf of the employee, by the employer, in the amounts calculated by applying the specific, legally prescribed rates. The Bank is also legally obligated to withhold contributions from gross salaries to employees, and on behalf of its employees, to transfer the withheld portions directly to government funds. The Bank has no legal obligation to pay further benefits to its employees that are due from the Pension Insurance Fund of the Republic of Serbia.

(b) Other Employee Benefits – Retirement Benefits
In accordance with the Labour Law and the Rules of Procedure, the Bank is under obligation to pay its vesting employees retirement benefits in the amount of two average monthly salaries of the vesting employee as at the payment date, but not below two average monthly salaries paid by the Bank as at the payment date or the two average monthly salaries paid in the Republic of Serbia according to the most recent data published by the Republic of Serbia Statistical Office, whichever arrangement is most favourable for the retiree.

The entitlement to these benefits is usually conditioned by the employee remaining in the service up to the age limit for retirement and until completion of the minimum prescribed years of service. The expected costs of these benefits are accrued over the period of employment.

Provisions for retirement benefits are made based on the independent actuary's report and stated at the present value of the expected future payments. Inputs for the calculation of these provisions are presented in Note 28.

(c) Provisions for Termination Benefits
Termination benefits are payable when employment is terminated before the regular retirement date, or whenever an employee accepts voluntary redundancy in exchange for those benefits. The Bank recognises termination benefits when it is explicitly committed to either: terminating the employment of current employees according to an adopted plan without the possibility of withdrawal; or providing termination benefits as a result of an offer made to encourage voluntary redundancy aimed at decreasing the number of employees.

Benefits falling due more than 12 months after the balance sheet date are discounted to their present value.

d) Profit Sharing and Bonuses
The Bank recognises a liability and an expense for bonuses and profit-sharing based on a formula that takes into consideration the profit attributable to its shareholders after certain adjustments. The Bank recognises a provision in instances of contractual or constructive obligations.

3.15. Equity

Equity consists of share capital (ordinary shares), share premium, reserves and retained earnings/accumulated losses.

Dividends on shares are recorded as liabilities in the period in which the relevant decision on their payment was rendered. Dividends approved for the year after the reporting date are disclosed in the note on the events after the reporting period.

3.15.1. Share Capital

Ordinary shares are classified as equity.

Where the Bank purchases its own share capital, the consideration paid, including any directly attributable incremental costs (net of income taxes) is deducted from equity attributable to the equity owners until the shares are cancelled or reissued. Where such shares are subsequently reissued, any consideration received, less any directly attributable incremental transaction costs and the related income tax effects, is included in equity attributable to the equity owners. The Bank did not repurchase its own shares.

3.15.2. Other Forms of Issued Capital

The share premium is the difference between the par (nominal) value of shares and their selling price. The par value of shares is the product of the par value per share and the total share count. Reserves from profit arise as a result of allocation of portions of profit net of income taxes other than the profit paid in the form of dividend to shareholders or employee profit sharing.

3.16. Taxes and Contributions

Deferred Taxes
Deferred tax liabilities are recognised 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 reverse in the foreseeable future.

Deferred tax assets are recognised for all deductible temporary differences, carry forward of unused tax credits and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carry forward of unused tax credits and unused tax losses can be utilised 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 recognised only to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which temporary differences can be utilised.

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 a portion of the deferred tax assets to be utilised. Unrecognised deferred tax assets are reassessed at each reporting date and are recognised to the extent that it has become probable that future taxable profit will allow deferred tax assets to be utilised.

Deferred tax assets and liabilities are calculated at the tax rate expected to be effective in the year of realisation of tax benefits, i.e., settlement of deferred tax liabilities, based on the official tax rates and regulations enacted or substantively enacted on the reporting date.

Current and deferred taxes are recognised as income or expenses and are included in the net profit/(loss) for the period.

Deferred income taxes related to items that are recorded directly in equity are also recognised in equity

Other Taxes

Indirect taxes and contributions include property taxes, value added tax, payroll contributions charged to the employer and various other taxes, contributions and duties payable under republic and municipal tax regulations. These are included within other expenses (Note 13).

3.17. Internal Control System for Accounting Procedures

Addiko Bank has an internal control system (ICS) in place for accounting procedures, which defines and allows for the realisation of processes throughout the organisation. The governing bodies in each of the organisational units within the Group are responsible for implementation of the Group's rules and procedures. Compliance with the Group's policies is monitored as part of both external and internal audits.

ICS, as part of the Bank's risk management system, has the following general objectives:

- Protection and implementation of the business and risk strategies and Group's policies;
- Effective and efficient use of all resources with a view to achieve the target commercial success;
- Ensuring reliable financial reporting; and
- Support to the compliance with all relevant legislation, rules and regulations.

The specific objective with regard to the Group's accounting procedures is that ICS ensures that all business transactions are recorded accurately, timely and in a uniform manner for accounting purposes.

In addition, the system must ensure that no errors or intentional fraud affect adequate presentation of the Bank's financial position and performance.

This is the case whenever the data provided in the financial statements and notes to the financial statements are essentially inconsistent with correct figures, i.e., whenever, individually or in the aggregate, they can affect decisions made by the users of the financial statements, as such a decision may incur serious damage, such as financial loss, the imposition of sanctions by the banking supervisor or reputational harm.

The internal control system itself is not a static system but is continuously being adapted to the changing environment. The implementation of the internal control system is fundamentally based on the integrity and the ethical behaviour of employees. The Executive Board and the management team actively and consciously embrace their role of leading by example.

4. Risk Management

4.1. Financial Risk Factors

The risk management system aims to mitigate the risks the Bank is exposed to in its operations, ensuring that all aspects of the Bank's business are stable and minimally susceptible to negative internal and external factors and that the Bank's risk profile meets the requirements of prudent banking business at all times.

The Bank bases its risk profile on the capital adequacy level that provides risk coverage required by the statutory regulations.

Moreover, the Bank monitors exposure to other risks arising from its operations and environment that are not required according to the statutory regulations on the capital adequacy ratio.

The Bank's risk management policies govern the management of all relevant risks (explained hereinafter) to which the Bank is exposed. The Bank's risk management policies and procedures are in compliance with statutory regulations of the National Bank of Serbia (NBS), and policies, procedures and other relevant documents of Addiko Group.

The approach to the management of individual risks is defined under the effective regulations of the Republic of Serbia and the Bank's internal regulations. The targeted level of capital adequacy is based on the principle that the Bank's capital adequacy ratio should be in line with the scope, type and complexity of the Bank's operations and, in addition to the risks contained within NBS regulations, provide a buffer for other risks arising from the Bank's operations and environment.

Risk management includes risk identification, risk measurement/assessment, undertaking of measures to mitigate risks and risk monitoring. Risk management is performed by:

1. The Bank's bodies and other committees prescribed by the Law – the Board of Directors, Executive Board, Audit Committee, Assets & Liabilities Committee (ALCO) and Credit Committee;
2. Working groups and committees of the Bank's Executive Board – Risk Advisory Body, Advisory Body for Corporate Clients, as well as Operational Risk Advisory Body;
3. The Bank's organisational units – Risk Control Department, Corporate Risk Management Division, Retail Risk Management and Collection, BSM & Treasury Department, Compliance Department and other units, as appropriate.

The Board of Directors defines the Risk Management Strategy and policies, which are executed by the Executive Board. The Executive Board adopts procedures for risk identification, measurement, assessment and management, analyses efficiency of their application and reports to the Board of Directors about those activities.

The Risk Management Strategy is a reflection of the business strategy and it describes the planned structure of operations, strategic development and growth, taking into account processes, methodology and organisational structure relevant to managing risk factors. As such, the Risk Management Strategy is the link between the business strategy and the Bank's risk positioning. The Strategy is the highest-level risk management tool and defines the framework for monitoring, controlling and mitigating risks to which the Bank is exposed in its operations while at the same time maintaining the internal capital adequacy liquidity position and overall profitability. Reliable and sustainable growth is thus achieved, while also maintaining the level of the Bank's own resources which are sufficient to support its operations, based on the given level of risk and in line with regulatory requirements.

The implementation of the Bank's overall Risk Management Strategy is ensured in the following manner:

- Defining the Bank's aptitude for risk assumption and measurement of the total risk level, as well as individual risk types, in line with the Bank and Group Business Strategies;
- Appropriate identification and quantification of each risk individually, especially in terms of internal capital and liquidity requirements, defining the existing/targeted limits for the financial year and suitable management and coordination mechanisms;
- Converting strategic objectives to detailed guidelines and rules regarding risk management, by means of comprehensive internal governance of every individual risk type, thus achieving efficiency in fulfilling the objectives at the level of an individual client/transaction;
- Establishing an organisational framework suitable for risk management purposes, and which clearly delineates lines of responsibility.

The Bank has established the Risk Appetite Framework (RAF), which determines its aptitude to risk assumption and the RAF is part of the process relevant to the development and implementation of the risk management business policy and strategy. Furthermore, the level of assumed risk versus the capacity to incur risk is also defined. The RAF defines risk levels the Bank is willing to undertake. The measures applied to define the RAF have been fine-tuned, taking into account the 2018 Budget. The Risk Management Strategy and Recovery Plan are the framework for proper internal risk management and supervision.

Additionally, as part of strategic risk management, the Bank will implement one other crucial process - the internal capital adequacy assessment process (ICAAP), to determine capital levels adequate for the coverage of all materially significant risks to which it is exposed. The ICAAP is a tool used for assessing the adequacy of internal capital vs. the Bank's risk profile and for implementing this strategy, suitable for the purpose of maintaining internal capital adequacy.

The key risks to which the Bank is exposed arise from its very operations as well as market conditions, and the Bank faces those in the form of:

- credit risks,
- market risks,
- liquidity risk,
- operational risk (which includes legal risk)

as well as other risks such as:

- compliance risk,
- strategic risk.

There have been no significant changes to the objective, manner, process and methods of managing the above listed key risks to which the Bank is exposed.

Hereunder is a summary of the key risks which the Bank monitors and manages on an ongoing basis.

4.1.1. Credit Risk

Credit risk is the risk of negative effects on the Bank's financial result and equity arising from borrowers' inability to settle the liabilities matured due to the Bank. The Bank's credit risk depends on the creditworthiness (credit rating) of its borrowers, their regular and timely liability settlement and quality of collateral securitising the Bank's receivables.

The segmentation of the Bank's loan portfolio is performed based on the type of client, as follows: 'corporate' (which includes three sub-segments: small, medium and large), micro, entrepreneurs, public sector, financial institutions and private individuals (retail).

In line with the relevant decision of the Bank's Board of Directors, the Credit Committee is the decision-making body in charge of credit-related issues; this Committee renders decisions within limits defined per BoD decision on internal regulations of the Bank and carries out other activities, as stipulated by the Law and other regulations.

Once duly authorised by the BoD, the Executive Board of Addiko Bank, defines the rules for assigning specific credit responsibilities to specific parties, under the competences of the Bank's Credit Committee. The Bank's Executive Board authorises the Executive Board member in charge of risk management to render decisions on assigning specific credit-related responsibilities to employees within the limits below the competences of the Credit Committee, taking into account employee know-how, experience and performance.

The process of credit risk identification, assessment, measurement and management is conducted continuously and includes the Bank's total portfolio which is subject to credit risk.

Generally speaking, the process of credit risk management consists of three key components:

- directing and undertaking activities for the purpose of measuring, assuming, avoiding and dispersing risk,
- limiting risks, and
- risk supervising (measuring, monitoring and reporting).

In terms of measuring, directing and undertaking activities aiming to undertake, avoid and disperse risk, the Bank applies four approaches:

- Financial analysis of the client, analysis of the client's history with the Bank and other financial institutions, analysis of the latest loan application, analysis of the client's business model, business plans and projections and consequently the approval (undertaking) of associated credit risk;
- Regular presentations of the status of client's operations to the competent underwriter of said credit risk, at least on an annual basis, throughout the lifetime of the contract concluded between the Bank and the client.
- Regular monitoring of the client's activities, especially in the area of regular repayment of matured obligations, substantial change of the client's financial condition and rating;
- As necessary, restructuring of the client's obligations to the Bank and, consequently taking steps toward enforced collection, should restructuring fail.

The role of the Risk Control Department is to strategically manage risks of the Bank and also to identify, measure, assess, monitor and report on credit risk, both at the portfolio- and Bank-level. Within this Department, the Credit Risk Control Team monitors, measures and reports on credit risk locally and at the Group level and also defines reports in line with the specific needs of the end-users of said reports. The Risk Control Department is responsible for portfolio-level exposure to credit risk for the purpose of establishing large exposure aggregates, determining and monitoring the quality of the loan portfolio (structure per risk category, loan size and industry) as well as monitoring development/trends against prior periods.

Credit risk reports for the purpose of reporting to the Executive Board, Board of Directors and Audit Committee are drafted on at least a quarterly basis, while Group reports are prepared in line with the Group's specific requirements. The efficient management of credit risk, as well as timely and efficient decision-making process is ensured based on these reports.

The Risk Control Department also conducts the process of controlling and computing provisioning in accordance with the NBS regulations and calculations of expected credit loss (ECL), in line with IFRS 9, as per the methodology defined by the Bank.

The Risk Management Division covers the activities of assessing credit risks of performing clients and preventing the occurrence of new NPLs and managing the existing NPLs. The client segments for which this Division is responsible are 'corporate' clients, the public sector and financial institutions.

The Corporate Credit Department within the Corporate Risk Management Division actively participates in the preparation of loan applications and credit risk assessment per individual client, which includes an expert opinion or a 'vote' on each particular loan application (in favour, against or conditionally in favour) as well as in ongoing monitoring of client creditworthiness in accordance with NBS and Group requirements.

The Corporate Distressed Asset Management Department within the Corporate Risk Management Division performs the following activities:

1) Prevention of new non-performing loans through continuous analysis and monitoring of the changes in the loan portfolio within the Division's competence. Also, they conduct activities on implementing the early warning system

re credit risk increase and implementation and improvement of the corporate credit risk monitoring.

2) Active participation in the loan restructuring process in order to allow client recovery, in the enforced collection process and in other measures contributing to NPL collection and minimising additional risk costs.

The Retail Risk Management and Collection Division measures and monitors credit risk and performance of the retail portfolio (private individuals, SME, entrepreneurs and agricultural producers). The Division consists of two departments, one unit and two independent functions.

Within the Retail Collection Department two new units were formed – the Workout Unit and Arrears Management Unit. The Workout Unit processes clients with terminated loan contracts through instigation of court/out-of-court forced collection procedures, leaving the clients with a prior, voluntary debt settlement option. The Arrears Management Unit treats all clients and all exposures designated as belonging to the retail client segment in accordance with the Group's segmentation. All clients with liabilities one day past due are transferred to the remit of this unit and its activity primarily entails collection of the receivables past due.

The Retail Credit Department performs financial analyses and credit risk assessment for performing status clients (PL) from the micro business client segment (micro and small entities, entrepreneurs, agricultural producers) and private individuals.

The Retail Portfolio Management Department manages risks inherent in the retail portfolio based on the regular monitoring, quantitative and qualitative analyses of the loan portfolio, monitoring key risk indicators through constant optimisation of lending policies, products and processes in order to ensure the Bank's defined risk appetite.

The expert function within the Retail Risk Management and Collection Division deals with the prevention, detection, investigation of and credit fraud recovery. The main objective is fraud prevention in the process of loan approval as well as continuous monitoring of the loan portfolio, for fraud identification purposes. The function also covers the review of the lending process for the retail client segment aimed primarily at improvement of the loan life cycle through identification and assessment of actual and potential weaknesses and deficiencies.

The Bank's Risk Advisory Body monitors the Bank's exposure to the credit risk, exposure risk and risk of the borrower's country of origin and proposes measures for managing these risks to the Executive Board. Sessions of the Risk Advisory Body are held at least quarterly.

In line with its authorisations, the Risk Advisory Body discusses in its sessions, in terms of credit risk, inter alia, the structure of the loan portfolio of the Bank according to certain credit risk indicators at the Bank portfolio level and at the level of portfolio sub-segments, in respect of total credit risk exposure, aggregate allowance for impairment of balance sheet assets and provisions for losses per off-balance sheet items relative to the total portfolio, the aggregate exposure coverage by aggregate collateral obtained and per collateral type, the Bank's exposure to risk re the borrower's country of origin, etc.

The advisory body for monitoring corporate clients is responsible for monitoring the portfolio of clients within the competence of the business sector re the economy and the public sector. Matters discussed by this Body are reports on the condition and movement in the standard clients' portfolio, rendering decisions about WL classifications for clients who show early warning signs and rendering decisions on credit risk mitigation measures in connection with said clients. The Risk Advisory Body meets at least quarterly, and if required, more frequently.

4.1.1.1. Credit Risk Measurement and Impairment Provisioning Policy

Client Credit Rating System

The Bank performs credit risk assessment in compliance with uniform standards of Addiko Group, which is in line with both domestic statutory regulations and internal policies and procedures for client rating. The criteria for classification and rating of the Bank's clients are fully in accordance with the effective NBS Decision on Classification.

The assessment includes qualitative and quantitative risk assessment, i.e. overall financial analysis, creditworthiness evaluation and client credit rating.

The quantitative analysis is based on an assessment of the client's creditworthiness, which includes an analysis of the balance sheet structure, liquidity ratios, indebtedness, efficiency, profitability, cash flows, credit limits, and the assessment of client's future business in the upcoming period (for the duration of the loan term). The qualitative indicators are based on the assessment of development of the industry and sector the client operates in, assessment of applied accounting policies and assessment of strategic and economic factors characteristic for the client within the relevant industry.

Client credit rating is assessed upon the completion of a financial analysis, and based on certain criteria applied in the analysis. In addition, regular monthly recalculation of the client's internal credit rating is conducted based on the following information:

- days in arrears (days past due),
- external factors that may impact the deterioration of the client's financial situation, and
- any other external or internal information indicating a material increase in credit risk.

Classification of credit assets into the Bank's risk categories is conducted on the basis of internal credit ratings which are grouped and presented through the following 5 risk categories, for external reporting needs:

- 1A-1E: very low risk clients, with the best, excellent or very good credit ratings (best/excellent/very good creditworthiness);
- 2A-2E: clients with good or moderate credit ratings (good/good to moderate/moderate creditworthiness);
- 3A-3E: clients with medium to low credit ratings (acceptable/insufficient creditworthiness);
- 4A-4E (Watch List): clients with very low credit ratings or clients who are likely to default on their obligations. This category includes borrowers with past due receivables, unrecovered receivables or those who in the previous period have defaulted on their obligations or have experienced difficulties in repaying their debt in the previous period;
- 5A-5E (NPE-Default): clients who fulfil one or more of the aforementioned criteria, inter alia - if the past due interest or principle amount is materially significant and in arrears over 90 days, the Bank considers the creditworthiness of such clients as questionable, the loan restructuring process is applied which may lead to the restructuring of non-performing exposures (forborne exposures), realised credit losses or bankruptcy proceedings have been initiated.

Stages of Impairment and Significant Increase in Credit Risk

The Bank calculates expected credit losses in three varying stages in order to recognise the deterioration of credit quality in line with IFRS 9. For this reason, 12-month ECLs are calculated for Stage 1 assets while lifetime ECLs, are calculated for Stage 2 and Stage 3 assets.

Stage 1 commences at initial recognition of the financial asset, and at this time a 12-month ECL is recognised as a cost. For financial assets, interest income is calculated to the gross exposure. If there is no change in the credit quality of the financial instrument, the same treatment applies until final maturity.

Stage 2 - once significant deterioration of credit quality is established (increased credit risk), the financial asset is transferred to Stage 2 based on the previously defined criteria (as described in greater detail below). At this time, the lifetime ECL is calculated, resulting in a significant increase in allowance for impairment.

Detailed definition of Stage 2 in the regulatory process, i.e., determining significant deterioration in credit quality is executed based on the following criteria:

- the rate of credit risk increase is measured through relative and absolute PD inputs (individually for corporate and retail customers);
- over 30 days past due in a materially significant amount;
- forborne status;
- remaining exposures per loans greater than the value of the subject collateral (applicable only in terms of securing loans granted to private individuals).

Stage 3 occurs at the moment the credit quality of the financial asset deteriorates to the point where objective evidence of impairment is recognised, i.e. default status, Inclusion in Stage 3 is dependent on the following:

- the client is over 90 days past due, in a materially significant amount;
- the client's creditworthiness has been brought into question (significant doubt);
- restructuring due to deterioration in the customer's financial situation (forbearance);
- partial or total write-off of receivables;
- sale of a portion of or full receivable due to deterioration in the customer's financial situation; and
- insolvency/bankruptcy.

Lifetime ECLs are still recognised in this stage, while interest income is based on the net exposures (gross exposures less allowance for impairment).

The Bank applies the client-level assessment approach for these segments and has the same approach to corporate and retail clients (private individuals). If the liabilities of one type of client exposure are in default, then all other exposures i.e., the client's overall exposure is classified as default.

Forward-Looking Information

In line with IFRS 9, the Bank will categorise forward-looking information in its assessment on whether there has been a significant increase in the credit risk of a certain instrument since its initial recognition and take it into account when calculating ECL. The Bank has identified and documented key triggers of credit risk for each financial instrument portfolio, relying on the historical correlations between macroeconomic variables and credit risk. These key triggers include, among other factors, the following significant factors: unemployment rates, GDP growth rate, real estate prices and industrial manufacturing as well. All variables are included at the segment level, whenever reasonable and possible.

Forecasts of the movements of macroeconomic variables for the following years are received regularly from the Economic Research Team. These forecasts are created using internally and externally available data. Special attention is paid to checking and adjusting these data (if necessary) in order to ensure that these forecasts reflect the Bank's expectations for the upcoming period. This also involves defining of future scenarios with their corresponding probabilities, and in particular, the baseline, optimistic and pessimistic scenarios and the respective probabilities. Forecast values are consistently applied to all other relevant internal processes.

The table below presents the values for each scenario for the selected forward-looking information on future events used in assessing ECL at year end.

	Baseline scenario		Optimistic scenario	Pessimistic scenario
	Within 12 months (2018)	Remaining 2-year period	3-year period	3-year period
Real GDP growth (%)	3.0	3.0	4.0	1.0
Unemployment rate growth (average %)	15.4	14.7	13.9	16.9
Inflation rate (average %)	2.6	2.4	2.9	1.6

The optimistic scenario includes inputs taken for a mid-term growth period above the current trends, which decreases toward the potential growth over the last two observed years. The scenario takes into account historical experience and assumes adequate (monetary/fiscal) policy responses that assist the economy in moving toward a gradual slowdown to a long-term sustainable growth rate during the observed forecast period.

This scenarios also includes inflationary pressures triggered by somewhat greater demands, and a bigger drop in the unemployment rate towards its realistic level (structural unemployment).

The baseline scenario envisages the following: economic growth above trends, the shift from exporting toward consumers and investments and a looser fiscal policy help to reduce unemployment and enable faster salary growth. Favourable financing terms allow for sustainable recovery and resilience to risk (trade wars, (geo) political issues). The base case shall represent the most likely outcome.

The pessimistic scenario is a relatively controlled slowdown of economic growth up to two years, followed by a somewhat slower recovery pace in the upcoming years. This scenario takes into account historical experience and assumes appropriate (monetary/fiscal) policy responses that assist the economy in returning to a long-term, sustainable, if not somewhat weaker and more balanced growth rate in the envisaged period. In addition to the scenarios described above, other pessimistic (negative) scenarios are applied which allow the Bank to consider a wider range of possible outcomes for our loan portfolio.

Calculation of Expected Credit Losses

In order to assess impairment of financial assets that are measured at amortised cost or fair value through other comprehensive income, the Bank applies the ECL model.

Expected loss is defined as the difference between cash flows due to the Bank in accordance with the contractual terms of a financial instrument and the cash flows the Bank expects to receive (considering probabilities of default and expected recoveries). Although this requirement is introduced by IFRS 9, the standard does not prescribe detailed methods and techniques to be applied.

When establishing cash flows the Bank expects to receive, it applies the marginal loss approach, whereby the total expected loss is computed as the sum of marginal losses incurred at any moment, starting from the reporting date. Marginal losses arise from individual inputs used to estimate exposures and losses in the event of default and conditional probability of default for each period. The lifetime expected credit losses (lifetime ECL) are calculated separately for different scenarios taking into account current and forecast forward-looking information. The total expected credit losses under individual scenarios are eventually probability-weighted. The Bank considers three scenarios: the base line, optimistic and pessimistic scenarios and some less favourable scenarios are at times simulated in order to understand the dynamics and potential portfolio-specific risks.

Probability of default (PD) estimates are estimates at a certain date, which will be calculated based on statistical rating models and assessed. The applied segmentation in further steps is derived from the applied rating model as per the IFRS 9 Impairment Methodology - Banks - Private Individuals-Collateralised, Private Individuals-Uncollateralised, Corporate Clients

(Large, Medium, Small), Micro (entrepreneurs and agricultural producers segment), Countries, Local Administration, Project Financing, Banks and other. These statistical models take into consideration the internally available quantitative and qualitative data. Where it is available, market/external data may also be used as well (e.g. financial institutions and countries).

The Bank has opted for the indirect modelling approach. This means that the existing Basel II methodology was utilised as the starting point and adjusted in a manner fully harmonised with IFRS 9. This entails removal of any conservative elements from the model, inclusion of forward-looking information, as well as lifetime PD estimates.

Exposure at default (EAD) is an estimated exposure including the repayment of principal, interest, expected amounts to be drawn from lines of credit and letters of guarantee. EAD is the gross carrying value at the time of discounting to present value, as at the reporting date, using the effective interest rate. In situations when contracted maturities have not been defined, the quantitative and/or qualitative criteria will be applied to determine the structure of cash flows (e.g. frameworks). The applied credit conversion factor (CCF) for all relevant off-balance sheet exposures is 100%, except for performance bonds, revocable and irrevocable lines of credit, to which CCF ranging between 0% and 50% will be applied.

Loss given default (LGD) is an estimate of economic loss in the event of default. A simplified approach has been selected for the LGD parameter. The Bank utilises the expert-assessed aggregate value of LGD within ECL calculation under IFRS 9.

Loss given default (LGD) is an estimate of economic loss in the event of default. A simplified approach has been selected for the LGD parameter. The Bank uses the expert-assessed aggregate value of LGD within ECL calculation under IFRS 9. These values are adjusted internally and qualitative and/or qualitative verifications are carried out in order to ensure estimate adequacy.

For the purpose of determining PD and LGD parameters, statistical models have been applied, wherever possible and acceptable. These models are based on available historical and/or external market data. The methodologies are based on internally available credit risk modelling, adjusted in a manner that fully reflects IFRS 9 requirements.

Lifetime ECL is calculated separately for various scenarios, taking into account present and forecast information. Aggregation of the final ECL amount is conducted at the end of the process by applying the weighted average for each scenario individually. The Bank runs calculations for these three scenarios: base case, optimistic and pessimistic scenarios.

Establishing estimated credit losses and credit exposure impairment calls for staging of all exposures subject to credit risk in line with IFRS 9, as well as separation of those which are individually significant from those which are not individually significant in case of impaired credit risk exposures. The most significant criterion for determining which method is to be applied for estimating individual risk provisions is whether the aggregate amount of a particular exposure is individually significant or not.

