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TRANSLATION

Independent Auditors' Report

TO THE SHAREHOLDERS OF

MIRABANK A.D. BEOGRAD

Report on financial statements

We have audited the accompanying financial statements of Mirabank a.d. Beograd ("the Bank"), which comprise the balance sheet as at 31 December 2017, the income statement, statement of other comprehensive income, statement of changes in equity and cash flow statement for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards, and 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 Auditing of the Republic of Serbia, the Decision on External Audit of Banks and applicable audit standards in the Republic of Serbia. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about 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 our 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, we consider internal control relevant to the preparation and fair presentation of 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.

T R A N S L A T I O N

Opinion

In our opinion, attached financial statements give a true and fair view of the financial position of the Bank as at 31 December 2017, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Report on Other Legal and Regulatory Requirements

In accordance with the Law on Accounting of the Republic of Serbia, the Bank is responsible for the preparation of the accompanying annual business report. Our responsibility is to express an opinion on consistency of the annual business report with the financial statements for the year ended 31 December 2017. In this regard, we performed procedures in accordance with the applicable audit standard - *The Auditor's responsibilities relating to other information in documents containing audited financial statements*, which are limited to the assessment of consistency of the annual business report with the financial statements.

In our opinion, the annual business report is consistent with the financial statements.

Belgrade, 17 April 2018 KPMG d.o.o. Beograd

(L.S.)

Dušan Tomić
Certified Auditor

This is a translation of the original Independent Auditors' Report issued in the Serbian language. All due care has been taken to produce a translation that is as faithful as possible to the original. However, if any questions arise related to interpretation of the information contained in the translation, the Serbian version of the document shall prevail. We assume no responsibility for the correctness of the English translation of the Bank's financial statements.

Belgrade, 17 April 2018 KPMG d.o.o. Beograd

(L.S.)

DRUŠTVO ZA KONSALTING I REVIZIJU D.O.O. KPMG 1 BEOGRAD

Dušan Tomić
Certified Auditor

MIRABANK A.D., BEOGRAD

Financial Statements as at December 31, 2017

MIRABANK A.D., BEOGRAD

CONTENTS

INCOME STATEMENT
For the period 1 January to 31 December

(In thousands of RSD)

	Note	2017	2016
Interest income	4.1.18; 7a	191,021	133,519
Interest expenses	4.1.18; 7b	(74,402)	(34,065)
Net interest income		**116,619**	**99,454**
Fee and commission income	4.1.19; 8a	23,166	15,557
Fee and commission expenses	4.1.19; 8b	(4,056)	(2,791)
Net fee and commission income		**19,110**	**12,766**
Net (loss)/gain on financial assets held for trading	4.1.3; 9	(118,897)	124,698
Net income/(expense) on foreign exchange rate differences and effects of foreign currency clause	4.1.3; 10	131,793	(103,623)
Other operating income	11	4,220	6,811
Net expenses on impairment of financial assets and credit risk-weighted off-balance sheet items	4.1.10; 12	(2,886)	(11,628)
Net operating income		**149,959**	**128,478**
Salaries, salary compensations and other personal expenses	13	(243,651)	(230,741)
Depreciation and amortisation expenses	4.1.6, 4.1.8; 14	(86,341)	(74,170)
Other expenses	15	(306,659)	(264,082)
LOSS BEFORE TAX		**(486,692)**	**(440,515)**
Deferred tax loss	4.1.12; 16	1,319	(2,799)
LOSS AFTER TAX		**(485,373)**	**(443,314)**

Notes presented in the following pages
are integral parts of this financial statement.

Signed for Mirabank a.d., Beograd:

Dragana Bojin
Head of Accounting Department

Ilinca Rosetti
President of the Executive Board

Saša Mićević
Member of the Executive Board

STATEMENT OF OTHER COMPREHENSIVE INCOME
For the period 1 January to 31 December

(In thousands of RSD)

	2017	**2016**
LOSS FOR THE PERIOD	**(485,373)**	**(443,314)**
Other comprehensive income		
Items that will not be reclassified to profit or loss::		
Net effects of fair value changes on financial assets available for sale	-	-
Items that are or may be reclassified subsequently to profit or losss:		
Net effects of fair value changes on financial assets available for sale	21,346	6,009
Other comprehensive income	21,346	6,009
TOTAL COMPREHENSIVE INCOME	**(464,027)**	**(437,305)**

Notes presented in the following pages
are integral parts of this financial statement.