An individually significant exposure is the total gross exposure of a group of related parties at the Bank level in excess of EUR 150,000 without reduction for collateral value.

The collective assessment method is applied to:

- Exposures which are in Stage 1 or Stage 2;
- Individually significant exposures which are in Stage 3ii but, based on the individual calculation, the amount of expected losses equals zero (e.g., expected collection of cash flows exceed receivables);
- Exposures which are insignificant (small values) in Stage 3.

The model applied to the collective assessment of impairment is based on the concept that allowance for impairment is calculated as a product of the exposure at default (EAD), probability of default (PD) and loss given default (LGD), whereby LGD is based on relevant characteristics such as time in default status, risk and product segments.

Individually determined allowance for impairment are those for which expected future cash flows are estimated and recognised for each individual exposure/client. This calculation takes into account repayments from:

- the client's main operating activity (primary cash flows),
- realised collateral, ancillary assets and assets not connected with the borrower's main activities (secondary cash flows).

Dependent on presumed loss scenario, expected recovery is estimated individually in terms of the amount and time required for recovery. Assumptions underlying each of the relevant scenarios, along with corresponding probabilities, are duly documented and reasonable on a case by case basis. For calculations referring to the recovery process through the sale of property-collateral, the Bank bases its assumptions on the market value of collateral. Impairment factors are measures on an individual basis and are dependent on the quality of collateral; this measurement is based on various factors such as marketability, location, time till realisation and the legal status of the subject property. The positive difference between exposures in default status and the present value of expected future cash flows represents the impairment amount of individually significant defaulting exposures.

The Bank's Detection of Default Status and Default Status Exit Policy envisages the terms which must be fulfilled as well as the period in which the client may be relieved of default status. Most commonly, the period in which a client must not default in settling liabilities is 3 months. Upon the expiry of this period, if the terms of reestablishment are met, the client is reassigned the initial rating (rating assigned according to most recent financial statements).

The Bank's policy for credit risk provisioning defines the framework for this area, while the process and responsibilities of calculating impairment are defined by the Provisioning Procedure, in line with IFRS 9.

To ensure continuous improvement of the applied credit risk model, in 2018 certain upgrades to the model were made, in the uncollateralised retail clients segment, which resulted in additional fine-tuning, among other things. Changes included in improving the model's quality are reflected in migration stability and improved efficiency, in particular. Additionally, macro models have been adjusted such that they are harmonised with validation results and new macroeconomic forecasts which are applied in order to reflect the latest available economic positions, through all segments.

Validation

The methodology and assumptions in computing the ECL are included in the internal validation process. This means that continual quality control is implemented on the models and methodologies and recommendations for their improvement are provided. The applied validation standards are formalised beforehand to secure the consistent assessment over time. Validation is usually conducted once per year.

The Bank differentiates between the initial and continual validations:

- Initial validation is conducted when a new model is developed, if there is a more significant change to the existing methodology and/or in the event of significant adjustments to values.
- Continued validation is the regular review of existing methodologies.

In addition to the annual process, a monthly monitoring process has been established to ensure that the changes in portfolio development and the model are timely identified.

Write-off of Receivables

Receivables are written off under decisions of the Bank's competent bodies in accordance with their scope of authority, if they are determined to be irrecoverable, as well as in accordance with NBS Decision on the Accounting Write-off of Bank Balance Sheet Assets (Official Gazette of RS, no. 77/2017). By transferring receivables from the balance sheet to the off-balance items, the Bank has not waived collection of receivables due from clients.

When the Bank no longer reasonably expects that a receivable will be recovered in full or partially, internal write-off ensues.

Write-off may be executed only against already recognised ECLs. The written-off amount may be full or partial write-off.

In addition to the overall derecognition criteria (see section Derecognition and Contract Modification), the mentioned criteria lead to the derecognition of financial assets:

- Unsecured financial assets if the borrower is subject to instigated bankruptcy proceedings;
- Unsecured financial assets if no payments have been made per said financial asset for a period of one year;
- Secured financial assets if no payments have been made in a specified period, dependent on the type of collateral;
  - A. Property as collateral, if no payments have been made in the past 5-year period
  - B. Moveable assets, if no payments have been made in the past 2-year period
  - C. Other, if no payments have been made for a period of one year;
- Financial assets that have undergone restructuring three or more times and the Bank has assessed that the borrower is unable to repay its obligations;
- Financial assets under which the right to settle receivables due from the borrower in a court or other procedures is terminated through approval of forced settlement;

According to NBS Decision on the Accounting Write-off of Bank Balance Sheet Assets (Official Gazette of RS, no. 77/2017), hereinafter: the Decision, the Bank is obligated to transfer to off-balance items, all NPLs when the computed amount of impairment thereof credited to the account of impairment allowance equals 100% of the gross carrying value. In 2018, the Bank transferred uncollectable receivables fully (100%) impaired to the off-balance items.

Collaterals

The Bank uses the following collaterals in its operations accepted when executing the loan contracts, aiming to protect the Bank from credit risk:

1) mortgages assigned over commercial and residential buildings and premises,
2) sureties of legal entities and private individuals,
3) pledge liens over moveable property,
4) pledge liens over securities,
5) bank and corporate guarantees,
6) earmarked deposits.

Factors affecting collateral value appraisal:

a) collateral holding period,

b) the most recent appraised value of collateral (as per internal or external appraisal),

c) net realisable value of collateral (net of taxes, fees and commissions).

To assess impairment for future cash flow from collateral realisation, the Bank assesses the value of collateral and time to collection. The haircut that the collateral value is reduced for represents the adjustment up to the amount recoverable in the process of collection from collateral foreclosure. The appraised collateral value is taken as reduced by the haircut (reduction includes a decreased estimated value of the marketable price and the cost of selling the collateral) to the level of exposure.

The Bank endeavours to reduce risk by obtaining collateral, wherever possible. Collateral value is usually determined upon establishment as well as annually, based on statistical data or once every three years through appraisal performed by an independent appraiser in instances of immovable assets (real estate) or movable assets, while some collateral types such as deposits or securities are revalued monthly.

Through voluntary sale, court and out-of-court enforcement as well as bankruptcy proceedings, the Bank sells collateral serving as security for NPLs. The method of sale depends on the client cooperation, client legal status and the collateral's legal status.

Maximum exposure to credit risk without taking collateral into account:

Total receivables RSD '000

	31 December 2018	31 December 2017
Cash and balances held with the Central Bank	11,174,771	10,575,958
Financial assets at fair value through profit and loss	705,600	101,474
Financial assets measured through OCI	10,402,924	16,189,952
Investment units	–	589,429
Total	**105,591,240**	**101,133,996**
Off-balance sheet items	20,040,103	14,340,508
Total exposure	**125,631,343**	**115,474,504**

Net Bank's receivables as at 31 December 2018 are shown in the following table:

RSD '000

31 December 2018	Performing exposures						Non-performing exposures				
	Exposure - Stage 1	Allowance for impairment (Stage 1)	Net exposure (Stage 1)	Exposure - Stage 2	Allowance for impairment (Stage 2)	Net exposure (Stage 2)	Exposure - Stage 3	Allowance for impairment (Stage 3)	Net exposure (Stage 3)	Total receivables	Total net exposure
Cash and balances held with the Central Bank	11,174,771	–	11,174,771	–	–	–	–	–	–	11,174,771	11,174,771
Financial assets at fair value through PL	705,600	–	705,600	–	–	–	–	–	–	705,600	705,600
Financial assets measured through OCI	10,402,924	–	10,402,924	–	–	–	–	–	–	10,402,924	10,402,924
Loans and receivables due from banks and other financial institutions	2,445,394	(3,238)	2,442,156	–	–	–	–	–	–	2,445,394	2,442,156
Loans and receivables due from customers	60,255,807	(694,312)	59,561,495	14,167,814	(2,653,384)	11,514,430	6,004,102	(4,078,172)	1,925,930	80,427,723	73,001,855
Other assets	358,426	(3,839)	354,587	2,780	(510)	2,270	73,622	(68,885)	4,737	434,828	361,594
Total	**85,342,922**	**(701,389)**	**84,641,533**	**14,170,594**	**(2,653,894)**	**11,516,700**	**6,077,724**	**(4,147,057)**	**1,930,667**	**105,591,240**	**98,088,900**
Off-balance sheet items	19,731,971	(64,752)	19,667,219	188,117	(2,771)	185,346	120,015	(38,099)	81,916	20,040,103	19,934,481
Total exposure	**105,074,893**	**(766,141)**	**104,308,752**	**14,358,711**	**(2,656,665)**	**11,702,046**	**6,197,739**	**(4,185,156)**	**2,012,583**	**125,631,343**	**118,023,381**

Net Bank's receivables as at 31 December 2017 are shown in the following table:

RSD '000

31 December 2017	Performing exposures	Allowance for impairment on performing receivables	Net exposure	Non-performing receivables	Allowance for impairment on non-performing receivables	Net exposure	Total receivables	Total net exposure
Cash and balances held with the Central Bank	10,575,958	–	10,575,958	–	–	–	10,575,958	10,575,958
Financial assets at fair value through PL	101,474	–	101,474	–	–	–	101,474	101,474
Financial assets measured through OCI	16,189,952	–	16,189,952	–	–	–	16,189,952	16,189,952
Investment units	589,429	–	589,429	–	–	–	589,429	589,429
Loans and receivables due from banks and other financial institutions	2,833,648	(5,607)	2,828,041	–	–	–	2,833,648	2,828,041
Loans and receivables due from customers	58,310,801	(1,059,847)	57,250,954	11,987,398	(7,598,775)	4,388,623	70,298,199	61,639,577
Other assets	474,956	(3,674)	471,283	70,380	(64,828)	5,551	545,336	476,834
Total	**89,076,218**	**(1,069,128)**	**88,007,091**	**12,057,778**	**(7,663,603)**	**4,394,174**	**101,133,996**	**92,401,265**
Off-balance sheet items	13,676,373	(39,116)	13,637,256	664,135	(6,098)	658,038	14,340,508	14,295,294
Total Exposure	**102,752,591**	**(1,108,244)**	**101,644,347**	**12,721,913**	**(7,669,701)**	**5,052,212**	**115,474,504**	**106,696,559**

Breakdown of receivables per rating and status

The following table shows financial instruments per rating class as at 31 December 2018:

Financial assets measured through OCI

RSD '000

31 December 2018	1A-1E	2A-2E	3A-3E	Watch List	Non-performing loans	Unrated clients	Total
Loans due from other banks and financial institutions	400,997	–	–	–	–	110,598	511,595
Loans due from state agencies and institutions	–	9,891,329	–	–	–	–	9,891,329
Total	**400,997**	**9,891,329**	**–**	**–**	**–**	**110,598**	**10,402,924**

Loans and receivables due from banks and other financial institutions

RSD '000

31 December 2018	1A-1E	2A-2E	3A-3E	Non-performing loans	Unrated clients	Total
Loans due from other banks and financial institutions	1,396,059	1,044,595	24	–	4,716	2,445,394
Total	**1,396,059**	**1,044,595**	**24**	**–**	**4,716**	**2,445,394**

Loans and receivables due from customers

RSD '000

31. decembar 2018. godine	1A-1E	2A-2E	3A-3E	Watch List	Non-performing loans	Unrated clients	Total
Loans due from private individuals	1,980,931	18,687,364	7,316,114	4,797,747	3,583,305	408,715	36,774,176
SME loans	127,683	6,872,449	13,965,678	124,199	134,696	–	21,224,705
Loans due from corporate clients	1,400,647	6,924,746	9,078,008	1,357,220	2,264,891	–	21,025,512
Loans due from state agencies and institutions		623,901	701,665	19,898		57,866	1,403,330
Total	**3,509,261**	**33,108,460**	**31,061,465**	**6,299,064**	**5,982,892**	**466,581**	**80,427,723**

Other assets

RSD ’000

31 December 2018	1A-1E	2A-2E	3A-3E	Watch List	Non-performing loans	Unrated clients	Total
Loans due from other banks and financial institutions	–	191,631	–	–	1,343	92,685	285,659
Loans due from private individuals	17	3,418	3,802	2,188	58,056	3,697	71,178
SME loans	2,403	2,406	2,787	123	5,485	1,708	14,912
Loans due from corporate clients	1	1,410	97	48	6,118	54,724	62,398
Loans due from state agencies and institutions	–	122	12	5	15	527	681
Total	**2,421**	**198,987**	**6,698**	**2,364**	**71,017**	**153,341**	**434,828**

The following table shows financial instruments per rating class as at 31 December 2017:

Financial assets measured through OCI

RSD ’000

31 December 2017	1A-1E	Total
Loans due from other banks and financial institutions	16,189,952	16,189,952
Total	**16,189,952**	**16,189,952**

Loans and receivables from banks and other financial institutions

RSD ’000

31 December 2017	1A-1E	2A-2E	3A-3E	Unrated clients	Total
Loans due from other banks and financial institutions	223,083	2,605,722	29	4,814	2,833,648
Total	**223,083**	**2,605,722**	**29**	**4,814**	**2,833,648**

Loans and receivables due from customers

RSD '000

31 December 2017	1A-1E	2A-2E	3A-3E	Watch List	Non-performing loans	Unrated clients	Total
Loans due from private individuals	2,044,125	14,765,275	6,191,670	4,898,552	6,363,935	204,969	34,468,526
SME loans	69,003	4,074,172	9,976,655	271,481	68,360	79,647	14,539,318
Loans due from corporate clients	–	7,093,311	5,515,392	57,966	5,377,488	–	18,044,157
Loans due from state agencies and institutions	–	1,841,054	1,341,234	–	63,910	–	3,246,198
Total	**2,113,128**	**27,773,812**	**23,024,951**	**5,227,999**	**11,873,693**	**284,616**	**70,298,199**

Other assets

RSD '000

31 December 2017	1A-1E	2A-2E	3A-3E	Watch List	Non-performing loans	Unrated clients	Total
Loans due from other banks and financial institutions	–	251,346	1	–	2	145,101	396,450
Loans due from private individuals	78	3,637	7,896	3,048	55,166	2,463	72,288
SME loans	26	1,657	2,890	236	1,588	2,051	8,448
Loans due from corporate clients	–	1,371	58	35	10,306	55,694	67,464
Loans due from state agencies and institutions	1	132	15	8	5	525	686
Total	**105**	**258,143**	**10,860**	**3,327**	**67,067**	**205,834**	**545,336**

Breakdown of receivables and allowance for impairment per rating class as at 31 December 2018 is shown in the following table:

Financial assets measured through OCI RSD '000

31 December 2018	STAGE1 Fair value
1A-1E	400,997
2A-2E	9,891,329
Unrated clients	110,598
Total	**10,402,924**

Loans and receivables due from banks and other financial institutions RSD '000

31 December 2018	STAGE1		
	Gross exposure	Allowance for impairment	Net exposure
1A-1E	1,396,059	(2,228)	1,393,831
2A-2E	1,044,595	(1,010)	1,043,585
3A-3E	24	–	24
Unrated clients	4,716	–	4,716
Total	**2,445,394**	**(3,238)**	**2,442,156**

Loans and receivables due from customers RSD '000

31 December 2018	Gross exposure	Allowance for impairment STAGE1	STAGE2	STAGE3	Net exposure
1A-1E	3,509,261	(5,133)	(138,289)	–	3,365,839
2A-2E	33,108,460	(252,922)	(661,860)	–	32,193,678
3A-3E	31,061,465	(376,239)	(616,078)	(7,326)	30,061,822
Watch List	6,299,064	(44,037)	(1,224,209)	(46,243)	4,984,575
Non-performing loans	5,982,892	(89)	(12,949)	(4,024,602)	1,945,252
Unrated clients	466,581	(15,892)	–	–	450,689
Total	**80,427,723**	**(694,312)**	**(2,653,385)**	**(4,078,171)**	**73,001,855**

Other assets RSD '000

31 December 2018	Gross exposure	Allowance for impairment STAGE1	STAGE2	STAGE3	Net exposure
1A-1E	2,421	(43)	–	–	2,378
2A-2E	198,987	(1,202)	(13)	(260)	197,512
3A-3E	6,698	(149)	(148)	(1,020)	5,381
Watch List	2,364	(33)	(347)	(89)	1,895
Non-performing loans	71,017	–	(2)	(65,516)	5,499
Unrated clients	153,341	(2,412)	–	(2,000)	148,929
Total	**434,828**	**(3,839)**	**(510)**	**(68,885)**	**361,594**

Breakdown of receivables and allowance for impairment per rating class as at 31 December 2017 is shown in the following table:

Loans and receivables due from banks and other financial institutions RSD '000

	PRP		
31 December 2017	Gross exposure	Allowance for impairment	Net exposure
1A-1E	223,083	(8)	223,075
2A-2E	2,605,722	(5,599)	2,600,123
3A-3E	29	–	29
No rating	4,814	–	4,814
Total	**2,833,648**	**(5,607)**	**2,828,041**

Loans and receivables due from customers RSD '000

31 December 2017	Gross exposure	Allowance for impairment PRP	SRP	Net exposure
1A-1E	2,113,128	(51,439)	–	2,061,689
2A-2E	27,773,812	(470,348)	(48)	27,303,416
3A-3E	23,024,951	(379,891)	(1,683)	22,643,377
Watch list	5,227,999	(146,629)	(86,106)	4,995,264
NPE	11,873,693	–	(7,510,938)	4,362,755
No rating	284,616	(11,540)	–	273,076
Total	**70,298,199**	**(1,059,847)**	**(7,598,775)**	**61,639,577**

Other assets RSD ’000

31 December 2017	Gross exposure	Allowance for impairment PRP	Allowance for impairment SRP	Net exposure
1A-1E	105	(3)	–	102
2A-2E	258,143	(1,064)	(258)	256,821
3A-3E	10,860	(324)	(758)	9,778
Watch list	3,327	(111)	(156)	3,060
Non-performing loans	67,067	–	(62,119)	4,948
Unrated clients	205,834	(2,172)	(1,537)	202,125
Total	**545,336**	**(3,674)**	**(64,828)**	**476,834**

In 2018, no assets were acquired through collateral foreclosure that would be recorded in the Bank’s business books.

Exposure per geographic area, region and industry

The following table shows the distribution of the amounts of financial instruments with allowance for impairment per geographic areas and regions as at 31 December 2018 and 31 December 2017, respectively.

The Bank’s loan portfolio focuses on the EU and Serbia, which is shown in the following table:

Financial assets measured through OCI RSD ’000

	12.31.2018.	12.31.2017.
Serbia	9,891,329	15,427,929
European Union	511,595	1,351,452
Total	**10,402,924**	**16,779,381**

Loans and receivables due from banks and other financial institutions RSD ’000

	12.31.2018.	12.31.2017.
Belgrade	962,987	1,693,741
European Union	1,202,886	310,592
Rest of the world	279,521	829,315
Less: allowance for impairment	(3,238)	(5,607)
Total	**2,442,156**	**2,828,041**

Loans and receivables due from customers RSD ’000

	12.31.2018.	12.31.2017.
Belgrade	47,864,830	44,970,921
Vojvodina	16,977,267	13,833,203
Central and Southern Serbia	14,741,467	11,275,890
Other countries	–	–
European Union	41,936	104,475
Rest of the world	802,223	113,710
Less: allowance for impairment	(7,425,868)	(8,658,622)
Total	**73,001,855**	**61,639,577**

Other assets RSD '000

	12.31.2018.	12.31.2017.
Belgrade	217,456	287,413
Vojvodina	5,080	5,204
Central and Southern Serbia	17,789	19,014
Other countries	–	–
European Union	141,409	184,322
Rest of the world	53,094	49,383
Less: allowance for impairment	(73,234)	(68,502)
Total	**361,594**	**476,834**

The following table shows the distribution of gross amounts of financial instruments per geographic areas and branches of industry as at 31 December 2018:

Financial assets measured through OCI RSD '000

31 December 2018	Serbia	European Union	Total exposure
Financial institutions	9,891,329	511,595	10,402,924
Total	**9,891,329**	**511,595**	**10,402,924**

Loans and receivables due from banks and other financial institutions RSD '000

31 December 2018	Serbia	Europe	Rest of the world	Total
Financial institutions	945,564	1,202,886	279,521	2,427,971
Services	17,423			17,423
Total	**962,987**	**1,202,886**	**279,521**	**2,445,394**

Loans and receivables due from customers RSD '000

31 December 2018	Serbia	Europe	Rest of the world	Total
State (government)	472,527			472,527
Private individuals	35,965,008	41,936	74,640	36,081,584
Trade	11,290,900	–	–	11,290,900
Construction industry	4,674,125	–	–	4,674,125
Manufacturing and oil industry	15,734,733	–	–	15,734,733
Services	11,446,271	–	727,583	12,173,854
Total	**79,583,564**	**41,936**	**802,223**	**80,427,723**

Other assets RSD '000

31 December 2018	Serbia	European Union	Rest of the world	Total exposure
State (government)	128	76	28	232
Financial institutions	106,953	62,932	23,629	193,514
Private individuals	25,381	14,934	5,607	45,922
Construction industry	2,382	1,402	526	4,310
Manufacturing and oil industry	5,284	3,109	1,168	9,561
Trade	8,108	4,771	1,791	14,670
Services	92,089	54,185	20,345	166,619
Total	**240,325**	**141,409**	**53,094**	**434,828**

The following table shows the distribution of gross amounts of loans and receivables per geographic areas and branches of industry as at 31 December 2017:

Financial assets measured through OCI RSD '000

31 December 2017	Serbia	European Union	Total exposure
Financial institutions	15.427.929	1.351.452	16.779.381
Total	**15.427.929**	**1.351.452**	**16.779.381**

Loans and receivables due from banks and other financial institutions RSD '000

31 December 2017	Serbia	Europe	Rest of the world	Total
Financial institutions	1,653,500	310,592	829,315	2,793,407
Services	40,241	–	–	40,241
Total	**1,693,741**	**310,592**	**829,315**	**2,833,648**

Loans and receivables due from customers RSD '000

31 December 2017	Serbia	Europe	Rest of the world	Total
State (government)	530,143	–	–	530,143
Private individuals	32,983,244	104,475	113,710	33,201,429
Trade	7,995,570	–	–	7,995,570
Construction industry	2,775,166	–	–	2,775,166
Manufacturing and oil industry	10,113,404	–	–	10,113,404
Services	15,682,487	–	–	15,682,487
Total	**70,080,014**	**104,475**	**113,710**	**70,298,199**

Other assets RSD '000

31 December 2017	Serbia	European Union	Rest of the world	Total exposure
Financial institutions	143,579	85,119	22,804	251,502
Country	11	6	2	19
Private individuals	27,015	16,016	4,291	47,322
Trade	7,668	4,546	1,218	13,432
Construction industry	1,812	1,074	288	3,174
Manufacturing and oil industry	7,094	4,206	1,127	12,427
Services	**124,452**	**73,355**	**19,653**	**217,460**
Total	**311,631**	**184,322**	**49,383**	**545,336**

Exposure intervals

The following table shows the distribution of gross amounts of loans and receivables per exposure intervals as at 31 December 2018 and 31 December 17, respectively:

As at 31 December 2018, maximum - approx. 28% (31 December 2017: 25%) gross amount of loans and receivables due from clients was in intervals of RSD 1,000 - 5,000 thousand.

31 December 2018 RSD '000

Exposure intervals (In RSD 000)	Financial assets measured through OCI	Loans and receivables from banks and other financial institutions	Loans and receivables due from clients	Other assets	Total
< 1,000	**511,595**	**24**	**5,701,704**	**51,909**	**6,265,232**
1,000- 5,000	**–**	**10,490**	**22,634,586**	**22,122**	**22,667,198**
5,000 - 10,000	9,891,329	–	5,573,992	–	15,465,321
10,000- 25,000	–	35,341	5,029,053	50,311	5,114,705
25,000 - 50,000	–	80,574	3,549,442	98,210	3,728,226
50,000 - 100,000	**–**	**–**	**5,108,985**	**212,276**	**5,321,261**
100,000 - 500,000	**–**	**276,898**	**14,228,540**	**–**	**14,505,438**
500,000 - 1,000,000	**–**	**2,042,067**	**12,409,438**	**–**	**14,451,505**
>1,000,000	**–**	**–**	**6,191,983**	**–**	**6,191,983**
Total	**10,402,924**	**2,445,394**	**80,427,723**	**434,828**	**93,710,869**

31 December 2017 RSD '000

Exposure time intervals (In RSD 000)	Financial assets measured through OCI	Loans and receivables from banks and other financial institutions	Loans and receivables due from clients	Other assets	Total
< 1,000	**–**	**485**	**5,325,672**	**53,335**	**5,379,492**
1,000- 5,000	**1,351,452**	**8,638**	**17,690,835**	**19,036**	**19,069,961**
5,000 - 10,000	–	6,659	6,725,550	6,312	6,738,521
10,000- 25,000	15,427,929	11,540	5,880,825	67,739	21,388,033
25,000 - 50,000	–	35,518	3,605,507	68,664	3,709,689
50,000 - 100,000	**–**	**161,425**	**3,839,188**	**53,743**	**4,054,356**
100,000 - 500,000	**–**	**121,636**	**9,167,359**	**276,507**	**9,565,502**
500,000 - 1,000,000	**–**	**2,487,747**	**8,810,679**	**–**	**11,298,426**
>1,000,000	**–**	**–**	**9,252,584**	**–**	**9,252,584**
Total	**16,779,381**	**2,833,648**	**70,298,199**	**545,336**	**90,456,564**

The table below shows the movement of total exposures according to type of financial instrument for 2018:

Financial assets measured through OCI RSD '000

	Stage 1	Total
Opening balance as at 1 January 2018	**16,779,381**	**16,779,381**
Transfer to Stage 1	–	–
Transfer to Stage 2	–	–
Transfer to Stage 3	–	–
New production	1,896,014	1,896,014
Collection	(8,303,503)	(8,303,503)
Transfer to off-balance sheet items	–	–
Sale/assignment of receivables	–	–
Foreign exchange gains/losses	31,032	31,032
Balance - 31 December 2018	**10,402,924**	**10,402,924**

Loans and receivables due from banks and other financial institutions RSD '000

	Stage 1	Total
Opening balance as at 1 January 2018	**2,833,648**	**2,833,648**
Transfer to Stage 1	–	–
Transfer to Stage 2	–	–
Transfer to Stage 3	–	–
New production	1,107,735,450	1,107,735,450
Collection	(1,108,123,687)	(1,108,123,687)
Transfer to off-balance sheet items	–	–
Sale/assignment of receivables	–	–
Foreign exchange gains/losses	(17)	(17)
Balance - 31 December 2018	**2,445,394**	**2,445,394**

Loans and receivables due from clients RSD '000

	Stage 1	Stage 2	Stage 3	Total
Opening balance at 1 January 2018	**51,961,737**	**6,349,063**	**11,987,399**	**70,298,199**
Transfer to Stage 1	1,058,042	(1,012,820)	(45,222)	–
Transfer to Stage 2	(9,597,232)	10,954,711	(1,357,479)	–
Transfer to Stage 3	(370,708)	(381,720)	752,428	–
New production	41,458,307	–	–	41,458,307
Increase of receivables in the existing portfolio		80,284	1,821,657	1,901,941
Collection	(24,356,476)	(1,875,883)	(2,308,880)	(28,541,239)
Transfer to off-balance sheet items	–	–	(4,518,821)	(4,518,821)
Sale/assignment of receivables	–	–	(497,443)	(497,443)
Foreign exchange gains/losses	102,137	54,179	170,463	326,779
Balance - 31 December 2018	**60,255,807**	**14,167,814**	**6,004,102**	**80,427,723**

Other assets RSD '000

	Stage 1	Stage 2	Stage 3	Total
Opening balance at 1 January 2018	**471,788**	**3,168**	**70,380**	**545,336**
Transfer to Stage 1	–	–	–	–
Transfer to Stage 2	–	–	–	–
Transfer to Stage 3	–	–	–	–
New production	178,562	2,780	73,622	254,964
Collection	(291,924)	(3,168)	(70,380)	(365,472)
Transfer to off-balance sheet items	–	–	–	–
Sale/assignment of receivables	–	–	–	–
Foreign exchange gains/losses	–	–	–	–
Balance - 31 December 2018	358,426	2,780	73,622	434,828

Exposure and collateral

The following tables show the distribution of internally accepted collateral values, the level of market value of collateral the Bank recognises per its internal methodology to the level of exposure for the needs of exposure coverage as at 31 December 2018 and 31 December 17, respectively:

Collateral amount RSD '000

	12.31.2018.	12.31.2017.
Mortgages	14,717,139	19,005,674
- residential property	7,816,024	10,481,748
- commercial property	4,029,494	4,930,322
- land and other	2,871,621	3,593,604
Pledges on equipment, machinery and other movable assets	737,484	1,121,372
Other	767,922	3,072,954
Total	**16,222,545**	**23,200,000**

Loans and receivables due from banks and other financial institutions RSD '000

	31 December 2018		31 December 2017	
	Exposure	Collateral amount	Exposure	Amount Collateral
1A-1E	1,396,059	–	223,083	–
2A-2E	1,044,595	2,405	2,605,722	8,552
3A-3E	24	–	29	–
Unrated clients	4,716	–	4,814	–
Total	**2,445,394**	**2,405**	**2,833,648**	**8,552**

Loans and receivables due from clients RSD '000

	31 December 2018		31 December 2017	
	Exposure	Amount Collateral	Exposure	Amount Collateral
1A-1E	3,509,261	1,442,030	2,113,128	1,046,797
2A-2E	33,108,460	5,705,381	27,773,812	6,836,007
3A-3E	31,061,465	5,447,157	23,024,951	7,955,944
Watch list	6,299,064	2,131,578	5,227,999	2,089,202
Non-performing loans	5,982,892	1,493,994	11,873,693	5,263,498
Unrated clients	466,581	–	284,616	–
Total	**80,427,723**	**16,220,140**	**70,298,199**	**23,191,448**

Loans and receivables due from banks and other financial institutions RSD '000

	31 December 2018		31 December 2017	
	Exposure	Amount Collateral	Exposure	Amount Collateral
Up to 30 days past due	2,445,394	2,405	2,833,648	8,552
Total	**2,445,394**	**2,405**	**2,833,648**	**8,552**

Loans and receivables due from clients RSD '000

	31 December 2018		31 December 2017	
	Exposure	Amount Collateral	Exposure	Amount Collateral
Up to 30 days past due	75,646,342	15,039,708	62,264,076	20,349,990
31 to 60 days past due	**247,420**	**90,922**	**222,994**	**53,777**
61 to 90 days past due	**145,957**	**35,464**	**240,684**	**76,731**
91 to 180 days past due	**315,354**	**98,272**	**1,028,768**	**565,811**
181 to 365 days past due	**495,019**	**103,695**	**1,092,649**	**273,982**
Over 365 days past due	**3,577,631**	**852,079**	**5,449,028**	**1,871,157**
Total	**80,427,723**	**16,220,140**	**70,298,199**	**23,191,448**

Forbearance

A forborne asset is considered an asset, or client unable to adhere to the repayment schedule and terms of the contract due to financial difficulties. Due to newly arisen financial difficulties, the Bank may decide to extend the schedule and terms of the contract, to give the client the opportunity to repay the debt and to refinance the contract, in full or partially.

a) The amendments to the contractual terms and schedule which the client is unable to comply with due to financial difficulties and which are approved as a result of the client's new situation;
b) Total or partial refinancing of non-performing contracts, which would not be approved were the client not experiencing financial difficulties.

In this regard, the following are possibilities:

An exposure will not be considered a forborne asset if the client is not experiencing financial difficulties.

Forbearance and risks are regularly monitored by operational units responsible for the risk management of loans granted to corporates and retail clients. Additionally, forbearance is a trigger indicating the need to conduct impairment testing in line with IFRS 9 requirements.

The Bank's analysis of the impact caused by modification to Forbearance measures did not have a financially significant effect on the total results for 2018.

The following table provides an overview of the Bank's forborne receivables for 2018 and 2017, respectively:

RSD '000

	Opening balance 1 January 2018	Receivables which have become forborne or the forbearance measure has been extended (+)	Receivables which have not become forborne or the forbearance measure is no longer valid (-)	Adjustments due to IFRS 5 (+/-)	Loans and FX (+/-)	Other adjustments (+/-)	Closing balance as at 31 December 2018
National Bank of Serbia	–	–	–	–	–	–	–
State and other related parties	–	–	–	–	–	–	–
Lending institutions	–	–	–	–	–	–	–
Financial corporations	–	–	–	–	–	–	–
Loans due from non-financial corporations	3,285,596	66,845	(1,243,168)	–	–	–	2,109,273
Loans due from private individuals	1,522,343	220,013	(510,631)	–	–	–	1,231,725
Loans and receivables - balance sheet assets	**4,807,939**	**286,858**	**(1,753,799)**	**–**	**–**	**–**	**3,340,998**
Off-balance sheet items	**704**	**–**	**(109)**	**–**	**–**	**–**	**595**

RSD '000

	Balance - 31 December 2018	Receivables that are not in default/ impaired	Receivables that are not in default/ impaired (> 0 days)	Impaired receivables	Interest income for forborne receivables (+)
National Bank of Serbia	–	–	–	–	–
Lending institutions	–	–	–	–	–
Financial corporations	–	–	–	–	–
Loans due from non-financial corporations	2,109,273	1,104,444	–	1,004,829	52,259
Loans due from private individuals	1,231,725	391,139	10,982	829,604	5,734
Loans and receivables - balance sheet assets	**3,340,998**	**1,495,583**	**10,982**	**1,834,433**	**57,993**

RSD '000

	Opening balance 1 January 2017	Receivables which have become forbearance or the forbearance measure has been extended (+)	Receivables which have not become forbearance or the forbearance measure is no longer valid (-)	Adjustments due to IFRS 5 (+/-)	Loans and FX (+/-)	Other adjustments (+/-)	Closing balance as at 31 December 2017
National Bank of Serbia	–	–	–	–	–	–	–
State and other related parties	–	–	–	–	–	–	–
Lending institutions	–	–	–	–	–	–	–
Financial corporations	–	–	–	–	–	–	–
Loans due from non-financial corporations	6,987,682	136,860	(3,802,396)	–	–	–	3,322,146
Loans due from private individuals	1,677,980	201,017	(342,589)	–	–	–	1,536,408
Loans and receivables - balance sheet assets	**8,665,662**	**337,877**	**(4,144,985)**	**–**	**–**	**–**	**4,858,554**
Off-balance sheet items	**1,363**	**–**	**(659)**	**–**	**–**	**–**	**704**

RSD '000

	Balance - 31 December 2017	Receivables that are not in default/ impaired	Receivables that are not in default/ impaired (> 0 days)	Impaired receivables	Interest income for forborne receivables (+)
National Bank of Serbia	–	–	–	–	–
Lending institutions	–	–	–	–	–
Financial corporations	–	–	–	–	–
Loans due from non-financial corporations	3,322,146	198,547	25,050	3,098,549	72,332
Loans due from private individuals	1,536,408	537,290	15,166	983,952	23,407
Loans and receivables - balance sheet assets	**4,858,554**	**735,837**	**40,216**	**4,082,501**	**95,739**

Review of Non-Performing Receivables in Total Receivables

SThe following table shows exposures in default (NPE) and the level of coverage (Coverage 1 takes into account the values in Stage 3, while Coverage 2 also takes into account collateral value) in line with the internal segmentation, as at 31 December 2018:

Loans and receivables from clients

RSD '000

31 December 2018	Exposure	Non-performing loans (Stage 3)	Allowance for impairment on non-performing exposures	Collateral (NPE)	NPE ratio	Coverage 1	Coverage 2
Loans due from private individuals	36,774,176	3,604,515	2,784,150	1,125,840	9.80%	77.24%	108.47%
SME loans	21,224,703	134,696	101,023	29,233	0.63%	75.00%	96.70%
Loans due from corporate clients	21,025,512	2,264,891	1,192,999	335,201	10.77%	52.67%	67.47%
Loans due from state agencies and institutions	1,403,332	–	–	–	–	–	–
Total	**80,427,723**	**6,004,102**	**4,078,172**	**1,490,274**	**7.47%**	**67.92%**	**92.74%**

RSD '000

31 December 2017	Exposure	Non-performing loans (Stage 3)	Allowance for impairment on non-performing exposures	Collateral (NPE)	NPE ratio	Coverage 1	Coverage 2
Loans due from private individuals	34,468,526	6,477,640	4,953,992	2,415,051	18.79%	76.48%	113.76%
SME loans	14,539,318	68,360	39,634	24,235	0.47%	57.98%	93.43%
Loans due from corporate clients	18,044,157	5,377,488	2,547,545	2,842,989	29.80%	47.37%	100.24%
Loans due from state agencies and institutions	3,246,198	63,910	57,604	6,313	1.97%	90.13%	100.01%
Total	**70,298,199**	**11,987,398**	**7,598,775**	**5,288,588**	**17.05%**	**63.39%**	**107.51%**

A decrease in coverage was significantly conditioned by the continuous reduction of default exposures (unsettled liabilities) through the sale of the portfolio and intensified collection and recovery activities, and recognising excluded (suspended) interest as additional exposures in default, and fully covered allowance for impairment, tied to the process of IFRS 9 implementation.

4.1.1.3. The Credit Risk Reporting Process

Reporting for Local Purposes

The Credit Risk Control Team reports to the Executive Board and other Bank's bodies on credit risk at the Bank's portfolio level at least quarterly through delivery of materials presented at the Risk Advisory Body sessions.

This materials provide an analysis of the existing total credit portfolio and development dynamics over previous quarters and per various bases, as well as a review of the risk of certain forms of exposure relevant to current operations and control over total credit risk.

The underlying purpose of the analyses presented is to provide an overview of the Bank's exposure relating to its balance sheet and off-balance sheet items as at the last day of the reporting month, corresponding relevant positions and indicators (provisions, ratio of provisions and exposure, number of clients, etc.), as well as their dynamics and development in comparison to previous reporting periods.

On a quarterly basis, the Board of Directors receives a risk management report, the format and contents of which are standardised. In the part related to credit risk, this report includes various overviews and aspects of measurement, assessment and monitoring of credit risk in the context of credit risk exposure, portfolio quality per various criteria, as well as influence on the Bank's equity (having in mind Group ICAAP methodology).

Reporting to the Group

The Credit Risk Control Team reports to the Group on a monthly basis through delivery of Key Risk Indicators – KRI Report, used to prepare material for the monthly conference call with the Group's CRO and CRO team members, re the previous month's portfolio movements.

The same report provides information re loan monitoring and reporting to the Bank's Risk Advisory Body, Board of Directors and Audit Committee.

4.1.2. Market Risks

Within market risks, the Bank is exposed to foreign exchange risks, interest rate risk arising from the Banking Book and interest rate risk arising from debt securities (in line with the Group's standards, this risk is considered interest rate risk arising from the Trading Book) and equity securities (in line with the Group's standards, this risk is considered equity price risk). Additionally, in accordance with the Group's standards, the Bank also recognises credit spread risk, which matches specific equity price risk from the perspective of local regulations.

Market risks consists of contingent losses arising from equity price fluctuations on the market. The Bank has defined a market risk structure based on various factors: interest rate, interest spread, FX risk and securities investment risk. The Bank, in particular, focuses on identification, measurement, analysis and management of market risks. Market risks can be a result of securities (and similar products), cash and products in FX, derivatives, hedging exchange rate and hedging results, assets similar to the principal or they can also arise from the management of assets and capital/liabilities. In addition to market risks, market liquidity risks may occur if, in the event of poor demand, the Bank is unable to sell its trading positions in liquidity bottlenecks (or due to demands relative to risk based set-offs) within a short period of time. They are taken into account for the existing positions, as part of market risk related limitations.

4.1.2.2. Measurement of Market Risks

In addition to the standard definition and measurement prescribed by the National Bank of Serbia, being a member of Addiko Group, the Bank also measures exposure to market risks (FX, as well as by applying the value-at-risk method), 1-day, with a confidence interval of 99%. The main instrument used for this process is the Monte Carlo simulation which includes exponentially weighted volatility and correlation over a time horizon of 250 days. In order to determine available economic capital for market risks and calculate the ability to assume risk, VaR values are adjusted to a unique level of confidence of 99.9% and a time horizon of 250 days. The models are used to calculate contingent losses, taking into account historical market fluctuation (volatility) and market context (correlation).

4.1.2.3. Summary of Market Risk

4.1.2.3.1. Foreign Exchange Risk

Through various policies, procedures and working instruction manuals, the Risk Control Department defines all activities re controlling FX risks.

General activities which refer to the management of FX risk are as follows:

- Identification,
- Measurement,
- Control,
- Monitoring and
- Reporting.

FX risk is the possible occurrence of negative effects on the Bank's financial result and equity due to exchange rate fluctuations. The Bank is exposed to this risk based on positions maintained on the Bank's Banking Book and Trading Book.

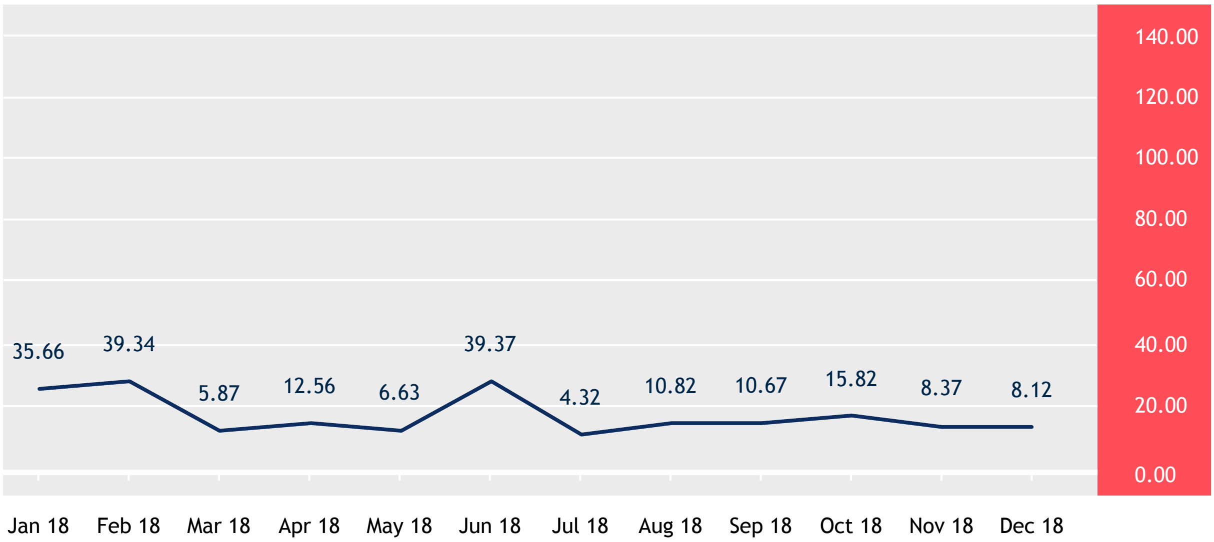
The FX risk ratio is monitored as a ratio between the net open FX position and the Bank's equity. The FX risk ratio is calculated in accordance with the NBS Decision governing the capital adequacy of banks. The Bank maintains the ratio between assets and liabilities in a manner ensuring that its total net open FX position at the end of each business day does not exceed the level set out in corresponding regulations.

The Accounting and Reporting Department calculates on a daily basis the total net open position and the Bank's FX risk ratio, in accordance with the NBS Decision governing the capital adequacy of banks.

Based on the Bank's net open position determined in this manner, the Risk Control Department, in collaboration with Addiko Group and its methodology and tools, to calculate daily the VaR for open FX positions, calculated per the J.P. Morgan - Geometric StDev - Monte Carlo methodology, with a confidence interval of 99% and time horizon of 1 day, which must be within internally prescribed limits. As at 31 December 2018, VaR (99%, 1 day) for the open FX position was EUR 8.1 thousand, i.e. RSD 958 thousand, and was significantly below the EUR 130 thousand, i.e. RSD 15.4 thousand limit.

The table below shows a summary of VaR (99%, 1 day) for the open FX position in 2018.

Open FX Position - VaR (99%, 1 day) EUR 000



In addition to Addiko Group's standardised scenarios which refer to the conversion of the EUR, at least once per month, the Bank runs a stress test scenario whose purpose is to estimate potential effects on the value of the local currency in fluctuations of +/-5 or +/-10 in the income statement and the financial results of the Bank prior to taxation.

In a scenario where the Bank's existing open FX position (with other variables held constant) as at 31 December 2018 there was a decrease/increase in the local currency (RSD depreciation/appreciation) by 5%/10% against the EUR, USD CHF and all other currencies, effects on the income statement before tax would be positive/negative by approx. RSD 16.4 million and RSD 32.8 million respectively, mainly due to calculated FX gains/losses arising from foreign currency denominated receivables and obligations.

The following analysis calculates the results of reasonably possible movements of exchange rates against the RSD, with other variables held constant.

Currency	Exchange rate fluctuations in 2018 (%)	Effect on the income statement before tax 2018 in RSD 000	Exchange rate fluctuations in 2017 (%)	Effect on the income statement before tax 2017 in RSD 000
EUR	+5%	10,249	+5%	(5,019)
CHF	+5%	5,274	+5%	30,345
USD	+5%	22	+5%	(27)
Other currencies	**+5%**	**838**	**+5%**	**515**

Currency	Exchange rate fluctuations in 2018	Effect on the income statement before tax 2018 in RSD 000	Exchange rate fluctuations in 2017	Effect on the income statement before tax 2017 in RSD 000
EUR	-5%	(10,249)	-5%	5,019
CHF	-5%	(5,274)	-5%	(30,345)
USD	-5%	(22)	-5%	27
Other currencies	**-5%**	**(838)**	**-5%**	**(515)**

Currency	Exchange rate fluctuations in 2018	Effect on the income statement before tax 2018 in RSD 000	Exchange rate fluctuations in 2017	Effect on the income statement before tax 2017 in RSD 000
EUR	+10%	20,498	+10%	(10,039)
CHF	+10%	10,547	+10%	60,691
USD	+10%	44	+10%	(55)
Other currencies	**+10%**	**1,676**	**+10%**	**1,030**

Currency	Exchange rate fluctuations in 2018	Effect on the income statement before tax 2018 in RSD 000	Exchange rate fluctuations in 2017	Effect on the income statement before tax 2017 in RSD 000
EUR	-10%	(20,498)	-10%	10,039
CHF	-10%	(10,547)	-10%	(60,691)
USD	-10%	(44)	-10%	55
Other currencies	**-10%**	**(1,676)**	**-10%**	**(1,030)**

** The tables above show exchange rate fluctuations of +5%/+10% (RSD depreciation) and exchange rate fluctuations of -5%/-10% (RSD appreciation) and their effects on the income statement before taxation.*

The Risk Control Department performs said stress test on a monthly basis and reports to the Assets and Liabilities Management Committee (ALCO) on the results, in accordance with the schedule of the Committee's sessions.

Possible exchange rate fluctuations against the RSD (with other variables held constant) on equity from the perspective of the Bank's foreign FX risk ratio, which is determined pursuant to the Decision on the Capital Adequacy of Banks, is provided in the following table:

Exchange rate fluctuations in 2018	Bank's foreign exchange risk ratio at 31 December 2018 after fluctuations in exchange rates in 2018 (equity %).	Exchange rate fluctuations in 2017	Bank's foreign exchange risk ratio as at 31 December 2017 after fluctuations in exchange rates in 2017 (equity %).
+5%	2.6	+5%	4.5
-5%	2.3	-5%	4.1
+10%	2.7	+10%	4.8
-10%	**2.2**	**-10%**	**3.9**

* *The table above shows exchange rate fluctuations of +5%/+10% (RSD depreciation) and exchange rate fluctuations of -5%/-10% (RSD appreciation) and their effect on equity from the perspective of the Bank's FX risk ratio determined pursuant to the Decision on the Capital Adequacy of Banks.*

The assumptions used to calculate the sensitivity analysis scenario in 2018 for the income statement before tax and capital are the same as the assumptions applied in sensitivity analysis scenario for 2017.

In order to protect itself against FX risk, the Bank executes derivative agreements and loan contracts with a foreign currency clause index.

The currency structure of financial instruments as at 31 December 2018 is provided in the table below. Financial assets with a contracted currency clause index are included in the appropriate FX position to which a particular receivable is connected.

RSD '000

Assets	EUR	USD	CHF	GBP	Other currencies	RSD	Total
Cash and balances held with the Central Bank	7,125,203	38,545	68,796	7,675	131,446	3,803,106	11,174,771
Receivables under derivatives	–	–	–	–	–	25,656	25,656
Securities	1,923,519	2,238,335	–	–	–	6,946,670	11,108,524
Loans and receivables due from banks and other financial institutions	1,784,593	285,293	240,075	27,776	89,440	14,979	2,442,156
Loans, receivables and pledged receivables due from clients	42,985,773	21,318	7,925,115	–	–	22,069,649	73,001,855
Other assets	199,637	5	47	12	–	161,893	361,594
Total balance sheet assets	**54,018,725**	**2,583,496**	**8,234,033**	**35,463**	**220,886**	**33,021,953**	**98,114,556**
Derivative instruments	8,179,066	1,143,229	318,020	71,029			9,711,344
Total Assets	**62,197,791**	**3,726,725**	**8,552,053**	**106,492**	**220,886**	**33,021,953**	**107,825,900**

RSD '000

Liabilities	EUR	USD	CHF	GBP	Other currencies	RSD	Total
Liabilities under derivatives	–	–	–	–	–	24,942	24,942
Deposits and other liabilities due to banks, other financial institutions and the Central Bank	4,893,163	46	104	–	–	2,696,513	7,589,826
Deposits and other liabilities due to other clients	46,295,912	3,590,257	586,270	106,440	203,946	15,006,228	65,789,053
Subordinate liabilities	–	–	3,911,759	–	–	–	3,911,759
Other financial liabilities	322,392	85,323	11,843	213	15	410,812	830,598
Total balance sheet liabilities	51,511,467	3,675,626	4,509,976	106,653	203,961	18,138,495	78,146,178
Derivative instruments	10,483,861	50,661	3,936,608	–	–	–	14,471,130
Total liabilities	**61,995,328**	**3,726,287**	**8,446,584**	**106,653**	**203,961**	**18,138,495**	**92,617,308**
Long foreign currency position	202,463	438	105,469	–	18,893	–	327,263
Short foreign currency position	**–**	**–**	**–**	**(161)**	**(1,968)**	**–**	**(2,129)**

The currency structure of financial instruments as at 31 December 2017 is provided in the table below. Financial assets with.

Assets	EUR	USD	CHF	GBP	Other currencies	RSD	Total
Cash and balances held with the Central Bank	5,336,631	38,640	57,900	7,656	18,053	5,117,078	10,575,958
Receivables under derivatives	–	–	–	–	–	157,022	157,022
Securities	4,392,192	2,634,985	–	–	–	9,853,678	16,880,855
Loans and receivables due from banks and other financial institutions	985,485	16,431	99,773	5,485	858,017	862,850	2,828,041
Loans, receivables and pledged receivables due from clients	37,177,542	–	10,078,313	–	–	14,383,722	61,639,577
Other assets	258,860	19	12	9,940	36,263	171,740	476,834
Total balance sheet assets	**48,150,710**	**2,690,075**	**10,235,998**	**23,081**	**912,333**	**30,546,090**	**92,558,287**
Derivative instruments	23,747,260	847,971	6,461,909	132,154	239,504	–	31,428,798
Total Assets	**71,897,970**	**3,538,046**	**16,697,907**	**155,235**	**1,151,837**	**30,546,090**	**123,987,085**

Liabilities	EUR	USD	CHF	GBP	Other currencies	RSD	Total
Liabilities under derivatives	–	–	–	–	–	32,347	32,347
Deposits and other liabilities due to banks, other financial institutions and the central bank	4,892,435	367,020	67	–	–	123,234	5,382,756
Deposits and other liabilities due to clients	38,164,921	3,078,323	653,719	154,483	333,534	19,534,031	61,919,011
Subordinate liabilities	–	–	3,774,141	–	–	–	3,774,141
Other financial liabilities	122,354	2,884	12,659	977	15	315,536	454,425
Total balance sheet liabilities	**43,179,710**	**3,448,227**	**4,440,586**	**155,460**	**333,549**	**20,005,148**	**71,562,680**
Derivative instruments	28,971,314	90,366	11,650,406	–	2,970	–	40,715,056
Total liabilities	**72,151,024**	**3,538,593**	**16,090,992**	**155,460**	**336,519**	**20,005,148**	**112,277,736**
Long foreign currency position	**–**	**–**	**606,915**	**–**	**815,318**		**1,422,233**
Short foreign currency position	**(253,054)**	**(547)**	**–**	**(225)**	**–**		**(253,826)**

In accordance with the Decision on the Capital Adequacy of Banks (Official Gazette of RS, nos. 103/2016 and 103/2018), the Bank is to maintain its FX risk ratio, i.e., currency matching of assets and liabilities, in such a manner that the Bank's total net open FX position, including absolute value of the net position in gold, does not exceed 20% of its capital at the end of each business day.

Throughout 2018, the Bank's foreign exchange risk ratio was in compliance with the regulations of the National Bank of Serbia.

As at 31 December 2018 and 2017, the Bank's FX risk ratio was as follows:

Foreign exchange risk ratio in %	2018.	2017.
as at 31 December *	2.48	4.32
maximum period - month of December **	6.03	11.68
minimim period - month of December **	0.22	0.11

**Indicator after calculation of the Bank's equity and recording of all transactions*
***Indicator was achieved for current business days in December*

4.1.2.3.2. Interest Rate Risk per Items in the Banking Book

Interest rate risk is a risk of negative effects on the financial result and capital of the Bank due to changes in interest rates. The Bank is exposed to this risk per items carried in the Banking Book.

The Bank specifically analyses and manages exposures arising from the following types of interest risk:

a) Maturity mismatching risk (for items with a fixed interest rate) and repricing risk (for items with a variable interest rate) for individual items in assets and liabilities, and for the Bank's off-balance sheet items;
b) Yield curve risk exposure arising from change in the shape and inclination of the yield curve;
c) Basis risk exposure arising from different reference interest rates with interest-sensitive items with similar characteristics in terms of maturity or repricing;
d) Optionality risk exposure arising from contractual provisions related to interest-sensitive items (loans with the possibility of prepayment, deposits with the possibility of early withdrawal, etc.).