Signed for Mirabank a.d., Beograd:

Dragana Bojin
Head of Accounting Department

Ilinca Rosetti
President of the Executive Board

Saša Mićević
Member of the Executive Board

BALANCE SHEET STATEMENT
As at December 31
(In thousands of RSD)

	Note	31 December 2017	31 December 2016
ASSETS			
Cash and balances with the central bank	4.1.2; 17	382,825	875,578
Financial assets at fair value through profit or loss held for trading	4.1.3; 18	5,800	124,698
Financial assets available for sale	4.1.3; 19	1,387,095	2,050,876
Loans and advances to banks and other financial institutions	4.1.3; 20	1,706,061	1,734,431
Loans and advances to customers	4.1.3; 21	2,200,643	2,509,710
Intangible assets	4.1.8; 22	211,679	238,937
Property, plant and equipment	4.1.6; 23	114,390	150,423
Other assets	24	14,234	13,233
Total assets		**6,022,727**	**7,697,886**
LIABILITIES			
Deposits and other liabilities to banks, other financial institutions and central bank	4.1.3.; 4.1.3.; 25	41,250	30,839
Deposits and other liabilities to customers	4.1.3.; 4.1.3.; 26	2,258,537	3,444,564
Subordinated liabilities	4.1.3; 27	1,184,958	1,235,022
Provisions	4.1.14; 4.1.15; 28	5,971	4,841
Deferred tax liabilities	4.1.12; 16	13,391	14,710
Other liabilities	29	49,910	35,173
Total liabilities		**3,554,017**	**4,765,149**
Equity			
Share capital	4.1.17; 30	3,631,200	3,631,200
Accumulated loss	4.1.17; 30	(1,189,845)	(704,472)
Reserves	4.1.17; 30	27,355	6,009
Total equity		**2,468,710**	**2,932,737**
Total liabilities and equity		**6,022,727**	**7,697,886**

Notes presented in the following pages
are integral parts of this financial statement.

Signed for Mirabank a.d., Beograd:

Dragana Bojin
Head of Accounting Department

Ilinca Rosetti
President of the Executive Board

Saša Mićević
Member of the Executive Board

STATEMENT OF CHANGES IN EQUITY
For the period 1 January to 31 December
(In thousands of RSD)

	Share capital	FV Reserves	Accumulated loss	Total
Balance as at 1 January 2016	**1,790,700**	**-**	**(261,158)**	**1,529,542**
Current year loss	-	-	(443,314)	**(443,314)**
Other comprehensive income				
Net effects of fair value changes on financial assets available for sale	-	6,009	-	**(6,009)**
Transactions with owners of the Bank				
Share issue	1,840,500	-	-	**1,840,500**
Balance as at 31 December 2016	**3,631,200**	**6,009**	**(704,472)**	**2,932,737**
Balance as at 1 January 2017	**3,631,200**	**6,009**	**(704,472)**	**2,932,737**
Current year loss	-	-	(485,373)	**(485,373)**
Other comprehensive income				
Net effects of fair value changes on financial assets available for sale	-	21,346	-	**21,346**
Balance as at 31 December 2017	**3,631,200**	**27,355**	**(1,189,845)**	**2,468,710**

Notes presented in the following pages
are integral parts of this financial statement.

Signed for Mirabank a.d., Beograd:

Dragana Bojin
Head of Accounting Department

Ilinca Rosetti
President of the Executive Board

Saša Mićević
Member of the Executive Board

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TRANSLATION

CASH FLOW STATEMENT
For the period 1 January to 31 December

(In thousands of RSD)

	2017	2016
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash inflow from operating activities	**161,746**	**104,646**
Inflow from interest	119,296	87,643
Inflow from fees and commissions	24,086	16,484
Inflow from other operating activities	18,364	519
Cash outflow from operating activities	**(673,777)**	**(586,637)**
Outflow from interest	(96,084)	(5,244)
Outflow from fees and commissions	(6,308)	(7,104)
Outflow from gross salaries, benefits and other personal expenses	(248,998)	(235,751)
Outflow from taxes, contributions and other duties charged to income, excluding corporate income tax	(10,488)	(6,452)
Outflow from other operating expenses	(313,899)	(332,086)
Net cash outflow from operating activities before an increase or decrease in placements and deposits	**(512,031)**	**(481,991)**
Cash inflow from placements, deposits taken and other liabilities		
Net inflow/(outflow) from loans and receivables to banks, other financial institutions, central bank and customers	754,477	(3,619,713)
Net (outflow)/inflow from deposits and other liabilities to banks, other financial institutions, central bank and customers	(648,705)	3,215,506
Net (outflow)/inflow from financial assets initially recognized at fair value through profit or loss, financial assets held for trading and other securities that are not intended for investment	(92,442)	123,856
Net cash outflow from operating activities	**(498,701)**	**(762,342)**
CASH FLOWS FROM INVESTING ACTIVITIES		
Net inflow/(outflows) from investments in investment securities	745,848	(1,995,421)
Net outflow for purchase of intangible assets and non-current assets	(27,370)	(83,725)
Net cash inflow/(outflow) from investing activities	**718,478**	**(2,079,146)**
CASH FLOWS FROM FINANCING ACTIVITIES		
Inflow from capital increases	-	1,840,500
Inflow from subordinated liabilities	-	615,180
Net cash inflow from financing activities	**-**	**2,455,680**
Net increase/decrease in cash and cash equivalents	**219,777**	**(385,808)**
Cash and cash equivalents at the beginning of the year	**875,933**	**1,279,286**
Net negative exchange rate differences	(22,975)	(17,545)
Cash and cash equivalents at the end of the period	**1,072,735**	**875,933**