In line with the responsibilities and competences prescribed by NBS regulations and enactments, the Bank's Board of Directors defines the strategy and goals of the Bank to comply with the criteria for the risks and the result, whereas the Executive Board has overall competence for the Bank's operations and implementation of the risk management strategy and policies and the strategy for capital management.

Other responsibilities related to interest rate risk are carried out through the following committees established by the Bank, in line with the law, regulations and enactments of the National Bank of Serbia:

- Audit Committee
- Assets and Liabilities Committee (ALCO).

The Risk Control Department is, in respect of interest risk management, inter alia, responsible for overall interest rate analysis, measurement, assessment, monitoring, control and reporting as well as creation and implementation of an adequate limits system and early warning procedures in compliance with the ICAAP process (Internal Capital Adequacy Assessment Process).

BSM & Treasury Department is, in respect of interest risk management, inter alia, responsible for:

- Managing interest-sensitive items of the assets and liabilities of the Bank in general and per each materially significant currency, so that interest rate risk is within acceptable limits;
- Submitting proposals to the ALCO for interest rate risk mitigation, avoidance and hedging in cases of higher operating costs and exceeding of defined limits due to changes in interest rates;
- In collaboration with other market sectors, implementing the measures rendered by the Executive Board on reducing the interest rate risk exposure; and
- Performing other operations defined by the applicable internal rules and regulations of the Bank.

In accordance with NBS Decision on Risk Management by Banks and the Addiko Group methodology, via GAP analysis applied to balance sheet items of assets and liabilities of the Bank, as well as interest-sensitive off-balance sheet items from the Banking Book (Interest Sensitivity Gap Balance), the Risk Control Department measures, i.e. assesses, at least on a quarterly basis, negative effects of interest rate change on the financial result (income statement) and the economic value of the Bank.

Exposure to interest rate risk in the Banking Book and assessment of effects of this rate on the Bank's financial result (income statement) is determined in accordance with the Earning approach based on the Delta approach whereby the result shows solely the delta (change) of interest income calculated by the predefined movement/change of interest rate. The calculation takes into consideration only interest-sensitive items from the Banking Book, while interest sensitivity gap balance is the calculation basis. Likewise, there is no dynamic overview (the planned new operations and the aspect of loan maturity are not included, there is no transfer among risk categories – fixed, variable and UFN).

In order to assess potential consequences of interest rate adjustments on net interest income, scenarios with predefined assumptions on interest rate movement are implemented as follows:

- Three-month and six-month interest rate movement with Forward 3m/6m interest curve by currency available through Bloomberg;
- Stress scenario for parallel interest rate movement by 200 bp*;
- Three-month and six-month local projection of interest rate movement by currency.

The interest rate gap analysis is conducted by the Risk Control Department, and the results are reported at least on a quarterly basis to the ALCO, Executive Board, Board of Directors and Audit Committee.

The table below shows sensitivity of the Bank's income statement to said reasonably possible adjustments to interest rates for the period of up to one year as of the reporting date, with all other variables held constant.

Total interest income (ind+ufn+fix) RSD '000

	Total	EUR	USD	CHF	RSD	MISC
FWD 6M	(565)	17	(628)	81	(30)	(5)
FWD 3M	16,793	19,590	(3,903)	5,611	(4,201)	(304)
Projection GBSMT 3M	(3,637)	(1,338)	(2,661)	611	(314)	65
Parallel movement + 200 bps	208,881	212,197	(35,324)	82,161	(46,621)	(3,532)
Projection GBSMT 6M	(3,776)	(1,310)	(2,188)	419	(768)	71

** 1% = 100 basis points (bp)*

For a more comprehensive measurement of the overall effect of the interest rate risk on the Bank's equity, taking into account only interest rate sensitive asset and liability items, the Bank measures the risk-equity-ratio as the determined economic value of the Bank relative to the Bank's equity, calculated in accordance with the NBS Decision on Capital Adequacy of Banks, under said assumptions and this shows the Bank's exposure to interest rate risk.

The Bank's risk-equity-ratio, as an indicator of a change in the economic value for items sensitive to interest rates relative to the Bank's equity, as at 31 December 2018, calculated pursuant to the Decision on the Capital Adequacy of Banks, equalled 12.8% (as at 31 December 2017: 5.1%), which was still well below the internally set limit of 15% of the Bank's equity.

The table below shows the total amount of financial assets and liabilities at their carrying values, categorised by the earlier pricing date (re-pricing date) and maturity date, as at 31 December 2018:

Financial assets RSD '000

	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Non-interest bearing	Total
Cash and balances held with the Central Bank	223,019	161,947	1,482,491	997,584	4,280	8,305,450	11,174,771
Securities	595,044	–	196,911	9,345,438	265,531	–	10,402,924
Loans and receivables due from banks and other financial institutions	1,794,738	–	607,855	–	–	39,563	2,442,156
Loans and receivables due from clients	7,105,629	37,938,817	14,496,420	10,477,779	5,569,547	(2,586,337)	73,001,855
Other assets	–	–	–	–	–	361,594	361,594
Assets total	**9,718,430**	**38,100,764**	**16,783,677**	**20,820,801**	**5,839,358**	**6,120,270**	**97,383,300**

Financial liabilities RSD '000

	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Non-interest bearing	Total
Deposits and other financial liabilities due to banks, other financial institutions and the Central Bank	3,522,842	342,764	869,825	2,836,670	–	17,725	7,589,826
Deposits and other financial liabilities due to other clients	19,354,596	11,507,989	18,695,701	9,971,176	5,919,621	339,970	65,789,053
Subordinate liabilities	–	–	–	3,911,759	–	–	3,911,759
Other liabilities	–	–	–	–	–	830,598	830,598
Liabilities total	**22,877,438**	**11,850,753**	**19,565,526**	**16,719,605**	**5,919,621**	**1,188,293**	**78,121,236**
Interest rate gap	**(13,159,008)**	**26,250,011**	**(2,781,849)**	**4,101,196**	**(80,263)**	**4,931,977**	**19,262,064**

** including only securities in the Banking Book (securities in the Trading Book of RSD 705,599 thousand ae excluded).*

The table below shows the total amount of financial assets and liabilities at their carrying values, categorised by the earlier of the date of pricing (re-pricing date) and maturity date as at December 31, 2017:

Financial assets RSD '000

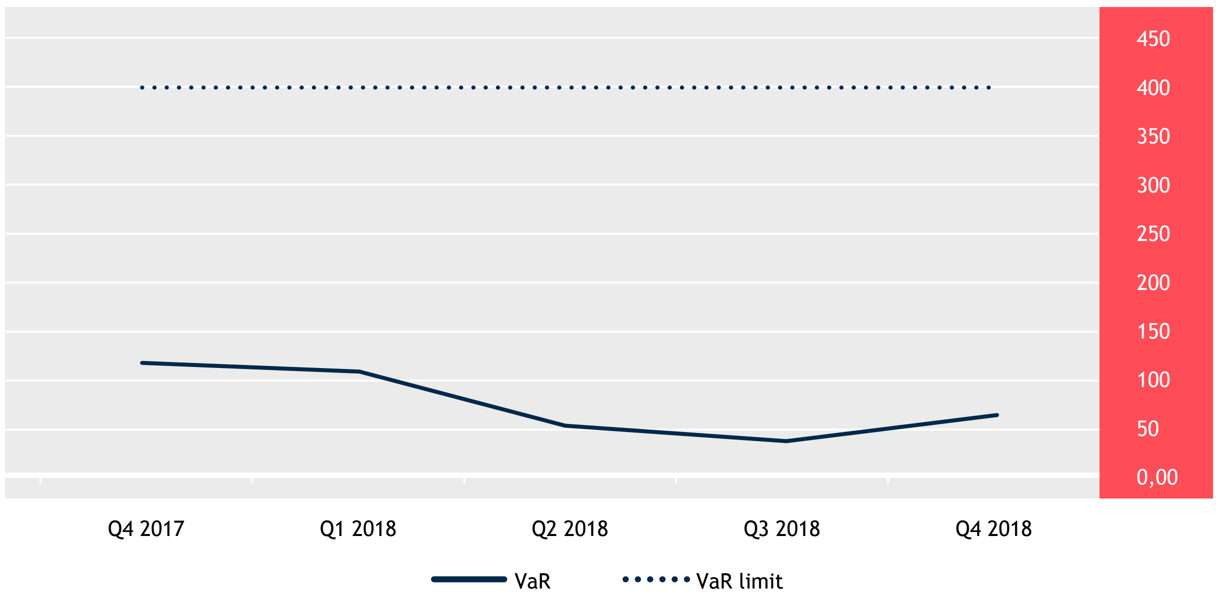
	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Non-interest bearing	Total
Cash and balances held with the Central Bank	437,104	517,617	1,858,482	1,509,038	4,755	6,248,962	10,575,958
Securities	690,900	-	1,502,379	12,690,122	1,997,454	-	16,880,855
Loans and receivables due from banks and other financial institutions	1,871,643	829,476	69,352	-	-	57,570	2,828,041
Loans and receivables due from clients	45,978,899	2,229,121	3,018,578	8,604,839	1,123,785	684,355	61,639,577
Other assets	-	-	-	-	-	476,834	476,834
Total assets	**48,978,546**	**3,576,214**	**6,448,791**	**22,803,999**	**3,125,994**	**7,467,721**	**92,401,265**

Financial liabilities RSD '000

	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Non-interest bearing	Total
Deposits and other liabilities due to banks	4,004,037	–	416,938	947,782	–	13,999	5,382,756
Deposits and other liabilities due to clients	8,649,923	4,561,721	11,776,443	35,116,094	89,037	1,725,793	61,919,011
Subordinate liabilities	–	–	–	3,774,141	–	–	3,774,141
Other liabilities	–	–	–	–	–	454,425	454,425
Total liabilities	**12,653,960**	**4,561,721**	**12,193,381**	**39,838,017**	**89,037**	**2,194,217**	**71,530,333**
Interest rate gap	**36,324,586**	**(985,507)**	**(5,744,590)**	**(17,034,018)**	**3,036,957**	**5,273,504**	**20,870,932**

Throughout 2018, interest rate risk VaR (99, 1-day) was at quite a low level. The figure below shows the movements of this ratio:

ABSe VaR (99%, 1d)



4.1.2.3.3. Equity Price Risk

The Bank is exposed to the risk of changes in the prices of equity securities, since the Bank's investments are classified in the balance sheet at fair value through other comprehensive income and partly as investment through the Trading Book. At the proposal of the Executive Board, the Bank's Board of Directors adopts appropriate market risk management policies. In turn, at the proposal the Risk Control Department (and BSM & Treasury Department) the Executive Board adopts the related supporting procedures and manuals for identification, measurement/assessment, mitigation and monitoring of market risks. These policies, procedures and manuals are based on the principles of the Bank and Addiko Group pertaining to the market risk management and control and in compliance with the minimum standards and criteria prescribed by the NBS.

Management of the price risk in debt and equity securities the Bank is exposed to is the responsibility of the Executive Board of the Bank. ALCO proposes to the Executive Board measures aimed at efficient and successful management of other market risks. For monitoring and control of the price and other market risks arising from the Banking Book and Trading Book, once per year the Bank defines a set of limits, as follows: volume/position limit, stop-loss limit p.a. and VaR limit (1-day, 99%). The limits for the Trading Book and Banking Book are defined at least once a year in coordination with Addiko Group, at the request/proposal of the BSM & Treasury Department, containing also the business strategy of the BSM & Treasury Department within each of the said Books. The request also contains the evaluation, i.e. the comments by the Risk Control Department regarding the proposed positions and limits, starting from the capital level and other parameters and ratios. The request for operating limits in the Banking Book and Trading Book is approved by the Bank's Executive Board and forwarded to Addiko Group. According to the standard of the Parent Bank, the positions and limits are defined in the same way for the Market Risk Steering Book, which in the case of the Bank, contains the following: VaR limit for interest rate risk and open FX position, which serve the purpose of strategic operations.

Within the Market Risk Steering Book, in 2018 the Bank operated and had limits established for the VaR interest rate risk portfolio from the Banking Book as well as the FX position.

In 2018, in accordance with the Group and local strategy, procedures and approved limits, the Bank did not have equity investments in other legal entities based on share trading at the Belgrade Stock Exchange (directly), but from early 2018 and throughout the year it had investment fund units carried in the Banking Book.

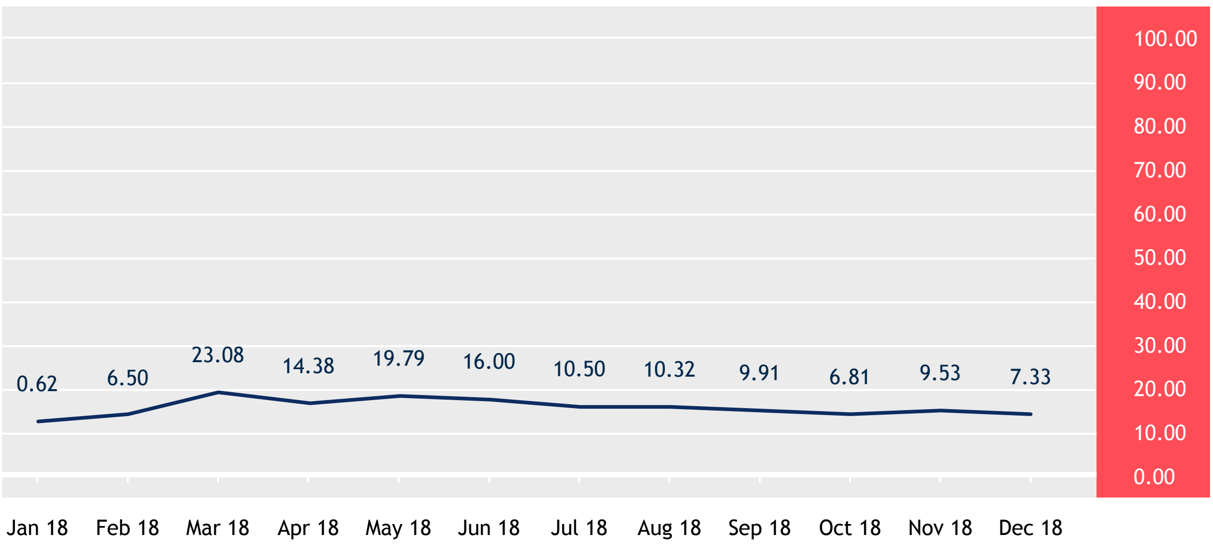
In 2018, the Bank continued to apply elements of additional credit risk protection in the financial derivative trading process with Addiko Group through mutual collateralisation (between the Bank and Addiko Group), in accordance with the executed Master Agreement for Financial Derivatives Transactions and Collateral Addendum to the said Master Agreement for Financial Derivatives Transactions, which are aligned with the ISDA (International Swaps and Derivatives Association) standards.

The securities induced price risk, as per relative NBS regulations, matches interest rate risks from the Trading Book, in accordance with the Addiko Group standards. The most significant factor which affects this risks are treasury bills and bonds carried in the Trading Book. As at 31 December 2018 VaR interest rate risk from the Trading Book was EUR 7.3 thousand, i.e. RSD 866 thousand, which was significantly below the EUR 50 thousand, i.e. RSD 5.9 million, limit.

The table below shows a summary of VaR (99%, 1-day) movements for interest rate risk from the Trading Book in 2018:

Kamatni rizik iz Knjige Trgovanja- VaR (99 %, 1 dan) EUR 000

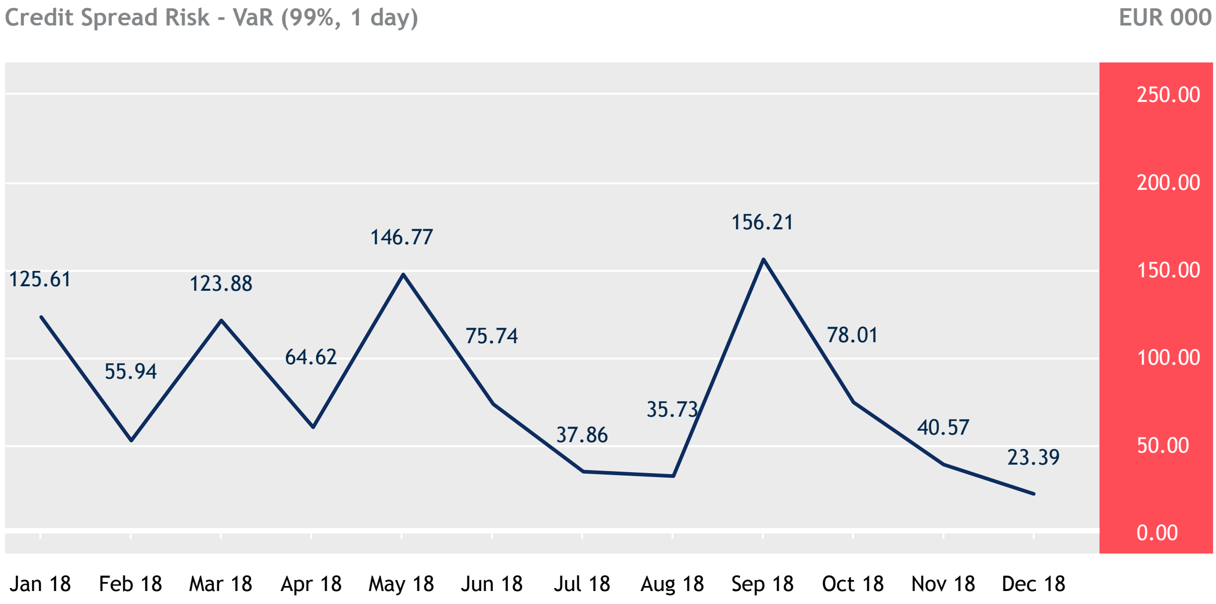
4.1.2.3.4. Risk of Investment in Equity Securities



According to Addiko Group standards, the Bank recognises the risk of investment in equity securities. However, in 2018 the Bank did not have any exposures under these securities.

4.1.2.3.5. Credit Spread Risk

The Bank also monitors credit spread risk - liquid, as a separate market risk component, which is defined as the risk of market price changes, as a result of changes in interest rate spreads. The key factor that impacts the credit spread risk is liquidity held in the form of securities. As at 31 December 2018 VaR (99%, 1-day), the credit spread risk was EUR 23.4 thousand, i.e. RSD 2.8 million, which was significantly below the EUR 470 thousand, i.e. RSD 55.6 million, limit.



4.1.3. Liquidity Risk

Liquidity risk is the possibility of adverse effects on financial result and equity, due to the Bank's inability to full its liabilities when these fall due as a result of:

- Withdrawal of existing sources of financing, and/or inability to obtain new sources of financing (funding liquidity risk), or
- Difficulties in converting assets into liquid funds due to market disturbances (market liquidity risk).

The Banks' liquidity management implies maintaining sufficient amounts of assets for settling due liabilities, ensuring regular and undisturbed operations with minimal costs. This implies the Bank's obligation to provide and maintain the liquidity reserve in its regular operations for emergencies and unforeseen circumstances.

Accordingly, the Bank has defined the area of liquidity risk control and management by a set of bylaws and enactments (strategies, policies, procedures, etc.), which are aligned with the legislation and bylaws of the National Bank of Serbia governing liquidity management and with other Bank's policies and relevant bylaws, as well as with standards of Addiko Group, to which the Bank is a member.

The objective of the liquidity risk strategy is to set out general parameters for prudent and ongoing management of liquidity risk inherent in the Bank's business model.

The monitoring and management of liquidity at the Bank level is within the competence of the Balance Sheet Management & Treasury Department. This is where the management of situational and structural liquidity and the coordination of financing resources at the Bank level takes place. Control of liquidity risk is within the competence of the Risk Control Department which performs activities re the measure and mitigation of risk, as well as timely and consistent reporting on exposure to liquidity risk.

The Bank has a business plan in place in the event of a liquidity crisis which defines the processes and instruments of control and protection necessary to eliminate an immediate crisis or overcome an acute crisis. In the event of a liquidity crisis, the Bank's main priorities are to rigorously sustain solvency and prevent reputational damage.

This Strategy defines:

- adequate identifying, defining, analysing, measuring, monitoring, reporting and limiting the Bank's overall appetite for liquidity risk, with the aim of ensuring sustainable development of its operations;
- ensuring that the liquidity risk structure is formed in accordance with available capital and liquidity, thus supporting its protection and value preservation for the Bank's shareholders;
- organisational framework for daily management and decision-making regarding liquidity risk;

- Efficient liquidity management (including data quality) and forward-looking approach that observes the defined early warning signals for the purpose of establishing liquidity adequacy on a long-term basis.

In line with the responsibilities and competences prescribed by NBS regulations and enactments, the Bank's Board of Directors defines the strategy and goals of the Bank to comply with the criteria for the risks and the result, whereas the Executive Board has overall competence for the Bank's operations and implementation of the risk management strategy and policies and the strategy for capital management.

Other responsibilities in respect of liquidity risk are exercised by the following committees, in line with the legislation, regulations and enactments of the National Bank of Serbia:

- Audit Committee
- Assets and Liabilities Committee (ALCO)

The Risk Control Department takes care of overall analysis, measurement, assessment, control and reporting on liquidity risk (including funding spread risk) as well as the creation and implementation of adequate limits system and early warning procedures in compliance with the ICAAP (Internal Capital Adequacy Assessment Process) and ILAAP (Internal Liquidity Adequacy Assessment Process) frameworks.

The BSM & Treasury Department is in charge of liquidity management at the local level, hence within this organisational unit, an employee is designated to perform, in line with Addiko Group standards, duties of the Bank's Liquidity Manager.

The basic instruments and indicators for monitoring and measuring short-term and long-term liquidity are the following:

- preparation and execution of cash flow plans in a defined timeframe (at least one month);
- liquidity ratios prescribed by the National Bank of Serbia (and calculated and delivered by the Accounting and Reporting Department);
- monitoring of the Liquidity Coverage Ratio (LCR);
- analysis of developments and projections of cash flow matching (GAP analysis) in certain time intervals;
- analysis, monitoring and limitation of negative net cash flows against available liquidity reserve under both normal conditions and a range of stress scenarios within on-year horizon; and
- monitoring of internally defined liquidity ratios.

In line with the Decision of the National Bank of Serbia on Risk Management by Banks, the Bank is obligated to maintain the prescribed liquidity levels. The ratio between the sum of the first-ranking liquid receivables and the second-ranking liquid receivables, on one hand, and the sum of the Bank's demand deposit liabilities or liabilities without agreed maturity and liabilities with maturity within one month from the day of liquidity ratio calculation, on the other hand, must be maintained by the Bank so that it equals:

a) at least 1.0 when calculated as an average of liquidity ratios for all business days in a month;
b) not below 0.9 for more than three consecutive business days;
c) at least 0.8 when calculated for one business day.

In accordance with the same Decision, since 24 December 2012 the Bank has also been monitoring the rigid (or cash) liquidity ratio, which represents first-ranking receivables relative to the sum of the Bank's demand deposit liabilities or liabilities without agreed maturity and liabilities with maturity within one month from the day of liquidity ratio calculation. The Bank shall maintain the level of the rigid (cash) liquidity ratio so that it equals:

a) at least 0.7 when calculated as an average of the liquidity ratio for all business days in a month,
b) not below 0.6 for more than three consecutive business days,
c) at least 0.5 when calculated for one business day.

Under NBS Decision on Liquidity Risk Management (Official Gazette of the RS No. 103/2016) effective as from 30 June 2017, the Bank is required to calculate the liquidity coverage ratio on monthly basis. The liquidity coverage ratio represents the Bank's liquidity buffer relative to the net liquid asset outflows over an assumed stress period of 30 days. The Bank is required to maintain the liquidity coverage ratio at a level of minimum 100% for all currencies.

A critically low level of liquidity of the Bank is the liquidity level whose ratio is lower than the above ratios. If the Bank establishes a critically low liquidity level, it is required to inform the National Bank of Serbia thereof no later than the following day.

In addition to the regulatory liquidity ratios (liquidity ratio - LIK and rigid liquidity ratio - rigid LIK), for the needs of internal liquidity monitoring, the Bank defines the following ratios which it monitors daily:

- the liquidity ratio (by analogy with LIK) per all significant currencies individually (EUR, USD, CHF and RSD) as well as other currencies in the aggregate, supplemented with swap and forward transactions maturing within a month from the day of applicable calculation (GAP limits per currency and currency ratio limits are established), and
- a set of liquidity ratios estimated as potentially significant for internal liquidity management (limits are established).

As in the case of internal limits for liquidity ratio and rigid liquidity ratio, the liquidity ratio limits per significant currencies individually are adopted by the Executive Board at the proposal of the Risk Control Department.

The Risk Control Department monitors movements of internal ratios/liquidity ratios and reports on the value of these ratios to the BSM & Treasury Department on a daily basis.

In addition, at least once a month at ALCO meetings, the Risk Control Department reports on the periodic trend of internal liquidity ratio movements.

For the purpose of analysing the effects of potential (negative) movements of the liquidity position, i.e. creating a number of liquidity stress scenarios, the Risk Control Department, in cooperation with the BSM & Treasury Department providing minimum information on availability and time lag of the liquidity potential and the responsible Finance Controlling Department, defines/updates on a weekly basis projected cash flows for a period of up to a year and determines the liquidity flows sensitivity to the disturbances envisaged by the scenarios. The stress scenario methodology is developed in cooperation with Addiko Group. For quantitative and qualitative measurement, monitoring, control and reporting on long-term liquidity, in the aggregate separately for major currencies, the Risk Control Department applies the methodologies defined internally and/or in coordination with Addiko Group and its standards.

Stress sensitivity is used to calculate stress effects on the cash flows, as well as on the liquidity reserve. Stress analysis is performed for various timeframes and levels of unforeseen events.

The Risk Control Department monitors and reports monthly on maturity (mis)matches of balance sheet liabilities and receivables and off-balance sheet items through the maturity scale (GAP analysis) for predefined periods of time, taking into consideration the set of predefined model assumptions (criteria for classification of assets and liabilities without maturity). This report is based on the GAP analysis applied to maturity structure of assets and liabilities of the Bank. The underlying purpose of such measurement and the report is to recognise assets and liabilities, i.e. (net) cash flows (inflows/outflows) starting from their agreed maturity per the remaining period until maturity. Balance sheet items without contractually defined maturities are included yet can also be treated separately and are grouped according to the documented assumptions. With regards to off-balance sheet items, the report includes derivatives with the effect on cash flows and undrawn framework loans, guarantees, and letters of credit under the stated assumptions.

Items without maturity that do not generate cash flows (fixed assets, intangible assets, other assets, equity investments, provisions, other liabilities, equity, etc.) are grouped in a separate column – non-relevant cash flows ('NR').

Overall liquidity at Addiko Bank in 2018 remained at a satisfactory level. Throughout the year, the Bank did not experience critically low levels of liquidity, i.e. none of the ratios monitored by the Bank were in violation.

A comparative review of the daily liquidity ratios for 2018 and 2017, respectively is found below:

Liquidity ratio

	2018	2017
as at 31 December	1.75	2.39
average in December	1.38	2.49
maximum ratio throughout the year	2.85	3.08
minimum ratio throughout the year	1.21	2.05

A comparative review of the daily rigid liquidity ratios for 2018 and 2017, respectively is found below:

Rigid liquidity ratio

	2018	2017
as at 31 December	1.44	2.05
average in December	1.16	2.20
maximum ratio throughout the year	2.49	2.74
minimum ratio throughout the year	1.00	1.76

Throughout 2018, the Bank's liquidity coverage ratio was in compliance with the limits prescribed by the bylaws of the National Bank of Serbia.

The table below shows the movement of the liquidity coverage ratio in 2018 and 2017, respectively:

Liquidity Coverage Ratio (LCR)

	2018	2017
as at 31 December	116%	165%
average ratio throughout the year	142%	197%
maximum ratio throughout the year	181%	280%
minimum ratio throughout the year	116%	165%

The following table provides an analysis of the Bank's non-derivative financial assets and financial liabilities grouped according to maturity date, by the net remaining maturity.

Gross receivables due from banks and clients are decreased by the amount of allowance for impairment as per loan facilities underlying the receivables. In maturities up to 1 months, the following are categorised: mature receivables, receivables and liabilities without contracted maturity, prepaid fees and commissions per loans and early repayment of interest per savings deposits.

Data as at 31 December 2018 RSD '000

	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Carrying value
Cash and balances held with the Central Bank	11,174,771	–	–	–	–	11,174,771
Receivables under derivatives	25,565	91	–	–	–	25,656
Securities	–	–	707,824	10,138,629	262,071	11,108,524
Loans and receivables due from banks and other financial institutions	2,429,653	313	9,963	2,227	–	2,442,156
Loans and receivables due from clients	3,499,617	3,559,280	16,183,105	17,097,408	32,662,445	73,001,855
Other assets	360,373	33	169	754	265	361,594
Assets - Receivables	**17,489,979**	**3,559,717**	**16,901,061**	**27,239,018**	**32,924,781**	**98,114,556**
Liabilities under derivatives	24,942	–	–	–	–	24,942
Deposits and other financial liabilities due to banks, other financial institutions and the Central Bank	3,113,912	375,424	775,676	3,324,814	–	7,589,826
Deposits and other financial liabilities due to other clients	33,196,834	10,639,122	18,471,887	3,395,698	85,512	65,789,053
Subordinate liabilities	545	–	–	3,911,214	–	3,911,759
Other liabilities	120,899	143,357	512,200	10,289	43,853	830,598
Liabilities	**36,457,132**	**11,157,903**	**19,759,763**	**10,642,015**	**129,365**	**78,146,178**
Maturity mismatch at year-end	**(18,967,153)**	**(7,598,186)**	**(2,858,702)**	**16,597,003**	**32,795,416**	
Cumulative gap - asset and liability maturity mismatch	**(18,967,153)**	**(26,565,339)**	**(29,424,041)**	**(12,827,038)**	**19,968,378**	

Bearing in mind that in 2018 all of the Bank's liquidity ratios were continually in compliance with regulatory requirements, and that continuing on into 2019, it plans to apply to its liabilities, a partial maturity extension strategy in collaboration with international financial institutions (additional long-term borrowings), rollover retail deposits with the same or extended maturities (for amortised contingent groups of deposit assets that are scheduled to mature in the first half of 2019), as well as to decrease the maturity of its assets by shorter term lending to retail clients, the result expected is reduced GAP liquidity than that set on 31 December 2018.

Data as at 31 December 2017

RSD '000

	Up to 1 month	1-3 months	3-12 months	1-5 years	over 5 years	Carrying value
Cash and balances held with the Central Bank	10,575,958	–	–	–	–	10,575,958
Receivables under derivatives	157,022	–	–	–	–	157,022
Securities	690,902	–	1,136,281	13,056,218	1,997,454	16,880,855
Loans and receivables due from banks and other financial institutions	1,971,027	824,540	27,847	4,627	–	2,828,041
Loans and receivables due from clients	6,273,848	1,561,814	9,695,352	16,872,416	27,236,147	61,639,577
Other assets	476,776	18	40	–	–	476,834
Assets - Receivables	**20,145,533**	**2,386,372**	**10,859,520**	**29,933,261**	**29,233,601**	**92,558,287**
Liabilities under derivatives	28,999	3,348	–	–	–	32,347
Deposits and other liabilities due to banks, other financial institutions and the Central Bank	4,072,725	2,666	122,638	1,184,727	–	5,382,756
Deposits and other liabilities due to clients	32,641,810	3,061,975	14,562,838	11,564,563	87,825	61,919,011
Subordinate liabilities	–	–	–	3,774,141	–	3,774,141
Other liabilities	315,543	23,684	59,410	16,623	39,165	454,425
Liabilities	**37,059,077**	**3,091,673**	**14,744,886**	**16,540,054**	**126,990**	**71,562,680**
Maturity mismatch at year-end	**(16,913,544)**	**(705,301)**	**(3,885,366)**	**13,393,207**	**29,106,611**	
Cumulative gap - asset and liability maturity mismatch	**(16,913,544)**	**(17,618,845)**	**(21,504,211)**	**(8,111,004)**	**20,995,607**	

For the purpose of monitoring liquidity risk, the off-balance sheet items are treated in line with the following assumptions:

- Guarantees - 5% payment for a period of up to 1 month,
- Frameworks - 5% payment up to 6 month,
- Irrevocable liabilities for undrawn credit lines - 100% payment up to 1 year.

These assumptions re off-balance sheet items, as well as overall assumptions for monitoring needs and measuring liquidity risk, are defined in collaboration with the Group, taking into account estimates of the expert department and the assumptions defined by the NBS for these same items for measuring liquidity ratios (liquidity ratio and rigid liquidity ratio), in that the Risk Control Department notifies the ALCO of all these established assumptions as well as their adjustments.

In accordance with the aforesaid assumptions, the table below provides maturities of these items as at 31 December 2018:

RSD '000

	up to 1 month	1-3 months	3-12 months	1-5 years	over 5 years	Total
Guarantees 5%	504,078	–	–	–	–	504,078
Revocable frame agreements 5%	36,636	73,271	329,720	–	–	439,627
Irrevocable liabilities for undrawn credit lines - 100%	90,396	180,792	813,566	–	–	1,084,754
Total	**631,110**	**254,063**	**1,143,286**	**–**	**–**	**2,028,459**

In accordance with the aforesaid assumptions, the table below provides maturities of these items as at 31 December 2017:

RSD '000

	up to 1 month	1-3 months	3-12 months	1-5 years	over 5 years	Total
Guarantees 5%	290,046	–	–	–	–	290,046
Revocable frame agreements 5%	31,750	63,499	285,747	–	–	380,996
Irrevocable liabilities for undrawn credit lines - 100%	76,638	153,277	689,746	–	–	919,661
Total	**398,434**	**216,776**	**975,493**	**–**	**–**	**1,590,703**

Maturity structure of derivatives according to the contractually agreed maturities as at 31 December 2018:

RSD '000

	1-3 months	1-5 years	Total
Sales transactions	**18,030,285**	**–**	**18,030,285**
Swaps with related banks	12,778,016	–	12,778,016
Swaps with other banks	5,201,225	–	5,201,225
Swaps with legal entities	51,044	–	51,044
Sales transactions	**18,025,249**	**–**	**18,025,249**
Swaps with related banks	12,765,745	–	12,765,745
Swaps with other banks	5,208,843	–	5,208,843
Swaps with legal entities	50,661	–	50,661
Maturity mismatch at year-end	**5,036**	**–**	**5,036**

Maturity structure of derivatives according to the contractually agreed maturities as at 31 December 2017:

RSD '000

	1-3 months	1-5 years	Total
Sales transactions	**51,379,193**	**–**	**51,379,193**
Swaps with related banks	47,264,291	–	47,264,291
Swaps with other banks	4,023,478	–	4,023,478
Swaps with legal entities	91,424	–	91,424
Sales transactions	**51,144,095**	**–**	**51,144,095**
Swaps with related banks	47,151,565	–	47,151,565
Swaps with other banks	3,992,530	–	3,992,530
Maturity mismatch at year-end	**235,098**	**–**	**235,098**

4.1.6. Other Risks

- **Compliance Risk**

Compliance risk is the result of a failure to align operations with the laws and by-laws, internal acts, procedures for the prevention of money laundering and financing of terrorism and standard professional rules and codes, good professional practices and the Bank's business ethic. Three major compliance risks are the following:

a) Risk of sanctions imposed by the regulatory body – risk resulting from business irregularities which may lead to the regulator imposing measures against the Bank under conditions and as provided for under legislation;
b) A risk of financial losses – risk resulting from all risks the Bank is exposed to, particularly due to non-compliance with the laws and internal acts and inadequate application of strategies and policies, i.e., due to management of the Bank resulting in financial losses for any reason, and
c) Reputational risk – risk arising from non-compliance with the laws and internal acts which leads to disruption to reputation and trust of the clients.

• Operational Risk

Operational risk is the risk of occurrence of losses arising from inappropriate or unsuccessful internal processes, human error and systemic or external events, which include legal risk. The definition of operational risk does not include strategic and reputational risks. According to its internal acts, the Bank also accepts the definition set out in the Law on Banks and the National Bank of Serbia Decision on Risk Management by Bank, and therefore this risk also includes the risk of possible occurrence of negative effects on the Bank's financial result and capital due to failures in the work of employees (unintentional and intentional), inappropriate internal procedures and processes, inadequate information management and other systems within the Bank, as well as due to the occurrence of unforeseen external events.

The Bank measures, i.e. evaluates operational risk exposure taking into consideration the possibility, i.e. the frequency of occurrence of said risk, as well as its potential effect on the Bank, paying close attention to events whose occurrence is less likely, but which may potentially cause significant material losses.

The Bank applies two approaches to operational risk identification and evaluation: reactive approach to risk assessment, based on event occurrence, and proactive approach through scenario analysis (SA) and risk assessment - Risk and Control Self-Assessment (RCSA), as an instrument of qualitative assessment.

The goal of managing operational risk in the Bank is to achieve a proactive approach (e.g. risk management) instead of a reactive approach (e.g. loss management).

The Bank applies the following methods and tools to support operational risk management:

- Loss database for systematic collection of data on losses due to operational risk throughout the institution;
- Qualitative assessments (scenarios and risk assessments) to identify and assess the risks occurring within business processes;
- Regular reporting on operational risk.

All the Bank's employees are obligated to take active part in identifying and reporting on operational risk related losses.

Identification of operational risks is performed and assessed so as to allow defining appropriate actions for avoiding, mitigating, transferring or accepting the risks, including the priorities for implementing safeguards.

The goal is to reduce losses as much as possible, in accordance with allocated resources and budget. The Bank will propose measures to minimise operational risk if it deems that the benefit arising from these measures will not exceed the costs of their implementation, and that they will contribute to the Bank's efficiency.

The Bank identifies, assesses and monitors operational risk in all materially significant products, activities, processes and systems, including outsourcing, and before their introduction it estimates operational risk which may arise from their introduction.

The Bank applies the basic indicator approach (BIA) to calculate the capital requirement for operational risk. According to this approach, the capital requirement for operational risk equals the amount of the three-year average exposure ratio multiplied by a capital requirement rate of 15%.

The three-year average exposure ratio is the arithmetic mean of the ratios for the past three years. If the exposure ratio is negative or equal to zero in any of the three years, the amount is not included in the calculation of the three-year average. Instead, the average is calculated as the ratio of the sum of positive values of the exposure ratio and the number of years when such values were generated.

The Bank monitors exposure to operational risk through regular reports on operational risk related losses (contingent losses), which are submitted to the Operational Risk Management Advisory Body and the Executive Board of the Bank.

The Bank's Operational Risk Officer (ORO) drafts reports on operational risk on a regular basis.

The Board of Directors of the Bank and the Audit Committee are notified by way of operational risk reports in line with the schedule of these meetings. The National Bank of Serbia is notified of operational risk events in accordance with statutory regulations or as required by the regulatory body. In addition, the Bank reports to the Group on a regular basis, in line with their prescribed reporting standards.

• Legal Risk

The total number of passive legal proceedings increased in 2018. The number of legal proceedings which refer to loan application processing fees significantly increased during 2018. The majority of pending court cases refer to the FX clause, increase in margin and interest rate clause - which are described in more detail in the section entitled Historical Risks of Unilateral Change of the Margin.

This increase in the number of pending cases shows that although the total value of proceedings declined again, there is risk of an increase in the number of court cases due to judicial practices and new laws (e.g. laws on conversion, the amended law on consumer lending, and the law on consumer protection).

Addiko Bank a.d. Beograd has established a centralised data base (as is the case in Addiko Group and all its subsidiaries), which allows both Addiko Bank a.d. Beograd and Addiko Bank AG, i.e. the holding company to monitor and manage early identification of possible new developments and court decisions in the countries where Addiko Group subsidiaries operate. In addition to this, other monitoring and management tools have been implemented in order to establish and ensure reliable data quality and dispute handling, in order to monitor activities pertaining to passive disputes as well as their development on a daily basis.

Historical Risks of Unilateral Change of the Margin

In 2018, the value of amounts claimed through courts from Addiko Bank a.d. Beograd, with regard to the FX clause, unilateral adjustment of the margin and lawsuits arising from such claims amount to EUR 24.5 million.

Legal Risk Monitoring and Provisions

Provisions for passive court proceedings involving Addiko Bank a.d. Beograd, in particular, in terms of the risk of losing lawsuits and incurring corresponding court expenses, are calculated mainly in accordance with the international accounting standards applied throughout Addiko Group. Accordingly, it is not necessary to allocate provisions if it is highly likely that Addiko Bank a.d. Beograd will win a particular dispute. If the probability of successful outcome is less than 50%, provisions must be allocated. The local Legal Departments, which are familiar with specific court cases and/or outsourced attorneys, are responsible for successful performance assessment. This particularly refers to very complex litigation or litigation involving high claimed amounts. In addition to the overall provisions, provisions are also allocated in very complex and/or important disputes which carry a higher legal risk. The same criteria are applied to passive disputes initiated by claimants with relation to FX indexed loans, however with two important additions: firstly, successful outcome of a particular lawsuit are not assessed by local Legal Departments only but also by several outsourced attorneys and secondly, these types of legal disputes are monitored more intensely on a Group level, as a result of a growing number of regulations pertaining to foreign currency indexed loans in CEE countries (e.g. the so called ‘enforced conversion of CHF-indexed to EUR-indexed loans’).

In addition to the legal data base, where data are updated on a daily basis, Addiko Bank a.d. Beograd as well as all other Addiko Group members, are obligated to provide regular reports on local legal matters and the latest developments and also to draft ad hoc reports on every new lawsuit. Consequently, this manner of reporting allows for information pertaining to the total number of court proceedings to which Addiko Group is a party, as well as legal risks underlying such proceedings (measured in performance assessments recording legal risk provisions in appropriate amounts, effective monitoring of changes and, when necessary, adoption of measures be available at all times.

Summary of legal disputes - possible ensuing invalidation of the contracted FX clause, clause re change of the interest rate and interest rates in accordance with court decisions and changes in relevant legislation.

In the past ten year, many private individuals throughout SEE took out loans indexed in a foreign currency (particularly CHF indexed loans). As was the case in earlier years, such contracts are no longer subject to client complaint and court proceedings; however, the latter is an exercise initiated by consumer protection organisations. The main argument is that borrowing clients were not given sufficient information on the consequences of these contracts at the time of their execution and/or that FX clauses and/or interest rates were contracted in breach of contractual provisions. This is an attempt at renegotiating terms and conditions and provisions of FX indexed loan contracts.

At the time of drafting this document, several first-instance and second-instance court decisions were passed with regard to the above described disputes; some of the court decisions were to the Group’s detriment, while in other cases they were in favour of the Bank.

In Serbia, a lawsuit against Addiko Bank a.d. Beograd was initiated by Efektiva, while in 2014 the appeals of two more banks before first-instance courts were declined in favour of the claimants. On 15 September 2016, the Higher Court of Belgrade ruled as unfounded claimants’ appeals and confirmed the decision of the Third Court of General Jurisdiction of Belgrade dated 23 June 2014, whereby the case was dismissed.

Currently, there is indication that courts, due to a substantial increase in the CHF exchange rate, could change the course of their rulings in CHF loans related to court cases, decide in favour of suing clients and accordingly allow the termination of CHF indexed loan contracts. The first legally enforceable court decision in connection therewith was rendered by the second-instance court in Novi Sad, in September 2016. The court declined Erste Bank’s appeal and confirmed the first-instance court’s decision, according to which the CHF indexed loan contract in question was terminated due to significantly changed circumstances. The Serbian subsidiary of the Group is faced with similar court practices and, e.g., in once case the second-instance court reversed the original first-instance court’s decision, which had been in favour of the Bank. Moreover, the second-instance court ordered the first-instance court to establish whether there had been a significant increase in the CHF exchange rate during the loan repayment period.

In 2017, the Supreme Court of Cassation rendered an opinion on executed contracts for CHF indexed loans and the resulting disputes by stating that due to the Venice Commission Rules, it abstained from issuing an overall opinion and that decisions would be rendered on a case by case basis. In 2018, the Commercial Court of Niš demanded the Supreme Court of Cassation to render a decision regarding the disputable issue of CHF indexed loans, in particular in light of the new circumstances. The Commercial Court of Niš believes that the argumentation re the changed circumstances is unfounded and that CHF indexed loans cannot be terminated on the grounds of the new circumstances. The Supreme Court of Cassation ruled out the request to resolve the disputable legal matter regarding CHF indexed loans, while the key statements of the Supreme Court of Cassation were acceptability and legality of contracting foreign currency clauses and that these types of cases should be analysed and resolved on a case by case basis.

The number of disputes dealing with the new circumstances significantly increased (18 new court cases in 2018), while disputes re the fees pertaining to loan application processing and those referring to loans insured by the National Mortgage Insurance Corporation also increased (443 in total, of which 349 were initiated in 2018). It is expected that more clients will file disputes due to charged loan application processing fees, since the Supreme Court of Cassation rendered the opinion stating that banks should clearly state fees and commissions included in the loan application processing fee.

As regards banks in Serbia, there still have been no legislatively initiatives, however regulatory initiatives exist. In Serbia, the National Bank of Serbia issued a recommendation to all banks in May 2013 and stated that borrowing clients with CHF indexed loans should be given certain reliefs (such as the possibility to repay CHF loans in smaller instalments in the next three years) or that increased interest rates should be reimbursed as a result of interest rate adjustments. Furthermore, the National Bank of Serbia Decision on Measures for Preserving Stability of the Financial System in the Context of Foreign Currency Indexed Loans, which took effect in March 2015, envisages four models of contract amendment (e.g. conversion of CHF indexed loans to EUR indexation based on certain criteria) which banks must offer to clients who borrowed in a foreign currency and who intend to convert indexation. Addiko Bank in Serbia has already met its implementation obligations referring to these regulatory measures. Nevertheless, it should be noted that a small number of clients have accepted the offer and due to slight media and political interest, regulatory changes are not to be expected.

4.2. Capital Management

The strategic goals of the Bank with respect to capital management are as follows:

- Ensuring sufficient capital to meet the minimum regulatory capital requirements in compliance with the regulations of the National Bank of Serbia;
- Ensuring sufficient capital to support the Bank's aptitude for risk assumption and satisfy internal capital needs;
- Ensuring the going concern concept, providing return on equity to the shareholders and benefits to other interested parties;
- Ensuring a strong capital base, as support for further sustainable development of the Bank's operations;
- Capital allocation in line with the Bank's strategic goals, including optimisation of return on internal and regulatory capital.

The Bank's capital management is compliant with the effective relevant legislation and regulations of the National Bank of Serbia governing banking operations. In addition to this, capital management also complies with the requirements of Addiko Group, of which the Bank is a member.

The Bank's Board of Directors defines and approves the Strategy for Capital Management, which constitutes the Bank's basic document for capital management.

The Bank's Executive Board has formed a working body: Risk Management Committee. The Risk Management Committee monitors, analyses and implements simulations and stress tests related to changes in the Bank's capital in the forthcoming period, such as changes in the regulatory capital, capital adequacy and internal capital (calculated based on the Internal Capital Adequacy Assessment Process – ICAAP). The Risk Management Committee proposes to the Executive Board measures for managing the Bank's capital.

The Bank establishes a capital management plan for the purpose of maintaining an adequate level and structure of available internal capital that may support the expected growth of loans and receivables, future sources of funding and their use, risks to which the Bank is exposed and may be exposed to in the forthcoming period, as well as any changes in minimum capital requirement set forth by the Decision on the Capital Adequacy of Banks. Taking into account said elements, including guidelines under the Decision on Risk Management by Banks, the Bank performs capital planning quantification.

The Capital Management Plan includes:

- Strategic objectives and period for their achievement, taking into consideration the influence of the macroeconomic environment and phases of business cycle;
- Manner of organising the available internal capital management process;
- Process and procedures for planning an adequate level of available internal capital;
- Manner of achieving and maintaining an adequate level of available internal capital; and

- Contingency plan in the event of emergencies that may affect the amount of available internal capital.

In accordance with the Decision on the Capital Adequacy of Banks (Official Gazette of RS No. 103/2016) (hereinafter: the Decision'), the Bank is required to maintain the minimum amount of capital in RSD equivalent of EUR 10,0000,000 at the official middle exchange rate of the National Bank of Serbia.

The Bank is required to maintain at all times its capital adequacy ratios listed above at the following minimum prescribed levels:

- the common equity Tier 1 capital ratio (CET1 ratio) minimum of 4.5%;
- the core capital adequacy ratio (T1 ratio) minimum of 6%; and
- the total capital adequacy ratio (CAR) minimum of 8%.

Additionally, the Bank is to maintain capital adequacy ratios increased in a manner that will ensure coverage of the following capital buffer requirements:

- the capital conservation buffer equal to 2.5% of the Bank's total risk-weighted assets; and
- the systemic risk buffer equal to 3% of the total foreign currency and FX indexed corporate and retail loans in the Republic of Serbia on condition that the share of such loans in the total Bank's loans approved to corporate and retail clients is above 10%.

The Decision defines the Bank's regulatory capital is the sum of the core (Tier 1) capital and supplementary (Tier 2) capital, where the core (Tier 1) capital is comprised of the common equity Tier 1 capital (CET1) and additional Tier 1 capital, less deductibles. In order to be included in the core or supplementary capital, items of the Bank's capital must meet the criteria prescribed by the Decision at all times.

The Bank's common equity Tier 1 capital is the sum of the following items (adjusted for the regulatory adjustments less deductible items):

1) shares and other equity instruments;
2) relevant share premium with the common equity Tier 1 instruments;
3) the Bank's profit;
4) revaluation reserves and other unrealised gains;
5) reserves from profit and other reserves of the Bank;
6) reserve funds for general banking risks.

Instruments are included in the Bank's common equity Tier 1 capital only if the Bank may use them unconditionally, fully and without delays to cover or absorb risks or losses if any occur.

Deductible items from the common equity Tier 1 capital are:

1) current and prior year's losses and unrealised losses;
2) intangible assets;
3) deferred tax assets dependable on the Bank's future profitability in line with the effective regulations;
4) defined benefit pension fund assets on the Bank's balance sheet;
5) the Bank's direct, indirect and synthetic holdings of its own common equity Tier 1 instruments, including those that the Bank is under an actual or contingent obligation to repurchase by virtue of a contractual obligation;
6) the Bank's direct, indirect and synthetic holdings of common equity Tier 1 instruments of FSI entities where those entities have reciprocal holdings in the Bank, designed to artificially inflate the Bank's capital;
7) the Bank's applicable direct, indirect and synthetic holdings of common equity Tier 1 instruments of FSI entities where the Bank holds no significant investments;
8) the Bank's applicable direct, indirect and synthetic holdings of common equity Tier 1 instruments of FSI entities where the Bank holds significant investments;
9) the amount for which the Bank's additional Tier 1 capital deductible items exceed the Bank's additional Tier 1 capital;
10) the amount of exposures qualifying for application of a risk weight of 1.250%, where the Bank decides to deduct the exposure from the common equity Tier 1 rather than apply the said risk weight;
11) any tax charge relating to the common equity Tier 1 items foreseeable at the moment of its calculation, except where the Bank has previously suitably adjusted the amount of common equity Tier 1 items insofar as such tax charges reduce the amount up to which those items may be used to absorb risks or losses;
12) amount of the required reserve for estimated losses on the Bank's balance sheet assets and off-balance sheet items.

For purposes of the common equity Tier 1 capital calculation during the year the Bank is required to determine profit/loss at the end of each interim period and deduct all losses from CET1 as these are incurred in accordance with paragraph 1 of the legal provision under 1) of this item.

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

a. shares and other equity instruments that meet the criteria of additional Tier 1 capital instruments;
b. relevant share premiums that accompany additional Tier 1 capital.

Deductible items from additional Tier 1 capital are:

1) the Bank's direct, indirect and synthetic holdings of own s additional Tier 1 capital instruments, including those that the Bank is under an actual or contingent obligation to repurchase by virtue of a contractual obligation;

2) the Bank's direct, indirect and synthetic holdings of additional Tier 1 capital instruments of FSI entities where those entities have reciprocal holdings in the Bank, designed to artificially inflate the Bank's capital;
3) the Bank's applicable direct, indirect and synthetic holdings of additional Tier 1 capital instruments of FSI entities where the Bank holds no significant investments;
4) the Bank's direct, indirect and synthetic holdings of additional Tier 1 capital instruments of FSI entities where the Bank holds significant investments, excluding items that, as the issue underwriter, it has held for no more than five business days or less;
5) the amount for which the Bank's supplementary capital deductible items exceed the Bank's supplementary Tier 2 capital;
6) any tax charge relating to the additional Tier 1 capital items foreseeable at the moment of its calculation, except where the Bank has previously suitably adjusted the amount of additional Tier 1 items insofar as such tax charges reduce the amount up to which those items may be used to absorb risks or losses.

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

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

Deductible items from supplementary Tier 2 capital are:

1) the Bank's direct, indirect and synthetic holdings of own supplementary capital instruments and subordinated liabilities, including those that the Bank is under an actual or contingent obligation to repurchase by virtue of a contractual obligation;
2) the Bank's direct, indirect and synthetic holdings of supplementary capital instruments and subordinated liabilities of FSI entities where those entities have reciprocal holdings in the Bank, designed to artificially inflate the Bank's capital;
3) the Bank's applicable direct, indirect and synthetic holdings of supplementary capital instruments and subordinated liabilities of FSI entities where the Bank holds no significant investments;
4) the Bank's direct, indirect and synthetic holdings of supplementary capital instruments and subordinated liabilities of FSI entities where the Bank holds significant investments, excluding items that, as the issue underwriter, it has held for no more than five business days or less.

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

Calculation of Bank Capital RSD '000

	31 December 2018	31 December 2017
Common Equity Tier 1 Capital (CET1)	11,964,480	12,243,000
Common Equity Tier 1 Capital Instruments	17,517,484	17,517,484
Share premium	3,027,810	3,027,810
Reserves from profit	487,299	–
Losses due to initial application of IFRS 9	(1,126,066)	–
Intangible assets	**(946,053)**	**(680,945)**
Other unrealised losses	(16,255)	(10,641)
Required reserve from profits for estimated losses	**(6,979,739)**	**(7,610,708)**
Additional Tier 1 capital	**–**	**–**
Tier 2 capital	**1,357,258**	**2,063,405**
Subordinate liabilities	**1,357,258**	**2,063,405**
CAPITAL	**13,321,738**	**14,306,405**

In 2018 the Bank calculated the required reserve for estimated losses under the effective NBS Decision on Classification of the Bank Balance Sheet Assets and Off-Balance Sheet Items (Official Gazette of RS nos. 94/2011, 57/2012, 123/2012, 43/2013, 113/2013, 135/2014, 25/2015, 38/2015, 61/2016, 69/2016, 91/2016, 101/2017, 114/2017 and 103/2018).