Notes presented in the following pages
are integral parts of this financial statement.

Signed for Mirabank a.d., Beograd:

Dragana Bojin
Head of Accounting Department

Ilinca Rosetti
President of the Executive Board

Saša Mićević
Member of the Executive Board

TRANSLATION NOTE: This is a translation of the original document issued in the Serbian language. All due care has been taken to produce a translation that is as faithful as possible to the original. However, if any questions arise related to interpretation of the information contained in the translation, the Serbian version of the document shall prevail.

1. Establishment and Operations of the Bank

The founder of Mirabank a.d. Beograd (hereinafter: the Bank), Duingraaf Financial Investments B.V., Weena 327, Rotterdam, The Netherlands (hereinafter: the Founder), obtained the preliminary permit to incorporate the Bank with the Decision of the National Bank of Serbia No. IO NBS 32 dated August 18, 2014. The National Bank of Serbia issued a Decision No. IO NBS 58 dated December 16, 2014, thus granting the operating license to the Bank.

Upon obtaining the approval from the National Bank of Serbia for the acts of the Founding Assembly of the Bank (the Decision on Appointment of the President and Members of the Board of Directors of the Bank, the Decision on Appointment of the President and Members of the Executive Board of the Bank, the Decision on the Adoption of the Articles of Association of the Bank, the Decision on the First Share Issue of the Bank, the Decision on the Adoption of the Strategy and Business Policy of the Bank), the Bank was registered with the Companies Registry based on the Decision of the Serbian Business Registers Agency BD 8779/2015 dated February 5, 2015.

The Founder of the Bank and the Bank are not members of the banking group. The initial capital of the Bank is EUR 15 million in RSD counter value; capital conversion was performed on April 6, 2015, upon opening of the Bank's account with the National Bank of Serbia, following which the Bank began conducting its operations through that account and payment transactions, and at the same time it initiated the reporting process to the National Bank of Serbia.

On May 11, 2016, with registration in the Central Securities Depository and Clearing House, the Bank's capital was increased through the II share issue in the amount of 1,840,500 ordinary shares with a nominal value of RSD 1.000 per share, after which the total share capital of the Bank (along with the initial issue in the amount of RSD 1.790.700 thousand) amounted to RSD 3.631.200 thousand. Pursuant to the Decision BD 39191/2017 of May 16, 2016, the Business Registers Agency completed registration of changes/increase in share capital.

Pursuant to the Law on Banks, (Official Gazette of the Republic of Serbia No. 107/2005, 91/2010 and 14/2015), Decision on Incorporation and Articles of Association of the Bank, the Bank was registered to perform the following operations:

- Deposit activities, i.e., accepting and placing all types of cash deposits,
- Lending activities, i.e., granting and taking all types of loans,
- Foreign exchange, foreign currency operations and exchange transactions,
- Payment transactions,
- Payment cards' issuing,
- Activities regarding securities,
- Issuing sureties, guarantees, sureties on promissory notes and other types of warranties
- Purchase, sale and collection of receivables (factoring, forfeiting, etc.),
- Activities for which it is authorized in compliance with the Law,
- Providing other financial services.

Members of the Executive Board of the Bank as at 31 December 2017 are:

Ilinca Rosetti, President,
Mirjana Garapic Zakanyi, Member,
Saša Mićević, Member.

Members of the Board of Directors of the Bank as at 31 December 2017 are:

Hamad Abdulla Rashed Obaid Alshamsi, President,
Majed Fuad Mohammad Odeh
Mahmood Ebraheem Mahmood Mohamed Al Mahmood
Kheriba Mustafa Ghazim
Dejan Nikolic
Vladimir Radic

The headquarter of the Bank is in Belgrade, 1 Španskih boraca Street in Novi Beograd, and its operations are conducted in 1 branch office in the territory of the Republic of Serbia at the same address. As at 31 December, 2017, the Bank had 42 employees (as at 31 December 2016 had 42 employees).