Capital requirements are calculated in accordance with the Decision on the Capital Adequacy of Banks (Official Gazette of RS Nos. 103/2016 and 103/2018).

A bank whose capital adequacy ratio is higher than or would be higher than 12% due to distribution of profit by less than 2.5 percentage points, may distribute profit only through allocation to the elements of its core capital.

The table below shows the Bank's capital adequacy ratio calculation at year-end 2018 and 2017 in compliance with the requirements of the National Bank of Serbia.

Calculation of the Capital Adequacy Ratio RSD '000

	2018	2017
Capital	**13,321,738**	**14,306,405**
Credit risk weighted assets multiplied by the capital adequacy ratio reciprocal value	61,674,535	54,791,099
Exposure to foreign exchange risk multiplied by the capital adequacy ratio reciprocal value	329,781	617,437
Exposure to price risk multiplied by the capital adequacy ratio reciprocal value	177,154	26,288
Exposure to operational risk	10,066,350	10,060,363
Risk weighted assets per exposures to credit valuation adjustment risk (CVA risk)	163	–
Total Risk-Weighted Assets	**72,247,983**	**65,495,187**
Capital Adequacy Ratio	**18.44%**	**21.84%**

4.3. Fair Value Assessment

The fair value is the price that would be received to sell an asset or paid to transfer obligations in a regular transaction between market participants, on the measurement date.

Fair value of financial instruments traded in an active market (such as tradable securities and securities available for sale) is based on quoted market prices as at the reporting date. Quoted market prices used for the Bank's financial assets represent the current bidding prices. Fair value of financial instruments not traded in the active market (such as derivatives which are traded OTC) is determined by various valuation techniques. The Bank applies different methods and determines assumptions based on the market conditions existing as at the reporting date. Quoted market prices or quoted prices for similar instruments are used for long-term liabilities. Other techniques, such as estimated discounted cash flows, are used for determining the fair value of the remaining financial instruments.

Fair value of interest rate swaps is recalculated as the present value of estimated future cash flows. Fair value of forward FX contracts is determined by applying quoted market exchange rates as at the reporting date. It is assumed that the nominal values of receivables and payables, less any impairment losses, approximate their fair values. Fair values of financial liabilities for disclosure purposes are assessed by discounting future cash flows at the current market interest rate available to the Bank for similar financial instruments.

IFRS 13 - Fair Value Measurement - establishes the fair value hierarchy which categorises the inputs used in valuation techniques into three levels that are applied for fair value measurement:

- Level 1: Quoted market price (unadjusted) in an active market for an identical instrument
- Level 2:Information based on market inputs other than quoted prices included in[1]Level 1 observable either directly (i.e. as prices) or indirectly (i.e. derived from prices) or indirectly (i.e. derived from prices)
- Level 3: Information on an asset or a liability that are not based on observable market data (unobservable inputs).

Fair value of financial instruments traded in active markets is based on quoted market prices as of the balance sheet date. A market is deemed active if quoted prices are immediately and regularly available at the stock exchange, with dealers, brokers, industrial groups, units for pricing or the regulatory agency, and if the said prices reflect the current market transactions, which are regularly performed at arm's length. Quoted market prices used for the Bank's financial assets represent current bidding prices. The said instruments are recorded within Level 1 of the fair value hierarchy. The instruments within Level 1 primarily include BELEX investments into equity instruments classified as financial assets held for trading or financial assets available for sale. Fair value of financial instruments not traded in an active market (such as derivatives traded OTC, with publicly available data) is determined by application of various valuation techniques. Those valuation techniques use observable data from the market as much as possible, if available, and rely on special estimates of the Bank as little as possible. If all materially significant inputs necessary for determining fair value of an instrument are present, the instrument measured is classified within Level 2 of the fair value hierarchy.

If one or more materially significant inputs are not based on available market data, the instrument is classified within Level 3 of the fair value hierarchy. Special valuation techniques used for financial instruments are:

- Quoted market prices or prices of dealers for similar instruments,
- Fair value of interest rate swaps is calculated as the present value of estimated future cash flows based on the available yield trend,
- Fair value of forward FX contracts is determined by application of forward exchange rates as of the reporting date, with discounting the acquired value to the present value,
- Other techniques, such as analysis of discounted cash flow, are used to determine fair values of the remaining financial instruments.

Fair Value of Financial Assets and Liabilities Carried at Fair Value

In 2018 and 2017, the Bank did not transfer financial assets held for trading and financial assets available for sale from Level 1 to Level 2.

RSD '000

31 December 2018	Level 1	Level 2	Level 3	Total
Financial assets				
Securities	–	11,108,524	–	11,108,524
Receivables under derivatives	–	25,656	–	25,656
Total financial assets	**–**	**11,134,180**	**–**	**11,134,180**
Financial liabilities				
Liabilities under derivatives	–	(24,942)	–	(24,942)
Other financial liabilities	**–**	**(24,942)**	**–**	**(24,942)**

RSD '000

31 December 2017	Level 1	Level 2	Level 3	Total
Financial assets				
Securities		16,880,855	–	16,880,855
Receivables under derivatives	–	157,022	–	157,022
Total financial assets	**–**	**17,037,877**	**–**	**17,037,877**
Financial liabilities				
Liabilities under derivatives	–	(32,347)	–	(32,347)
Other financial liabilities	**–**	**(32,347)**	**–**	**(32,347)**

Fair value of financial derivatives in established by discounting cash flows at interest rates taken from Reuters or Bloomberg.

Fair value of treasury bills is calculated on the basis of their par value discounting by the interest rate published on the website of the Treasury Department of the Ministry of Finance.

Fair Value of Financial Assets and Liabilities Carried at Other than Fair Value

The Bank assessed the fair values of the financial instruments carried at other than fair value, as follows:

- By discounting the expected future cash inflows from financial assets at the expected rate of return, consisting of the 'risk-free' interest rate and premiums for credit risk per corresponding maturities of the financial assets,
- By discounting the expected future cash outflows arising from financial liabilities at the 'risk-free' interest rate plus the zero credit spread applicable to the corresponding financial liability according to its maturity.

The Bank's management believes that, due to the nature of the Bank's financial assets, as well as the type of its clients, the carrying amounts of loans and receivables due from banks and other financial institutions do not depart from their fair values.

Fair values of the financial instruments carried at other than fair value as of 31 December 2018 are presented in the table below:

RSD ’000

	Carrying value	Fair value	Level 3
Financial assets			
Cash and balances held with the Central Bank	11,174,771	11,174,771	11,174,771
Loans and receivables due from banks and other financial institutions	2,442,156	2,441,937	2,441,937
Loans and receivables due from clients	73,001,855	75,626,320	75,626,320
Other assets	361,594	361,594	361,594
Total	**86,980,376**	**89,604,622**	**89,604,622**
Financial liabilities			
Deposits and other liabilities due to banks, other financial institutions	7,589,826	7,589,826	7,589,826
Deposits and other liabilities due to clients	65,789,053	66,432,186	66,432,186
Subordinate liabilities	3,911,759	3,911,759	3,911,759
Other liabilities	830,598	830,598	830,598
Total	**78,121,236**	**78,764,369**	**78,764,369**

Fair values of the financial instruments carried at other than fair value as of 31 December 2017 are presented in the table below:

RSD ’000

	Carrying value	Fair value	Level 3
Financial assets			
Cash and balances held with the Central Bank	10,575,958	10,575,958	10,575,958
Loans and receivables due from banks and other financial institutions	2,828,041	2,831,799	2,831,799
Loans and receivables due from clients	61,639,577	64,728,599	64,728,599
Other assets	476,834	476,834	476,834
Total	**75,520,410**	**78,613,190**	**78,613,190**
Financial liabilities			
Deposits and other liabilities due to banks, other financial institutions and the Central Bank	5,382,756	5,447,969	5,447,969
Deposits and other liabilities due to other clients	61,919,011	62,043,660	62,043,660
Subordinate liabilities	3,774,141	4,339,931	4,339,931
Other liabilities	454,425	454,425	454,425
Total	**71,530,333**	**72,285,985**	**72,285,985**

5. Interest Income and Expenses

RSD '000

	2018	2017
a) Interest income from:		
Required reserves held with the Central Bank	55,040	71,701
Operations with the Central Bank	825	2,890
Loans due from banks and financial institutions	16,408	38,235
Loans due from corporate clients	1,209,725	1,269,759
Loans due from retail clients	2,107,563	1,944,947
Corporate loan origination fees	101,301	97,762
Retail loan origination fees	122,062	97,331
Securities	539,755	639,358
Total interest income	**4,152,679**	**4,161,983**
b) Interest expenses from:		
Liabilities due to banks and financial institutions	40,130	15,364
Liabilities due to corporate clients	434,290	444,160
Liabilities due to retail clients	282,209	274,234
Borrowings	226,885	219,165
Total interest expenses	**983,514**	**952,923**
Net interest income	**3,169,165**	**3,209,060**
a) Interest income		
Financial assets available for sale	27,181	34,054
Financial assets measured through other comprehensive income	512,574	605,304
Financial assets measured at amortised cost	3,612,924	3,522,625
Total interest income	**4,152,679**	**4,161,983**

Interest expenses per financial liabilities were measured at amortized cost in the entire amount. Interest income on impaired NPLs (unwinding) amounted to RSD 126,484 thousand (2017: RSD 201,875 thousand).

6. Fee and Commission Income and Expenses

RSD '000

	2018	2017
a) Fee and commission income		
Issued guarantees and other surety fees	115,709	83,737
Domestic payment fees	378,123	351,511
Foreign payment fees	138,411	142,292
Card operation fees	287,992	258,586
Financial asset operation fees	133	104
Other fees collected from banks and other financial institutions	2,192	2,370
Other fees from corporate clients	16,928	23,552
Currency sales/purchase fees	173,572	175,802
Retail account maintenance fees	175,854	40,250
Other retail client fees	112,500	187,681
Total fee and commission income	**1,401,414**	**1,265,885**
b) Fee and commission expenses		
Bank transaction fees	3,424	3,600
Corporate client transaction fees	11,610	12,414
Domestic payment fees	39,319	37,499
Foreign payment fees	46,374	45,467
Card operation fees	30,727	24,393
Securities fees	977	1,823
Total fee and commission income and expenses	**132,431**	**125,196**
Net Income And Commission Fees	**1,268,983**	**1,140,689**

Fee and commission income and expenses per financial assets/liabilities were measured at amortized cost in the entire amount.

7. Net Gains on Changes In The Fair Value Of Financial Instruments

RSD '000

	2018	2017
Losses on the value adjustment of derivatives held for trading	(24,943)	(32,412)
Gains on the value adjustment of derivatives held for trading	261,294	539,050
Fair value adjustments of securities held for trading	5,047	(18,854)
Net gains on financial assets held for trading	**241,398**	**487,784**
Losses on financial assets available for sale	(79,774)	(269,189)
Gains on financial assets available for sale	223,934	423,588
Net gains on financial assets available for sale	26,464	29,029
Net gains on financial assets available for sale	**170,624**	**183,428**
Total	**412,022**	**671,212**

8. Net Foreign Exchange (Losses)/Gains and (Negative)/Positive Currency Clause Effects

RSD '000

	2018	2017
Foreign exchange losses per foreign currency receivables and liabilities	(33,893,423)	(38,167,248)
Negative currency clause effects per receivables	(620,146)	(3,296,142)
Negative currency clause effects per liabilities	(1,300)	(416)
Total foreign exchange losses	**(34,514,869)**	**(41,463,806)**
Foreign exchange gains per foreign currency receivables and liabilities	33,773,166	40,921,536
Positive currency clause effects per receivables	731,616	446,913
Positive currency clause effects per liabilities	1,242	3,318
Total foreign exchange gains	**34,506,024**	**41,371,767**
Net Effect	**(8,845)**	**(92,039)**

9. Other Operating Income

RSD '000

	2018	2017
Rental income	3,451	4,538
Income from unused employee bonuses	–	18,088
Other income from employees	4,971	10,823
Income per the centralised management function	161,767	202,619
Gains on the sales of loans and receivables	–	240,304
Other income	74,510	23,124
Total other operating income	**244,699**	**499,496**

10. Other Income

RSD '000

	2018	2017
Gains on the sales of other equipment	10,413	26,885
Gains on the sales of non-current assets held for sale (Note 23)	–	858
Collected damages	92	403
Reversal of provisions for liabilities (Note 23)	79,744	345,077
Other income	20,465	9,687
Total other income	**110,714**	**382,910**

11. Net Reversal Of/(Losses) on Impairment Of Financial Assets not Measured at Fair Value Through Profit or Loss

Losses on impairment of financial assets not measured at fair valuethrough profit or loss RSD '000

	2018	2017
Losses on impairment of financial assets		
Loans and receivables due from banks and other financial institutions (Note 20c)	(995)	–
Loans and receivables due from clients (Note 20c)	(12,235,694)	(4,996,146)
Securities	(1,591)	–
Other assets (Note 20c)	(3,722)	(15,627)
Write-offs in the course of the year	(1,536,931)	(2,816,341)
Total expenses on the impairment of balance sheet items	**(13,778,933)**	**(7,828,114)**
Provisions for losses per off-balance sheet assets	(277,771)	(68,811)
Total expenses	**(14,056,704)**	**(7,896,925)**
Gains on reversal of impairment of financial assets not measured at fair value through profit or loss		
Loans and receivables due from clients (Note 20c)	13,779,013	6,996,933
Securities	55,895	–
Collected in the course of the year	279,727	722,063
Total on balance sheet assets	**14,114,635**	**7,718,996**
Income from the release of provisions for off-balance sheet items	226,594	94,356
Total income	**14,341,228**	**7,813,352**
Net reversal of/(losses) on impairment of financial assets not measured at fair value through profit or loss	**284,523**	**(83,573)**

12. Salaries, Salary Compensations and Other Staff Costs

RSD '000

	2018	2017
Net salaries	895,939	944,813
Payroll taxes and contributions	343,994	354,607
Other staff costs	185,555	129,807
Provisioning charge for termination benefits (Note 28)	18,883	17,390
Provisioning charge for retirement benefits (Note 28)	5,911	11,582
Total salaries, salary compensations and other staff costs	**1,450,282**	**1,458,199**

13. Amortisation/Depreciation Costs

RSD '000

	2018	2017
Amortisation charge of intangible assets	107,490	101,255
Depreciation charge of leasehold improvements	19,300	30,362
Depreciation charge of buildings	9,434	10,253
Depreciation charge of other equipment	51,711	65,363
Total amortisation and depreciation charge	**187,935**	**207,233**

14. Other Expenses

RSD '000

	2018	2017
Donations and financial aid	29,363	20,761
Leases (rentals)	296,664	320,633
Other costs related to rented premises	84,692	89,225
Insurance premiums	298,000	302,122
Entertainment	5,815	11,076
Marketing and advertising	201,748	197,508
IS usage	556,286	584,807
Cost of fuel for vehicles and vehicle maintenance	6,488	8,498
Telecommunications and postage services	80,582	85,293
Membership fees, foreign and domestic	2,944	3,017
Indirect taxes and contributions	238,673	242,660
Consultant services	62,690	118,303
Municipal utilities	46,418	51,975
Office supplies	6,396	10,214
Other expenses to and on behalf of employees	52,471	54,137
Court and administrative fees	61,222	36,969
Costs of card operations	112,261	104,516
Security services	66,358	77,508
Other administrative costs	107,707	101,296
Cost of materials	2,632	4,036
Losses on write-off and sales of property, equipment and intangible assets	14,603	89,869
Cost of provisions for liabilities (Note 28)	110,015	35,990
Other expenses	58,290	292,506
Total Other Expenses	**2,502,318**	**2,842,919**

Rental costs mostly relate to the rent paid for the lease of business premises of RSD 262,275 thousand (2017: RSD 280,292 thousand). Insurance premiums mostly comprise insurance of deposits amounting to RSD 272,663 thousand (2017: RSD 285,310 thousand). Indirect taxes and contributions are payroll taxes and contributions charged to the Bank as the employer. Marketing and advertising costs mostly pertain to the costs of TV commercial of RSD 88,337 thousand (2017: RSD 86,532 thousand), internet advertising of RSD 31,760 thousand (2017: RSD 22,730 thousand), while the remaining costs included research, promotional materials, etc. IS usage costs mostly refer to the costs of services relating to the core banking system of RSD 274,705 thousand (2017: RSD 339,304 thousand), while costs of licenses and software maintenance amounted to RSD 94,613 thousand (2017: RSD 118,133 thousand).

15. Income Tax

(a) Components of income tax

Total income tax expense comprises RSD '000

	2018	2017
Current income tax expenses	(1,025)	(1,156)
Total	**(1,025)**	**(1,156)**
Calculated tax on the initial application of IFRS 9	(39,743)	–
Calculated income tax	(1,025)	(1,156)
Total income tax expense	**(40,768)**	**(1,156)**

(b) Reconciliation of the Tax Expense Recognised in the Income Statement and Profit Before Tax and the Statutory Income Tax Rate

RSD '000

	2018	2017
Profit before taxes	**1,340,726**	**1,219,404**
Income tax at the rate of 15%	**201,109**	**182,911**
Tax effects of income and expenses not recognised for tax purposes	(45,459)	48,624
Tax on capital gains	1,025	1,156
Tax losses utilised	(155,650)	(231,535)
Other	39,743	–
Tax losses carried forward	–	–
Total income taxes included in the income statement	**40,768**	**1,156**
Effective tax rate	**0.10%**	**0.10%**

(c) Basis for recording deferred tax assets and liabilities and their effect on the Bank's income statement for 2018 and 2017:

RSD '000

	Deferred tax assets 2018	Deferred tax liabilities 2018	Income statement 2018	Deferred tax assets 2017	Deferred tax liabilities 2017	Income statement 2017
Unrealised gains on available-for-sale securities	–	(33,785)	–	–	(32,100)	–
Unrealised losses due to initial application of IFRS 9	158,974	–	39,743	–	–	–
	158,974	**(33,785)**	**39,743**	**–**	**(32,100)**	**–**

Unused Tax Losses

RSD '000

Year of inception	Tax loss amount	Portion utilised	Year of utilisation	Remaining tax loss amount	Year of expiry
2013	7,565,484	2,581,233	2017/2018	–	2018
2014	1,996,873	–	–	1,996,873	2019
2015	7,080,127	–	–	7,080,127	2020
2016	1,463,306	–	–	1,463,306	2021
Total	**18,105,790**	**2,581,233**		**10,540,306**	

Losses stated in the tax statement, other than capital gains and losses, are available for carryforward against taxable profit of the future accounting periods for duration of no longer than five years.

As at 31 December 2018, the Bank formed deferred tax assets per initial application of IFRS 9 in the amount RSD 198,717 thousand, usable in the forthcoming 5-year period. In the current year, 2018, RSD 39,743 thousand was utilised.

In the following year, the Bank will reassess its unrecognised deferred tax assets and recognise them to the extent it is probable that future taxable income will be available to allow for the recovery of deferred tax assets as prescribed by IAS 12. Paragraph 37.

16. Cash and Balances Held With the Central Bank

RSD '000

	2018	2017
In RSD		
Gyro account	**2,865,593**	**4,323,783**
Cash on hand	933,803	797,278
Interest receivables from NBS	3,710	15
Total in RSD	**3,803,106**	**5,121,076**
In foreign currencies		
Required foreign currency reserve	6,767,057	4,996,190
Cash on hand	604,590	458,384
Foreign currency accounts for trading in securities	18	308
Total in foreign currencies	**7,371,665**	**5,454,882**
Balance as at 31 December	**11,174,771**	**10,575,958**

In the statement of cash flows, cash and cash equivalents are considered cash assets held on the Bank's accounts, cash on hand, FX assets held on accounts with domestic and foreign banks.

The following items are included in cash and cash equivalents for the purposes of the cash flow statement:

RSD '000

	2018	2017
Gyro account	2,865,593	4,323,783
Cash on hand	1,538,393	1,255,662
Foreign currency accounts held with foreign banks	1,479,675	310,453
Foreign currency accounts for trading in securities	18	24
Balance as at 31 December	**5,883,679**	**5,889,922**

In 2018 the Bank calculated the required RSD and foreign currency reserves in accordance with the Decision on Obligatory Reserves Held with the National Bank of Serbia (Official Gazette of RS nos. 3/2011, 31/2012, 57/2012, 78/2012, 87/2012, 107/2012, 62/2013, 125/2014, 135/2014, 4/2015, 78/2015 and 102/2015) until October 2018. Under the Amendment to the Decision from October 2018 (Official Gazette of RS no.76/2018), the funds received from the international financial institution shall no longer be fully exempt from the required reserve calculation.

The Bank is required to notify NBS by the end of each calendar month of its intention not to calculate the required reserve on the balance of funds received from the international financial institutions after October 17, 2018 as from the ensuing period. At the same time, the Bank is required to submit to NBS information on the sources and amounts of such funds received, purpose of the funds and interest rates per sources of funding and per of loans extended from such funds and on the average interest margins on the loans approved from other sources.

The Bank is under obligation to maintain the average daily balance of the allocated required reserve over the reporting period in the amount of the calculated required reserve, where it is allowed that during the month daily balances of both RSD and foreign currency required reserves may be above or below the calculated required reserves. All days within the accounting period are taken into account in calculation of the average daily balance of the required reserve.

The RSD required reserve is calculated for deposits, loans and securities as well as other RSD denominated liabilities with the exception of RSD deposits received under transactions calculated by the Bank in the name and on behalf of third parties. Such amounts, however, do not exceed loans and receivables amounts which the Bank extended from these deposits.

The required reserve allocated in RSD consists of the sum of the calculated RSD reserve and a portion of the calculated FX reserve. For the basis which includes FX reserves with maturities of up to two years, the calculated required reserve was allocated in RSD, at 38%. For the basis which includes FX reserves with maturities over two years, the calculated required reserve was allocated in RSD, at 30%. The allocations were made in these percentages throughout the reporting period.

As at 31 December 2018, the calculated RSD required reserve, the amount of which had to be maintained in the gyro account from 18 December 2018 to 17 January 2018, totalled RSD 4,130,660 thousand and was in compliance with said Decision of the National Bank of Serbia.

In 2018, the required RSD reserve was calculated at the following unchanged rates:

- 5% – applicable to the amount of RSD liabilities with agreed maturities of up to two years;
- 0% – applicable to the amount of RSD liabilities with agreed maturities of over two years;

The National Bank of Serbia pays interest to banks on the amount of the actual average daily balance of the allocated RSD required reserve in the reporting period, up to the amount of the calculated RSD required reserve.

The interest rate payable by the National Bank of Serbia throughout 2018 was 1.75% p.a. from January to March, 1.5% p.a. from March to April, and 1.25% from April till the end of 2018.

In 2018, the required FX reserve was calculated at the following unchanged rates:

- 20% – applicable to the amount of FX liabilities with agreed maturities of up to two years;
- 13% – applicable to the amount of FX liabilities with agreed maturities of over two years;
- 100% – applicable to the amount of RSD liabilities with the currency clause index, irrespective of maturity.

In 2018, the calculated required reserve allocated in foreign currency in percentage terms remained unchanged throughout the year. Allocated reserves in foreign currency amounted to:

- 62% of the amount calculated on foreign currency liabilities and currency clause-indexed liabilities with agreed maturities of up to two years,
- 70% the amount calculated on foreign currency liabilities and currency clause-indexed liabilities with agreed maturities of over two years.

As at 31 December 2018, the calculated FX required reserve, the amount of which had to be maintained from 18 December 2018 to 17 January 2019, totalled EUR 47,325 thousand.

The National Bank of Serbia does not pay any interest on the amount of the average balance of the allocated foreign currency reserve.

17. Receivables and Liabilities Under Derivatives

RSD ’000

	2018	2017
Derivative receivables	25,656	157,022
Total securities	**25,656**	**157,022**
Derivative payables	24,942	32,347
Total securities	**24,942**	**32,347**

All derivative financial instruments are carried at fair value within the Bank’s off-balance sheet items with positive changes in the fair value of derivatives recognised as assets and negative changes in the fair value of derivatives as liabilities. Fair value at the beginning of a transaction equals the price of the transaction.

The table below shows contracts for FX swaps with the settlement dates after the reporting date in gross amounts as at 31 December 2018:

RSD '000

	Contracts with positive value	Positive fair value	Contracts with negative value	Negative fair value
FX swap - Receivable on settlement date RSD / Liability on settlement date EUR	RSD 714,210,000 / EUR 6,000,000	3,968	–	–
FX swap - Receivable on settlement date RSD / Liability on settlement date EUR	RSD 595,300,000 / EUR 5,000,000	3,300	–	–
FX swap - Receivable on settlement date GBP / Liability on settlement date EUR	GBP 541,452 / EUR 600,000	67	–	–
FX swap - Receivable on settlement date RSD / Liability on settlement date EUR	RSD 6,012,168,240 / EUR 50,700,000	17,927	–	–
FX swap - Receivable on settlement date CHF / Liability on settlement date EUR	–	–	CHF 37,516,000 / EUR 33,200,000	12,723
FX swap - Receivable on settlement date CHF / Liability on settlement date EUR	–	–	CHF 3,029,400 / EUR 2,700,000	1,092
FX swap - Receivable on settlement date EUR / Liability on settlement date RSD	–	–	EUR 20,000,000 / RSD 2,369,996,000	6,104
FX swap - Receivable on settlement date USD / Liability on settlement date EUR	–	–	USD 11,057,515 / EUR 9,700,000	3,944
FX swap - Receivable on settlement date EUR / Liability on settlement date RSD	–	–	EUR 12,000,000 / RSD 1,420,512,000	1,079
Forward transactions	USD 110,000 / RSD 11,463,001	93	–	–
Forward transactions	USD 110,000 / RSD 11,459,206	89	–	–
Forward transactions	USD 100,000 / RSD 10,425,950	91	–	–
Forward transactions	USD 70,000 / RSD 7,289,093	53	–	–
Forward transactions	USD 100,000 / RSD 10,406,570	68	–	–
Fair value at year-end		**25,656**	**–**	**24,942**

The table below shows contracts for foreign currency swaps with the settlement dates after the reporting date in gross amounts as at 31 December 2017:

RSD '000

	Contracts with positive value	Positive fair value	Contracts with negative value	Negative fair value
FX swap - Receivable on settlement date EUR / Liability on settlement date CHF	EUR 49,500,000 / CHF 57,776,895	12,413	–	–
FX swap - Receivable on settlement date EUR / Liability on settlement date RSD	EUR 6,700,000 / RSD 804,339,020	10,572	EUR 6,700,000 / RSD 804,339,020	10,572
FX swap - Receivable on settlement date RSD / Liability on settlement date EUR	EUR 2,000,000 / RSD 240,072,000	2,880	RSD 835,849,700 / EUR 7,000,000	3,348
FX swap - Receivable on settlement date CAD / Liability on settlement date EUR	CAD 457,665 / EUR 300,000	566	–	–
FX swap - Receivable on settlement date GBP / Liability on settlement date EUR	–	–	GBP 972,686 / EUR 1,100,000	582
FX swap - Receivable on settlement date EUR / Liability on settlement date USD	–	–	USD 7,096,200 / EUR 6,000,000	7,751
FX swap - Receivable on settlement date CHF / Liability on settlement date EUR	CHF 57,948,363 / EUR 49,500,000	4,955	EUR 48,500,000 / CHF 56,758,580	4,443
FX swap - Receivable on settlement date RSD / Liability on settlement date EUR	RSD 835,849,700 / EUR 7,000,000	3,348	EUR 2,000,000 / RSD 240,072,000	2,880
FX swap - Receivable on settlement date RSD / Liability on settlement date EUR	RSD 8,759,481,700 / EUR 73,000,000	110,292	–	–
FX swap - Receivable on settlement date RSD / Liability on settlement date EUR	RSD 358,306,500 / EUR 3,000,000	2,888	EUR 73,500,000 / RSD 8,711,175,900	2,744
FX swap - Receivable on settlement date RSD / Liability on settlement date EUR	RSD 59,739,300 / EUR 500,000	498	–	–
FX swap - Receivable on settlement date RSD / Liability on settlement date EUR	RSD 598,421,500 / EUR 5,000,000	2,330	–	–
FX swap - Receivable on settlement date AUD / Liability on settlement date EUR	AUD 2,629,560 / EUR 1,700,000	1,818	–	–
FX swap - Receivable on settlement date RSD / Liability on settlement date EUR	RSD 238,267,000 / EUR 2,000,000	1,238	–	–
FX swap - Receivable on settlement date RSD / Liability on settlement date EUR	RSD 4,800,000 / EUR 571,831,680	417	–	–
FX swap - Receivable on settlement date RSD / Liability on settlement date EUR	RSD 8,726,802,000 / EUR 73,500,000	1,767	–	–
FX swap - Receivable on settlement date RSD / Liability on settlement date EUR	RSD 474,331,600 / EUR 4,000,000	22	–	–
Forward transactions	USD 38,813 / RSD 3,914,274	67	EUR 100,000 / USD 119,380	15
Forward transactions	USD 56,552 / RSD 5,703,056	101	USD 15,000 / RSD 1,485,415	1
Forward transactions	USD 53,321 / RSD 5,384,709	98	EUR 150,000 / USD 179,205	10
Forward transactions	USD 44,987 / RSD 4,561,859	101	USD 35,000 / RSD 3,468,325	1
Forward transactions	USD 69,152 / RSD 7,006,861	150	–	–
Forward transactions	USD 55,000 / RSD 5,541,619	87	–	–
Forward transactions	USD 45,000 / RSD 4,523,526	63	–	–
Forward transactions	USD 30,000 / RSD 3,013,347	40	–	–

RSD '000

	Contracts with positive value	Positive fair value	Contracts with negative value	Negative fair value
Forward transactions	USD 55,000 / RSD 5,533,044	80	–	–
Forward transactions	USD 45,000 / RSD 4,530,542	69	–	–
Forward transactions	USD 57,128 / RSD 5,696,369	29	–	–
Forward transactions	USD 100,657 / RSD 10,030,929	48	–	–
Forward transactions	USD 46,333 / RSD 4,623,498	27	–	–
Forward transactions	USD 49,433 / RSD 4,936,261	31	–	–
Forward transactions	USD 30,390 / RSD 3,026,438	13	–	–
Forward transactions	USD 15,000 / RSD 1,488,444	1	–	–
Forward transactions	USD 20,000 / RSD 1,987,282	4	–	–
Forward transactions	USD 30,000 / RSD 2,984,952	8	–	–
Forward transactions	USD 20,000 / RSD 1,983,246	1	–	–
Fair value at year-end		157,022		32,347

18. Securities

RSD '000

	2018	2017
Securities measured through profit or loss	705,599	101,474
Securities measured through capital	10,402,924	16,189,952
Investment units measured through capital	**–**	**589,429**
Investment units measured through profit and loss	1	–
Total securities	**11,108,524**	**16,880,855**

Allowance for impairment on securities measured through other comprehensive income is presented within equity in the amount of RSD 1,464 thousand.

Debt securities of the Republic of Serbia may be short-term and long-term, in local or foreign currencies.

Short-term debt securities are issued in the form of no coupon treasury bills by the Republic of Serbia Ministry of Finance.

Long-term debt securities are issued in the form of coupon bonds by the Republic of Serbia.

The nominal value is 10,000.00 monetary units if a debt security is denominated in RSD, or 1,000 if it is denominated in foreign currency.

Debt securities of the Republic of Serbia are issued with maturities ranging from 1 to 15 years.

The market value of the Republic of Serbia debt securities is calculated by discounting all future cash flows of the securities by the relevant debt securities interest rate used in the most recent auctions as published on the website of the Treasury Department of the Ministry of Finance.

In 2018, the Bank invested its free RSD funds in debt securities of the Republic of Serbia at interest rates (rates of return) ranging from 4.08% to 4.70% p.a. (2017: from 4.05% to 5.60% p.a.), in USD at an interest rate of 4.40% p.a. (2017: from 3.10% to 4.01% p.a.). In 2018, the Bank also invested its free RSD funds into RSD bonds of EBRD at the average rate of return of 3.41% p.a.

The Bank earned interest income through investments in securities at fair value through OCI in 2018 in the amount of RSD 512,574 thousand (2017: RSD 606,067 thousand).

Securities measured through OCI RSD '000

Opening gross balance as at 1 January 2017	**16,781,879**
Decrease during the year	(127,762)
Net gains on sales	154,399
Interest income	606,067
Increase in unrealised loss	35,673
Reserves decreased	(21,849)
Foreign exchange effects	(649,026)
Net balance as at 31 December 2017	**16,779,381**
Opening gross balance as at 1 January 2018	**16,779,381**
Decrease during the year	(7,291,733)
Net gains on sales	303,708
Interest income	512,574
Increase in unrealised loss	(5,614)
Reserves increased	139,154
Foreign exchange effects	(34,546)
Net balance as at 31 December 2018	**10,402,924**

In 2018, the Bank earned interest income on investments in securities held for trading in the amount of RSD 27,181 thousand (2017: RSD 34,054 thousand).

Securities within the Bank's portfolio are remeasured every ten days. A number of days remaining to maturity is considered for each security and the pricing is performed by interpolation of the interest rates applied according to the number of days to maturity.

Interest rate input data for remeasurement of securities are obtained from Bloomberg and Reuters systems. The most recent interest rate on securities in the auctions held by the Ministry of Finance are obtained from Bloomberg. Interest rates for RSD securities with maturities below 3 months and EUR securities with maturities below 12 months are obtained from the Reuters system (Reuter's interbank interest rates) as follows:

- Overnight and 2-week rates are applied to RSD securities,
- Overnight rate increased by annual CDS of the Republic of Serbia expressed in USD (YCCD2104) is applied to EUR securities.

The prices made are imported into the Bank's information system where each price is multiplied by the par value of the security and divided by 100. The value arrived at in this manner represents the security's current value.

The fair value is obtained by deducting the sum of the cost and deferred discount value from the securities current value.

19. Loans and Receivables Due From Banks and Other Financial Institutions

RSD '000

	2018	2017
In RSD		
Loans and receivable under REPO transactions	–	800,000
Loans and receivables to banks	–	853,244
Loans and receivables to other financial institution	10,271	10,318
Total in RSD	**10,271**	**1,663,562**
In foreign currencies		
Foreign currency accounts held with other banks	1,482,406	310,597
FX loans and receivables	952,684	859,218
Other FX loans and receivables	33	271
Total in foreign currencies	**2,435,123**	**1,170,086**
Gross loans and receivables due from banks		
Allowance for impairment in RSD	(20)	(5,575)
Allowance for impairment in foreign currencies	(3,218)	(32)
Total	**2,442,156**	**2,828,041**

In 2018, the Bank approved RSD loans to other banks at interest rates ranging from 2% to 3.1% p.a. (2017: from 2% to 3.1%), EUR loans at interest rates ranging between 0% and 2.42% p.a.(2017: between 0% and 2.42%), and USD loans at interest rates ranging between 0.88% and 1.1% p.a. (2017: between 0.88% and 1.1%).

20. Loans and Receivables Due From Clients

In 2018, the Bank sold receivables due from 398 clients and the gross value of the sold receivables recalculated in EUR totalled EUR 21.5 million.

The table below shows loans and receivables due from clients grouped per initial net maturities:

RSD '000

	2018.			2017.		
	Short-term	Long-term	Total	Short-term	Long-term	Total
In RSD						
- Legal entities (corporate clients)	4,173,064	358,630	4,531,694	1,462,645	619,301	2,081,946
- Retail (private individuals)	907,257	17,905,608	18,812,865	894,875	10,843,675	11,738,550
- Public sector	137,492	175,952	313,444	42,037	1,241,338	1,283,375
- Other clients	38,304	26,518	64,822	478,137	76,649	554,786
Total In RSD	**5,256,117**	**18,466,708**	**23,722,825**	**2,877,694**	**12,780,963**	**15,658,657**
In foreign currencies						
- Legal entities (corporate clients)	16,699,331	21,581,907	38,281,238	11,300,707	19,396,896	30,697,603
- Retail (private individuals)	1,531,584	15,732,802	17,264,386	4,167,370	17,700,191	21,867,561
- Public sector	609,726	74,484	684,210	153,868	1,404,022	1,557,890
- Other clients	100,601	374,463	475,064	181,596	334,892	516,488
Total in foreign currencies	**18,941,242**	**37,763,656**	**56,704,898**	**15,803,541**	**38,836,001**	**54,639,542**
Gross loans	**24,197,359**	**56,230,364**	**80,427,723**	**18,681,235**	**51,616,964**	**70,298,199**
Allowance for impairment						
- In RSD	(246,505)	(1,404,468)	(1,650,973)	(793,397)	(5,054,477)	(5,847,874)
- In foreign currency	(708,852)	(5,066,043)	(5,774,895)	(356,824)	(2,453,924)	(2,810,748)
Total allowance for impairment	**(955,357)**	**(6,470,511)**	**(7,425,868)**	**(1,150,221)**	**(7,508,401)**	**(8,658,622)**
Balance as at 31 December	**23,242,002**	**49,759,853**	**73,001,855**	**17,531,014**	**44,108,563**	**61,639,577**

In 2018, loan interest for clients of the Corporate Banking and Public Sector division was accrued depending on a particular clients' credit rating, type of loan and provided collateral.

Accordingly, interest for working capital loans approved to corporate clients in 2018 was accrued at the rate equalling EURIBOR increased by the average spread of 3.16% p.a. for foreign currency indexed loans and at the rate equalling BELIBOR increased by the average spread of 2.33% p.a. for RSD loans (in 2017: EURIBOR increased by the average spread of 3.22% p.a. for foreign currency indexed loans and BELIBOR increased by the average spread of 2.24% p.a. for RSD loans).

In 2018, investment loans were approved to legal entities for the maximum period of 7 years and at average spread of 3.29% p.a. increased by EURIBOR, for foreign currency indexed loans, while long-term RSD loans were approved for the average period of 2014 at a spread of 2.74% p.a. increased by BELIBOR(in 2017: long-term loans to legal entities were approved for the maximum period of 7 years at the average spread of 3.24% p.a. increased by EURIBOR, for foreign currency indexed loans, whereas long-term RSD loans were approved for the average period of 24 months at a 2.16% p.a. spread, increased by BELIBOR).

All-purpose retail loans in RSD were extended during 2018 at interest rates ranging from 6.99% to 18% p.a. (2017: from 6.99% to 19.99%)

(b) Breakdown per Loan Type

RSD '000

	2018	2017
Loans per transaction accounts	371,847	326,998
Overdraft loans	27,844	10,890
Consumer loans	40,178	147,192
Cash loans	18,351,971	11,261,143
Working capital loans	29,300,381	25,361,431
Investment loans	6,645,135	7,970,716
Housing loans	16,339,328	20,452,568
Credit cards	346,056	372,974
Other loans	8,960,156	3,944,837
Receivables per payment under guarantee called on	44,827	449,450
Total gross loans	**80,427,723**	**70,298,199**
Allowance for impairment of extended loans	(7,425,868)	(8,658,622)
Balance as at 31 December	**73,001,855**	**61,639,577**

(c) Movements on the Accounts of Impairment Allowances of Financial Assets and Other Assets

The table below shows allowance for impairment movements in 2018 and 2017:

RSD '000

	Per loans due from banks (Note 17)	Per loans due from clients (Note 18)	Other assets (Note 24)	Total
Balance as at 1 January 2017	**(8,820)**	**(14,329,257)**	**(85,282)**	**(14,423,359)**
Charge for the year (Note 10)	–	(7,812,487)	(15,627)	(7,828,114)
Reversal of impairment allowance credited to income (Note 10)	–	6,937,399	–	6,937,399
Foreign exchange effects	–	871,421	1,153	872,574
Write-off and derecognition	3,213	5,412,893	31,254	5,447,360
Decrease per unwinding effect IFRS 5	–	201,875	–	201,875
		59,534		59,534
Balance as at 31 December 2017	**(5,607)**	**(8,658,622)**	**(68,502)**	**(8,732,731)**
First application of IFRS 9				
Additional allowance for impairment	3,364	(1,262,012)	(1,010)	(1,259,658)
Suspended interest	**–**	**(1,715,195)**	**–**	**(1,715,195)**
Balance as at 1 January 2018	**(2,243)**	**(11,635,829)**	**(69,512)**	**(11,707,584)**
Charge for the year (Note 10)	(995)	(12,235,694)	(3,722)	(12,240,411)
Reversal of impairment allowance credited to income (Note 10)	–	13,779,012	–	13,779,012
Transfer of allowance for impairment	–	-130,551	–	(130,551)
Foreign exchange effects	–	(157,363)	–	(157,363)
Write-offs	–	3,405,807		3,405,807
Decrease per unwinding effect (Note 5)	–	-451,250	–	(451,250)
Balance as at 31 December 2018	**(3,238)**	**(7,425,868)**	**(73,234)**	**(7,502,340)**

21. Intangible Assets

RSD '000

	Licenses and similar rights	Licenses in progress	Total
Cost			
Balance as at 1 January 2017	1,626,335	18,149	1,644,484
Increase	–	277,006	277,006
Transfers (activations)	108,110	(108,110)	–
Retirement and disposal	(18,956)	(21,000)	(39,956)
Balance as at 31 December 2017	**1,715,489**	**166,045**	**1,881,534**
Increase	24,426	236,592	261,018
Transfers (activations)	498,767	(498,767)	–
Retirement and disposal	–	–	–
Other	–	111,581	111,581
Balance as at 31 December 2018	**2,238,682**	**15,451**	**2,254,133**
Accumulated amortisation			
Balance as at 1 January 2017	1,099,334	–	1,099,334
Amortisation charge for the current year (Note 13)	101,255	–	101,255
Retirement and disposal	–	–	–
Impairment	–	–	–
Balance as at 31 December 2017	**1,200,589**	**–**	**1,200,589**
Amortisation charge for the current year (Note 13)	107,491	–	107,491
Balance as at 31 December 2018	**1,308,080**	**–**	**1,308,080**
Net book value at			
31 December 2018	**930,602**	**15,451**	**946,053**
31 December 2017	**514,900**	**166,045**	**680,945**

In 2018, the Bank developed its software independently and in accordance with IFRS 38, the capitalisation amount referring to this software was RSD 24,937 thousand.

In accordance with IAS 36 – Impairment of Assets and IFRS 13 – "Fair Value Measurement", the fair value of the Bank's intangible investments – core software – was assessed on 31 December 2016. The assessment was conducted by an independent appraiser - Vision Consulting d.o.o., Beograd.

Measurement of the fair value of the Bank's core software was performed by applying the cost approach/replacement cost method, in view of the fact that the software is fully adjusted to the Bank's requirements. The Bank has the right of use only in terms of this software and this will not be converted into the right of ownership, and it is therefore not possible to realise any benefits from the lease of this software, which is why the income approach was not possible.

Due to numerous specific features of the software and its subsequent adjustments, there is no sufficiently similar software available in the market to which to apply the market approach.

Inputs of Levels 1, 2 and 3 were applied in the cost approach, with Level 2 inputs having a predominant role – estimated replacement costs for a new asset according to the initial 2008 contract in 2008 and actual acquisition costs (Level 1) and the new contract version from 2010 and adjusted actual acquisition costs (Level 1).

In accordance with the cost approach methodology, the appraised acquisition cost was decreased by the physical and functional write-off and these adjustments constitute Level 3 inputs.

22. Property, Plant and Equipment

RSD '000

	2018	2017
Buildings	374,669	384,740
Investments in progress (buildings)	–	–
Leasehold improvements	70,147	47,584
Computer and other equipment	159,572	154,386
Investments in progress	25,488	28,644
Total	**629,876**	**615,354**

RSD '000

	Buildings	Leasehold improve-ments	Investments in progress	Computer equipment	Other equipment	Investments in progress	Total
Cost							
Balance as at 1 January 2017	479,926	787,668	13,723	509,553	1,103,369	87,090	2,981,329
Increase	–	–	534	–	–	52,948	53,483
Transfers (activations)	14,258	36,382	(14,257)	27,946	86,105	(150,433)	–
Transfers from investment property and assets acquired under finance lease	–	–	–	–	–	–	–
Retirement and disposal	(43,013)	–	–	(46,587)	(419,605)	39,039	(470,166)
Impairment	–	–	–	–	–	–	–
Balance as at 31 December 2017	**451,171**	**824,050**	**–**	**490,912**	**769,869**	**28,644**	**2,564,646**
Increase							
Transfers (activations)							
Transfers from investment property	10,038	949	–	2,840	–	92,598	106,425
Retirement and disposal	–	41,001	–	26,337	28,416	(95,754)	–
Impairment	–	–	–	–	–	–	–
Balance as at 31 December 2018	**447,110**	**829,346**	**–**	**503,074**	**754,295**	**25,488**	**2,559,313**
Accumulated depreciation	**64,989**	**746,103**	**–**	**460,697**	**932,838**	**–**	**2,204,627**
Balance as at 1 January 2017	10,254	30,363	–	33,837	31,525	–	105,977
Depreciation charge for the year (Note 13)	–	–	–	–	–	–	–
Transfers from investment property	–	–	–	–	–	–	–
Retirement and disposal	(8,812)	–	–	(45,172)	(307,329)	–	(361,312)
Balance as at 31 December 2017	**66,431**	**776,466**	**–**	**449,362**	**657,034**	**–**	**1,949,292**
Depreciation charge for the year (Note 13)	9,434	19,300	–	26,192	25,521	–	80,445
Transfers from investment property	–	–	–	–	–	–	–
Impairment increases due to restructuring	–	–	–	–	–	–	–
Retirement and disposal	(3,424)	(36,567)	–	(17,012)	(43,298)	–	(100,300)
Balance as at 31 December 2018	**72,441**	**759,199**	**–**	**458,542**	**639,257**	**–**	**1,929,437**
Net book value at:	**–**	**–**	**–**	**–**	**–**	**–**	**–**
31 December 2018	**374,669**	**70,147**	**–**	**44,532**	**115,038**	**25,448**	**629,876**
31 December 2017	**384,740**	**47,584**	**–**	**41,552**	**112,835**	**28,644**	**615,354**

The Bank owns buildings with premises for the performance of its operations on 7 locations: Branch Bežanijska Kosa, Branch Hill Belgrade, Branch Bečej, Branch Bačka Palanka, Branch Subotica and Branch Kruševac.

All other business premises are rented and the item of leasehold improvements position relates to the refurbishment, equipment and putting to use of the rented premises.

The Bank did not pledge its property as collateral.

Operating Lease

The future minimum lease payments for operating lease of business premises as at 31 December were as follows:

RSD '000

	2018	2017
Up to 1 year	197,640	216,219
From 1 to 5 years	306,671	536,648
Over 5 years	–	10,299
Total	**504,311**	**763,166**

In addition to the above, the Bank has executed two lease agreements for commercial premises for an indefinite period,

Finance Lease

The Bank has not executed any new agreements in 2018.

23. Non-Current Assets Held for Sale

RSD '000

	2018	2017
Cost value		
Balance at the beginning of the year	119,826	149,267
Transfer from assets acquired in lieu of debt collection	43	15,446
Transfer from investment property	–	–
Sales during the year	(47,423)	(44,887)
Net book value at year-end	**72,446**	**119,826**

TIn previous years the Bank acquired a number of buildings provided as collateral securitising loans. The Bank's management decided to complete the sale of these assets so that the assets fulfilling the criteria of IAS 5 – Non-Current Assets Held for Sale and Discontinued Operations were transferred from the assets acquired in lieu of debt collection to the non-current assets held for sale.

Out of these assets, during 2018 the Bank sold real estate totalling RSD 47,423 thousand and realised gains on the sale of RSD 13,891 thousand.

The Bank's management is taking all the necessary actions to make the sale of the remaining assets – engagement of a real estate agency, advertising, search for prospective buyers – all in order to complete the sales as soon as possible.

24. Other Assets

RSD '000

	2018	2017
Receivables	**463,053**	**566,943**
Receivables from employees	601	351
Receivables from banks for card operations	145,756	87,804
Advances and deposits paid	79,880	77,872
Receivables for client liabilities paid	19,578	77,207
Other fees and other receivables	25,275	26,402
Receivables for rent (lease)	10,461	10,304
Other receivables	181,502	287,003
Other assets and prepayments and accrued income	**180,024**	**131,425**
Prepaid expenses	98,889	50,103
Prepayments and accrued income	700	887
Assets acquired in lieu of debt collection	68,801	68,801
Office supplies	11,634	11,634
Other assets, gross	**643,077**	**698,368**
Allowances for impairment of other receivables	***(73,234)***	***(68,502)***
allowance for impairment of inventories	***(11,634)***	***(11,634)***
Other assets, net	**558,209**	**618,232**

As at 31 December 2018 the Bank's assets acquired in lieu of debt collection mainly comprise land of RSD 63,617 thousand and buildings and apartments of RSD 5,125 thousand.

Out of the total amount of allowance for impairment for other receivables, RSD 68,502 thousand pertains to the allowance for impairment of other receivables (2017: RSD 68,502 thousand), while RSD 11,634 thousand (2017: RSD 11,634 thousand) refers to the allowance for impairment of inventories.

24. Deposits and Other Liabilities Due to Banks, Other Financial Institutions and the Central Bank

RSD '000

	2018	2017
RSD Transaction deposits	**102,053**	**122,051**
Transaction deposits of other financial institutions	25,102	56,220
Transaction deposits of other financial institutions	76,951	65,831
Transaction deposits in foreign currency	**263,123**	**292,146**
Transaction deposits of other banks	116,093	188,942
Transaction deposits of other financial institutions	147,030	103,204
Other RSD deposits	**1,809,456**	**1,183**
Other RSD deposits	1,460,001	–
Other deposits of other financial institutions	341,401	–
Liabilities for interest and fees	8,054	1,183
Other foreign currency deposits	**626,116**	**424,486**
Other deposits of banks	–	117,805
Other deposits of other financial institutions	619,656	303,648
Liabilities for interest and fees	6,460	3,033
Borrowings	**4,789,078**	**4,542,890**
Borrowings	4,004,078	1,895,563
Overnight FX borrowings	–	2,647,327
Received loans for liquidity	785,000	–
Balance as at 31 December	**7,589,826**	**5,382,756**

In 2018, short-term loans and deposits were approved to the Bank at interest rates depending on the currency and maturity in the following ranges: RSD loans – from 1.9% to 3.5% p.a. (in 2017 overnight loans: from 2.4% to 3.1% p.a.); in EUR: from 0.1% to 0.2% p.a. (in 2017: from 0% to 0.6% p.a.); and in USD from 1.25% to 2.4% pa (in 2017: from 1.45% to 3% p.a.).

RSD '000

	Currency	Amount in currency	Due date	Interest Rate	31 December 2018
EBRD - long-term loans	EUR	10,000,000	4.12.2023.	1.40%	1,181,946
	EUR	5,000,000	4.12.2023.	1.40%	590,973
	EUR	5,000,000	4.12.2023.	1.40%	590,973
	EUR	4,000,000	2.12.2020.	2.20%	472,778
	EUR	4,000,000	2.12.2020.	2.20%	472,778
Total long-term loans					**3,309,448**
EBRD - short-term loans	EUR	29,00,000	25.3.2019.	0.50%	342,764
	EUR	1,000,000	25.4.2019.	0.65%	118,195
	EUR	400,000	30.4.2019.	0.65%	47,278
	EUR	1,577,000	20.5.2019.	0.65%	186,393
Total short-term loans					**694,630**
Total received loans from EBRD					**4,004,078**

26. Deposits and Other Liabilities Due to Customers

RSD '000

	2018	2017
RSD Transaction deposits	**8,432,584**	**10,887,799**
Corporate clients	4,575,543	4,497,817
Public companies	470,432	3,897,436
Public sector	356,545	20,161
Non-resident entities	28,364	13,835
Other clients	244,501	245,196
Retail clients	2,757,199	2,213,354
Foreign currency transaction deposits	**19,296,940**	**16,596,787**
Corporate clients	6,748,675	3,308,995
Public companies	842,342	913,013
Public companies	11,140	1,810
Non-resident entities	91,109	47,462
Other clients	92,559	162,275
Retail clients	11,511,115	12,163,232
Other RSD deposits	**6,067,580**	**1,974,378**
Other corporate clients	2,976,030	1,407,620
Other public companies	1,937,000	479,000
Other public sector	1,058,000	29,450
Other non-resident entities	925	1,680
Other clients	42,864	8,591
Other retail clients	28,511	29,118
Interest and fee liabilities	18,652	18,837
Interest and fee liabilities with currency clause index	5,598	82
Other foreign currency deposits	**4,926,082**	**4,322,655**
Other corporate clients	1,488,556	1,652,203
Other public companies	2,994,417	2,194,002
Other public sector	–	2,154
Other clients	285,558	286,215
Other retail clients	157,551	188,081
Earmarked RSD deposits	**50**	**6,213,982**
Corporate clients	50	21,334
Public companies	–	6,187,848
Public sector	–	19
Other clients	–	23
Retail clients	**–**	**4,758**
Earmarked foreign currency deposits	928,745	493,955
Corporate clients	798,238	362,868
Public companies	118,195	118,473
Other clients	94	380
Retail clients	12,218	12,234
Savings deposits	**26,137,072**	**21,429,455**
RSD savings deposits	510,067	471,205
Foreign currency savings deposits	25,319,027	20,789,021
Deferred foreign currency interest	307,978	169,229
Balance as at 31 December	**65,789,053**	**61,919,011**

On demand deposits of corporate clients, both in RSD and foreign currencies, the Bank calculates 0% interest, except in instance of special arrangements, where the interest rate is defined by individual contracts with significant clients. Most commonly, upon execution of special arrangements, interest rates are linked to the National Bank of Serbia's key policy rate. The Bank calculates and pays interest on demand deposits of local government budget beneficiaries the rate of which may not be lower than the current discount rate of the National Bank of Serbia.

Corporate and public sector term deposits accrue interest in accordance with the maturity and the amount of funds deposited. At the initiative of the BSM & Treasury Department, interest rates are adjusted to the market trends in reference interest rates and in 2018 the average interest rate on RSD deposits was 2.47% p.a. and 0.76% p.a. for EUR deposits.

Interest rates applicable to demand savings deposits in foreign currencies ranged from 0% to 0.1% p.a. (in 2017: from 0% to 0.1%), and the rate of interest on RSD transaction deposits of retail clients equalled 0.10% p.a. (in 2017: 0.10%).

RSD savings term deposits of retail clients accrued interest at the rates between 0% and 4% p.a. (2017: between 0% and 4%). Foreign currency savings deposits of retail clients accrued interest at the rates ranging from 0% to 1.6% p.a. (in 2017: from 0% to 1.6%).

A breakdown of deposits and other liabilities due to clients per maturity is shown in the following table:

RSD '000

	2018			2017		
	Short-term	Long-term	Total	Short-term	Long-term	Total
In RSD						
Transaction deposits	8,432,584	–	8,432,584	10,887,799	–	10,887,799
Other deposits	5,449,588	593,742	6,043,330	1,668,801	286,658	1,955,459
Earmarked deposits	50	–	50	6,213,982	–	6,213,982
Savings deposits	484,946	25,121	510,067	444,195	27,010	471,205
Interest and fee liabilities	24,250	–	24,250	18,919	–	18,919
Total in RSD	**14,391,418**	**618,863**	**15,010,281**	**19,233,696**	**313,668**	**19,547,364**
In foreign currencies						
Transaction deposits	19,296,940	–	19,296,940	16,596,787	–	16,596,787
Other deposits	4,084,778	841,304	4,926,082	3,865,815	456,840	4,322,655
Earmarked deposits	810,550	118,195	928,745	493,955	–	493,955
Savings deposits	23,416,179	1,902,848	25,319,027	9,907,141	10,881,880	20,789,021
Interest and fee liabilities	307,978	–	307,978	169,229	–	169,229
Total in foreign currencies	**47,916,425**	**2,862,347**	**50,778,772**	**31,032,927**	**11,338,720**	**42,371,647**
Balance as at 31 December	**62,307,843**	**3,481,210**	**65,789,053**	**50,266,623**	**11,652,388**	**61,919,011**

27. Subordinated Liabilities

The balances of liabilities arising from subordinated loans as at 31 December 2018 and 2017 are provided in the following table:

RSD '000

	Oznaka valute	Iznos u valuti	Datum dospeća	Kamatna stopa	2018	2017
Addiko Bank AG	CHF	37,257,500	26,09,2020	6 mes Libor + 5.0168%	3,911,214	3,773,615
Interest liabilities					545	526
Total in RSD					**3,911,759**	**3,774,141**

In January 2017 the Bank converted the subordinated loan from EUR to CHF in the amount of EUR 35 million.

The subordinated loans received met all the requirements prescribed by the National Bank of Serbia to be included in the supplementary capital of the Bank.

28. Provisions

The Bank made the following provisions:

RSD '000

	2018	2017
Provisions per losses from guarantees	95,582	32,819
Provisions per unsecured letters of credit	433	–
Provisions per long-term commitments	9,606	12,395
Total provisions for losses per off-balance sheet assets	**105,621**	**45,214**
Provisions for litigations and disputes	184,552	157,652
Provisions for termination benefits	5,964	21,325
Provisions for retirement benefits	56,789	50,878
Provisions for bonuses	16,607	8,326
	263,912	238,181
Balance as at 31 December	**369,533**	**283,395**

a) Provisions per losses from guarantees, other contingent liabilities and termination/retirement benefits:
The Bank made provisions for losses on off-balance sheet items charged to expenses, in line with its business policy.

Provisions for other contingent liabilities, amounting to RSD 184,552 thousand, were made based on the calculation of a potential loss that would be incurred by the Bank in respect of a highly probable lawsuit.

Provisions for termination benefits decreased in 2018 to RSD 5,964 thousand (in 2017: RSD 21,352 thousand).

In September 2016, the Board of Directors of Addiko Bank a.d., Beograd adopted a new Rulebook on Internal Organisation, thus fundamentally changing the Bank's organisational structure. Based on this, the Job Classification Rulebook was amended. Specifically, certain organisational units were eliminated or merged with other units, and organisational units within the Bank's Head Office were united. The Bank's Executive Board identified employees who were redundant in accordance with the established criteria, as well as employees who would be offered reassignment to jobs to be created.

In accordance with these decisions and the Bank's Rules of Procedure, the Executive Board drafted a redundancy programme, which was submitted to the National Employment Agency. These measures aimed at headcount reduction will be implemented observing the corporate social responsibility principle. The priority is to reach an agreement with employees, i.e. to match the headcount with the reduced number of jobs through voluntary termination of employment or an annex to the employment contract for reassignment to new jobs within the Bank. In accordance with these decisions, in 2018 termination benefits totalling RSD 34,244 thousand were paid to the employees whose employment contracts were terminated.

Provisions for retirement benefits were formed based on the independent actuary's report as at the reporting date, and they are recognised in the amount of the present value of expected future payments.

The starting assumptions of the independent actuary for the said calculation were as follows:

- Data on employees (total years of service as at 31 December 2018, gender, age);
- Mortality rate tables 2010-2012
- Assumed increase in gross salaries 0%
- interest rate of 5.25%
- salaries paid by ADDIKO BANK in 2018 per employee

The Labour Law (Official Gazette of RS No. 75/2014) stipulates an obligation of the employer to pay a retirement benefit to the retiring employee in the minimum amount of two average salaries of the employee, whereby the amount of such retirement benefit may not be below two average salaries paid per employee in the Republic of Serbia, according to the latest available data published by the Statistical Office of the Republic of Serbia.

Movements on provision accounts are presented in the following table:

RSD '000

	Guarantees and other off-balance sheet items	Other contingent liabilities	Provisions for termination benefits	Provisions for retirement benefits	Provisions for bonuses	Total
Balance as at 1 January 2017	**70,759**	**469,103**	**24,448**	**24,448**	–	**604,830**
Charged/(reversed) to the income statement	(25,545)	(309,087)	17,390	17,390	–	(305,660)
Transfer from liabilities for bonuses	–	–	–	–	8326	8,326
Release of provisions	–	(2,364)	(20,513)	(20,513)	–	(24,101)
Balance as at 31 December 2017	**45,214**	**157,652**	**21,325**	**21,325**	**8,326**	**283,395**
First application of IFRS 9						
Additional allowance for impairment	9,230	–	–	–	–	9,230
Balance as at 1 January 2018	**54,444**	**157,652**	**21,325**	**21,325**	**8,326**	**292,625**
Charged/(reversed) to the income statement	51,177	30,271	11,876	11,876	9,945	109,180
Transfer from liabilities for bonuses	–	–	–	–	–	–
Release of provisions	–	(3,371)	(27,237)	(27,237)	(1,664)	(32,272)
Balance as at 31 December 2018	**105,621**	**184,552**	**5,964**	**5,964**	**16,607**	**369,533**

b) Provisions for Litigations

As at 31 December 2018 there were 832 lawsuits involving the Bank as a defendant. All these lawsuits were initiated between 2005 and 2018.

The aggregate value of all lawsuits filed against the Bank amounts to RSD 5,096,848 thousand, without calculated interest.

The Bank has adopted a procedure for performance assessment of passive legal proceedings and court cases and for the definition of provisions for the legal risk arising from these proceedings.

Performance assessment of passive legal proceedings is made based on:

- Legal merits of the claim;
- Legal analysis of the course of every court case;
- Consideration of facts and evidence presented in the course of the proceedings by the counterparty and facts and evidence presented or which may be presented by the Bank and mutual dependence and connection of such facts and evidence;
- Customary jurisprudence in the same or similar court cases;
- If a lawsuit is conducted by an attorney hired by the Bank, the performance assessment will take into account his/her opinion as well; exceptionally, in very complex cases, the Bank's unit in charge of the case at hand may seek an external legal opinion on the success of the case even if it is not conducted by an attorney, but by the Bank;
- Possibility to reach court or out-of-court settlement with the counterparty;
- Rules and conditions for provisioning as set out in the International Accounting Standard – IAS 37;
- Other elements that may affect the Bank's success in a court case.

Performance assessment of passive legal suits is carried out at least once every six months, no later than on the 15th day of the month prior to expiry of the calendar term.

The assessment is done based on legal and factual state at the assessment day.

As at 31 December 2018, the Bank made provisions for litigations and claims amounting to RSD 184,552 thousand.

The Bank was also involved in a number of lawsuits filed against third parties in an attempt to collect receivables. All the Bank's receivables claimed before court have been impaired in accordance with the Bank's methodology and charged to the Bank's expense.

29. Other Liabilities

RSD ’000

	2018	2017
RSD trade payables	50,393	31,873
Trade payables in foreign currency	35,476	63,064
Early loan repayment	97,457	226,209
Liabilities for employee bonuses and unused annual leaves	131,337	94,779
Other RSD liabilities	130,408	79,705
Other foreign currency liabilities	341,677	42,816
RSD advances received	13,016	13,194
Taxes and contributions payable	16,646	27,357
Liabilities from card operations	51,644	9,602
Accrued expenses	108,402	144,657
Deferred income	24,208	12,205
Total other liabilities	**1,000,664**	**745,461**

Other liabilities denominated in foreign currencies in the amount of RSD 341,677 thousand refer to the undisbursed payments per collections made from abroad in the amount of RSD 306,278 thousand.

30. Equity and Reserves

As at 31 December 2018 the Bank's equity comprised share capital, share issue premium, reserves, revaluation reserves, fair value reserves and retained earnings/accumulated losses.

The Bank’s equity structure is presented below:

RSD ’000

	2018	2017
Share Capital	17,517,484	17,517,484
Share premium	3,027,810	3,027,810
Reserves from profit	487,299	–
Fair value reserves	191,448	181,901
Losses from the first application of IFRS 9	(1,126,066)	–
Current year’s profit	1,299,958	1,218,248
Balance as at 31 December	**21,397,933**	**21,945,443**

a) Share capital and Share Premium

As at 31 December 2018 the Bank's subscribed capital paid in comprised 8,758,742 ordinary shares (31 December 2017: 8,758,742 shares) with the par value of RSD 2,000 per share.

Each share entitles the holder to one vote. All shares outstanding were fully paid in.

The shares are registered with the Securities Commission:

CFI Code: ESVUFR

ISIN No.: RSHYPOE 68424

On 27 March 2014 a change to the majority shareholder of Hypo Alpe-Adria-Bank a.d. Beograd was registered in the Central Securities Depository and Clearing House. Instead of the majority shareholder Hypo Alpe-Adria-Bank International AG Klagenfurt, Hypo SEE Holding AG Klagenfurt was registered as the majority shareholder. On 30 October 2014 Hypo SEE Holding AG changed its name to Hypo Group Alpe Adria AG.

As at 31 December 2014 Hypo Group Alpe Adria AG owned 7,159,669 Bank's shares while Industrija kotrljajućih ležajeva a.d. u stečaju, Beograd owned 73 shares.

On 13 November 2015, the Commercial Court in Belgrade approved the sale of 73 shares owned by the bankruptcy debtor Industrija kotrljajućih ležajeva ad, Beograd. The shares were purchased by Hypo Group Alpe Adria AG, which thus became the sole shareholder of Hypo Alpe-Adria-Bank a.d. Beograd.

On 30 December 2015 an increase in share capital was registered with the Serbian Business Registers Agency. The capital increase was recorded with the Central Securities Depository through the 29th issue of 1,599,000 ordinary shares, at the par value of RSD 2,000 per share. The shares were paid by converting a portion of subordinated loan into share capital amounting to RSD 3,198,000,000.

On 8 July 2016, under Decision of the Commercial Court in Vienna no. FN 350921k, Hypo Group Alpe Adria AG changed its legal name to Addiko Bank AG, headquartered at the address of Wipplingerstrasse 34/4 Vienna, Austria.

During 2018 there was no increase in the share capital. Hence, the total number of shares outstanding paid in was 8,758,742 and the nominal (par) value per share amounted to RSD 2,000.

The Bank has no subscribed capital not paid in.

Each share entitles the holder to one vote and are no restrictions to the payment of dividend on shares.

The structure of the Bank's shareholders as at 31 December 2018 was:

RSD ’000

Shareholder	Amount in RSD '000	% Equity interest	Number of shares
Addiko Bank AG	17,517,484	100%	8,758,742
Total	**17,517,484**	**100%**	**8,758,742**

The table below shows the Bank's shareholders as at 31 December 2017 were:

RSD ’000

Shareholder	Amount in RSD '000	% Equity interest	Number of shares
Addiko Bank AG	17,517,484	100%	8,758,742
Total	**17,517,484**	**100%**	**8,758,742**

Share Issue Premium

The share issue premium is the difference between the achieved selling price of shares and their par value:

a) From 2002 to 2008 the Bank formed a share issue premium in the amount of RSD 2,790,840 thousand;
b) In 2008, after two issues of shares, the Bank formed a share issue premium in the amount of RSD 4,414,469 thousand;
c) In March 2009 the total of 392,205 shares were issued with the par value of RSD 2,000, which were thereafter sold at RSD 8,500, resulting in the share issue premium of RSD 2,549,332 thousand;
d) In July 2010, the total of 584 shares were issued with the par value of RSD 2,000, which were later sold at RSD 8,500, resulting in a share issue premium of RSD 3,797 thousand;
e) Under Decision of the Bank's Shareholder Assembly No. 11866/16 dated 26 April 2016, the Bank absorbed the loss incurred in 2015 in the amount of RSD 5,452,120 thousand;
f) Under Decision of the Bank's Shareholder Assembly No. 13115/17 dated 28 April 2017, the Bank absorbed the loss incurred in 2016 in the amount of RSD 1,278,508 thousand, so that the share premium amounted to RSD 3,027,810 thousand as at 31 December 2017.

b) Reserves from Profit

Under Decision of the Bank's Shareholder Assembly no. 09216/18 dated 30 March 2018, the Bank distributed 60% of realised profit before tax, amounting to RSD 730,949 thousand, to dividends due to the Bank’s Shareholder, while the remaining amount of RSD 487,299 thousand was distributed to the Bank’s reserves.

c) Fair Value Reserves

Positive effects of fair value adjustments of the Bank's financial assets available for sale arose from the adjustment of the investments into financial assets available for sale to their fair values. These reserves were then adjusted for the effects of deferred taxes (Notes 14 and 17).

As at 31 December 2018, the Bank's revaluation reserves totalled RSD 190,203 thousand (31 December 2017: RSD 181,902 thousand). Securities impairment allowances amounted to RSD 1,464 thousand, less deferred tax amounting to RSD 219 thousand.

d) Reserves for Estimated Losses on Bank Balance Sheet Assets and Off-Balance Sheet Items

The Bank is obligated to calculate on a quarterly basis risks of contingent losses on balance sheet assets and off-balance sheet items pursuant to the Decision of the National Bank of Serbia on the Classification of Bank Balance Sheet Assets and Off-Balance Sheet Items.

Loans, receivables and other Bank's exposures are classified into categories, in accordance with assessed collectability of loans and receivables, depending on: the number of days past due in repayment of the principal and interest, borrower's financial position and quality of the obtained collateral.

As of 31 December 2018, the required reserve for estimated losses on balance sheet assets and off-balance sheet items amounted to RSD 6,979,739 thousand (31 December 2017: RSD 7,610,708 thousand).

Comparative overview of calculated allowance for impairment of balance sheet assets and provisions for contingent losses on off-balance sheet items charged to the Bank's income statement in accordance with the Bank's acts and calculated reserve as required by the National Bank of Serbia as at 31 December 2018:

RSD '000

	NBS Methodology	Bank's acts	Required reserve
Total per balance sheet assets	11,521,526	7,502,317	6,614,278
Total per off-balance sheet item	429,681	105,621	365,461
Total	**11,951,207**	**7,607,938**	**6,979,739**

Comparative overview of calculated allowance for impairment of balance sheet assets and provisions on potential losses on off-balance sheet items charged to the Bank's income statement in accordance with the Bank's enactments and calculated reserve as required by the National Bank of Serbia as at 31 December 2017 (in accordance with NBS regulations effective at said date):

RSD '000

	NBS Methodology	Bank's enactments	Required reserve
Total per balance sheet assets	14,558,261	8,732,729	7,392,597
Total per off-balance sheet item	248,322	45,214	218,111
Total	**14,806,583**	**8,777,943**	**7,610,708**

31. The Bank's Regulatory Compliance

The Bank is required to align its volume of operations and the structure of its risk-weighted assets with the adequacy and performance ratios prescribed by the Law on Banks and the relevant decisions of the National Bank of Serbia enacted in accordance with the aforementioned Law.

As at 31 December 2018, the Bank was in full compliance with all the prescribed ratio values.

The following table presents the adequacy/performance ratios achieved by the Bank:

RSD '000

Performance ratios	Adequacy Prescribed	2018	2017
1. Capital	Minimum EUR 10 million	EUR 113 million	EUR 121 million
2. Capital adequacy ratio			
- Capital adequacy ratio	min 8 %	18.44%	21.84%
- Core capital adequacy ratio (Tier 1 ratio)	min 6 %	16.56%	18.69%
- Common equity capital adequacy (CET1 ratio)	min 4,5 %	16.56%	18.69%
3. The sum of the Bank's long-term investments	max 60%	4.73%	4.30%
4. The sum of the Bank's large exposures	max 400%	86.36%	77.56%
5. Liquidity ratios:	min 1	1.75%	2.39%
- in the first month of the reporting period	min 1	1.99%	2.41%
- in the second month of the reporting period	min 1	1.99%	2.13%
- in the third month of the reporting period	min 1	1.38%	2.49%
6. Narrow liquidity ratios	min 0,7	1.44%	2.05%
- in the first month of the reporting period	min 0,7	1.72%	2.04%
- in the second month of the reporting period	min 0,7	1.65%	1.87%
- in the third month of the reporting period	min 0,7	1.16%	2.20%
7. Foreign exchange risk ratio	max 20%	2.48%	4.32%
8. The Bank's large exposures to a single entity or a group of related parties	max 25%	16.47%	17.86%
9. Bank investments in non-financial sector entities	max 10%	0.00%	0.00%

32. Transactions With Related Parties and Addiko Group Members

The sole owner of Addiko Bank a.d., Beograd is Addiko Bank AG, holding all (100%) shares of Addiko Bank a.d., Beograd. Related party transactions are performed at arm's length.

a) Statement of the Financial Position (Balance Sheet)
The table below presents balances arising from related party transactions as of 31 December 2018:

RSD '000

	Addiko Bank AG Vienna	Addiko Bank Ljubljana	Addiko Bank Zagreb	Addiko Bank Banja Luka	Addiko Bank Sarajevo	Addiko Bank Podgorica	Total
Financial assets 31 December 2018							
Loans and receivables from banks and other financial institutions	42,726	3,131	37,816	1,525	1,083	–	86,281
Receivables per changes in the fair value of derivatives	25,262	–	–	–	–	–	25,262
Other assets	65,455	36,469	13,325	17,056	15,745	11,435	159,485
Total financial assets	**133,443**	**39,600**	**51,141**	**18,581**	**16,828**	**11,435**	**271,028**
Financial liabilities 31 December 2018							
Derivative payables	17,758	–	–	–	–	–	17,758
Deposits and other financial liabilities to other clients	18,948	–	16,332	4,312	2,565	11,841	53,998
Subordinate liabilities	3,911,759	–	–	–	–	–	3,911,759
Provisions	–	–	–	70,643	–	–	70,643
Other liabilities	47,924	–	3,702	–	–	–	51,626
Total financial liabilities	**3,996,389**	**–**	**20,034**	**74,955**	**2,565**	**11,841**	**4,105,784**

The table below presents balances arising from related party transactions as of 31 December 2017:

RSD '000

	Addiko Bank AG Vienna	Addiko Bank Ljubljana	Addiko Bank Zagreb	Addiko Bank Banja Luka	Addiko Bank Sarajevo	Addiko Bank Podgorica	Total
Financial assets 31 December 2017							
Receivables per changes in the fair value of derivatives	132,726	–	–	–	–	–	132,726
Loans and receivables from banks and other financial institutions	78,565	1,592	6,659	829,690	456	–	916,962
Other assets	131,417	39,337	13,517	29,326	13,241	6,312	233,150
Total financial assets	**342,708**	**40,929**	**20,176**	**859,016**	**13,697**	**6,312**	**1,282,838**
Financial liabilities 31 December 2017							
Financial liabilities led by fair value through the income statement intended for trade	32,345	–	–	–	–	–	32,345
Deposits and other liabilities to banks	1,633,959	7,689	10,696	–	870	824	1,654,038
Subordinated liabilities	3,774,141	–	–	–	–	–	3,774,141
Other liabilities	43,960	684	8,208	–	80	852	53,784
Other financial liabilities	**5,484,405**	**8,373**	**18,904**	**–**	**950**	**1,676**	**5,514,308**

b) Income Statement

Tabela ispod prikazuje transakcije sa povezanim licina za godinu koja se završila 31. decembra 2018. godine:

RSD '000

	Addiko Bank AG, Vienna	Addiko Bank Ljubljana	Addiko Bank Zagreb	Addiko Bank Banja Luka	Addiko Bank Sarajevo	Addiko Bank Podgorica	Total
Income in 2018							
Interest income	207,500	–	–	6,369	–	–	213,869
Fee and commission income	–	–	–	301	–	–	301
Other income	65,833	27,755	3,934	12,182	10,838	5,412	125,954
Total income	**273,333**	**27,755**	**3,934**	**18,852**	**10,838**	**5,412**	**340,124**
Income in 2018							
Interest expenses	200,504	–	59	–	–	–	200,563
Fee and commission expenses	–	–	438	–	–	–	438
Administrative expenses	39,985	–	36,253	–	–	–	76,238
Total expenses	**240,489**	–	**36,750**	–	–	–	**277,239**

The table below presents balances arising from related party transactions as at 31 December 2017:

RSD '000

	Addiko Bank AG, Vienna	Addiko Bank Ljubljana	Addiko Bank Zagreb	Addiko Bank Banja Luka	Addiko Bank Sarajevo	Addiko Bank Podgorica	Total
Income in 2017							
Interest income	307	–	–	3,045	–	–	3,352
Fee and commission income	–	–	11	447	2	–	460
Net gains on financial assets	346,184	–	–	–	–	–	346,184
Other income	42,827	40,193	76,948	16,732	15,978	10,337	203,015
Total income	**389,318**	**40,193**	**76,959**	**20,224**	**15,980**	**10,337**	**553,011**
Income in 2017							
Interest income	214,026	–	85	–	296	–	214,407
Fee and commission expenses	–	166	1,074	141	–	9	1,390
Other expenses	66,346	–	32,593	–	–	–	98,939
Total expenses	**280,372**	**166**	**33,752**	**141**	**296**	**9**	**314,736**

c) Transactions with related parties - private individuals

In 2018, the Bank paid to the members of the Board of Directors for their engagement gross remuneration in the amount of RSD 3,842 thousand (2017: RSD 3,850 thousand).

In 2018, the Bank paid to the members of the Board of Directors for their engagement gross salaries in the amount of RSD 73,090 thousand (2017: RSD 103,439 thousand).

In 2018 gross salaries of the key management personnel amounted to RSD 168,586 thousand (2017: RSD 152,221 thousand)

The key management personnel are persons authorised and responsible for planning, managing and controlling the Bank's activities, directly or indirectly, including all Directors, (whether Executive Directors or not).

There were no other payments made to key management personnel other than the above said remunerations.

As at 31 December 2017 individuals related to the Bank had deposits placed with the Bank totalling RSD 75,394 thousand (31 December 2017: RSD 61,792 thousand)

As at 31 December 2018 loans extended to the individuals related to the Bank totalled RSD 118,827 thousand (31 December 2017: RSD 86,988 thousand).

33. Balance Reconciliation of Receivables and Payables

The Bank reconciled amounts receivable and payable with the balance as at 31 October 2018 while another reconciliation was carried out with the major clients as at 31 December 2018.

Until this auditors' report date, of about 11,000 OIS requests sent to clients, unreconciled receivables amounted to RSD 11,648 thousand. The contested balances mostly relate to those of the clients undergoing bankruptcy procedures or restructuring. The clients failed to confirm the balances of deposits and other liabilities of the Bank in the aggregate amount of RSD 10,278 thousand.

The Bank has continued to take actions to reconcile balances of receivables and liabilities with its customers and the reconciliation process is underway.

34. Off-Balance Sheet Items

RSD '000

	2018	2017
Total guarantees and commitments	**20,174,104**	**14,340,508**
Payment guarantees	2,486,959	1,109,068
Performance guarantees	7,594,601	4,691,849
Unsecured letters of credit	197,251	–
Irrevocable commitments	1,084,754	919,661
Revocable commitments for undrawn loans	8,792,539	7,619,930
Other guarantees	18,000	–
Total derivatives	**36,055,534**	**102,613,654**
Receivables for sold currencies	18,030,285	51,379,193
Liabilities for purchased currencies	18,025,249	51,234,461
Other off-balance sheet items	**955,550,519**	**453,110,029**
Managed funds	1,074,341	1,105,283
Other commitments	1,418,928	3,183,634
Guarantees and sureties received	9,578,335	10,719,104
Collateral	933,707,402	428,990,037
Pledged receivables	–	–
Other off-balance sheet assets	9,771,513	9,111,971
Total Off-Balance Sheet Items	**1,011,780,157**	**570,064,191**

At the end of each accounting period, the Bank calculates provisions for commitments and contingent liabilities. The amount recognised as a provision is the best estimate of outflow of resources required to settle the existing liabilities as at the reporting date. Breakdown of provisions per off-balance sheet items is presented in the Note 28.

Derivative Financial Instruments

Within off-balance sheet items derivatives are presented as receivables and liabilities under FX swaps. Swaps represent contracts between two parties on exchange of payments in a period, with amounts of payments depending on the change of a relevant index, such as an interest rate or an exchange rate.

Derivatives, including FX contracts, FX swaps and other derived financial instruments, are initially recognised at fair value within the off-balance sheet items on the contract execution date and are subsequently remeasured at fair value.

Derivatives are initially recognised at the moment when derivative contract has been agreed with the counterparty (date of agreement). The notional amount of principal to which the respective derivative is agreed is carried as an off-balance sheet item.

The positive or negative change of fair value of the derivative is carried within assets or liabilities, as shown in the Note 17.

35. Exchange Rates

The official middle exchange rates of the National Bank of Serbia, determined in the interbank foreign exchange market and used in the translation of the statement of financial position components denominated in foreign currencies into the RSD as at 31 December 2018 and 2017 were as follows:

	2018	2017
USD	103.3893	99.1155
EUR	118.1946	118.4727
CHF	104.9779	101.2847
GBP	131.1816	133.4302
JPY	0.9366	0.8791

35. Events After the Reporting Period

The Bank is planning to pay out dividend to the shareholder from profit realized for the year 2018.

At its session held on March 25, 2019, the Bank's Executive Board filed a motion that, at the session to be held, on the same day, the Bank's Board of Directors propose to the Shareholder Assembly that a decision be made that e 15.88% of the profit realized in the amount of RSD 206,464 thousand be distributed, i.e., allocated to the liabilities for dividend payment to the Bank's shareholder.

Except for the foregoing, there have been no significant events after the reporting period that would require disclosure in the notes to the Bank's financial statements for 2018.

Gordana Ivanković	Vladimir Stanisavljević	Vojislav Lazarević
Head of the Accounting and Reporting Department	Member of the Executive Board	President of the Executive Board

Addiko Bank a.d.
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