The Bank's Company registration number is 21080608. The Tax Identification Number assigned to the Bank is 108851504.

2. Basis for Preparation and Presentation of Financial Statements and Accounting Policy

The basis for preparation and basic accounting policies applied in preparation of individual financial statements are presented below.

The accounting policies were applied consistently to all the presented years, unless specified otherwise.

2.1. Basis for Preparation and Presentation of Financial Statements

Legal entities and entrepreneurs in the Republic of Serbia are legally obliged to keep books of account, recognize and evaluate their assets and liabilities, revenues and expenditure, prepare, present, submit and disclose their financial statements in compliance with the Law on Accounting (hereinafter: the Law, published in the Official Gazette of the Republic of Serbia, No. 62/2013).

The Bank, as a large legal entity, is obliged to apply the International Financial Reporting Standards ("IFRS"), which, within the meaning of the said Law, include the following: Chart of Accounts for preparation and presentation of financial statements ("Chart") and the International Accounting Standards ("IAS"), The International Financial Reporting Standards ("IFRS") and relevant interpretations issued by the International Financial Reporting Interpretation Committee ("IFRIC"), subsequent amendments to these standards and the related interpretations, as approved by the International Accounting Standards Board ("the Board"), the translation of which was determined and published by the Ministry in charge of finances. In addition, in accordance with the amendments to the Banking Act ("Off. Gazette of RS", no. 14/2016), the banks in the Republic of Serbia are obliged to in the preparation of annual financial statements apply IFRS, as well as subsequent amendments to standards and their related interpretation of the date of their issuance by the competent body.

These financial statements of the Bank for the period from 1 January to 31 December 2017 have been prepared in accordance with the International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB).

Financial statements were prepared on the historical costs basis, unless specifically stated otherwise in the accounting policies presented below.

The Bank's financial statements have been prepared in accordance with the going concern principle, which implies that the Bank will continue to operate in the foreseeable future.

For preparation of the present financial statements, the accounting policies described in the Note 4 were applied by the Bank.

2.2. Standards and interpretations applied for the first time in the current period

In the current year, the Bank applied the amendments to IFRS issued by the International Accounting Standards Board, whose application is mandatory for accounting periods beginning on or after January 1, 2017. The following standards and interpretations came into effect in the current accounting period:

- Changes and amendments to IAS 7 – Initiative for disclosure of data;
- Changes and amendments to IAS 12 Income Taxes - recognition of deferred tax assets for unrealized losses;
- Annual Improvements Cycle 2012 – 2014 – Changes and amendments to IFRS 12 Disclosure of Interest in Other Entities.

The abovementioned standards did not materially affect the reports compiled for the period ending on 31 December 2017.

2.3. Standards and interpretations in issue not yet effective

As at the date of these Financial Statements, the following standards, amendments and interpretations thereto were published, but not yet effective for the financial year ended 31 December 2017:

- Amendments to IFRS 2 Share-based Payment (effective for annual periods beginning on or after 1 January 2018);
- The cycle of annual improvements to IFRS 2014- 2016 - Amendments to IFRS 1 First-time Adoption of IFRS and IAS 28 Investments in Associates and Joint Ventures (effective for annual periods beginning on or after 1 January 2018);
- IFRIC 22 Interpretation – Foreign Currency Transactions and Advance Consideration (effective for annual periods beginning on or after 1 January 2018);
- The application of IFRS 9 Financial Instruments with IFRS 4 Insurance contracts (effective for annual periods beginning on or after 1 January 2018);
- Amendments to IAS 40 Investment Property - Investment property transfer (effective for annual periods beginning on or after January 1, 2018.)
- IFRS 9 Financial Instruments (effective for annual periods beginning on or after 1 January 2018),
- IFRS 15 Revenue from contract with customers (effective for annual periods beginning on or after 1 January 2018). A new standard, which replace the requirements of IAS 18 Revenue, IAS 11 Construction Contracts, IFRIC 13 Customer Loyalty Programs, IFRIC 15 Real Estate Construction Agreements, IFRIC 18 Transfers of Assets from Customers, introduces a basic principle that requires revenue to be recognized at the time of the transfer of goods or customer service, at the price of the transaction executed. In the case of sets of goods or services that are separated by nature, these goods and services must be specifically recognized, and any discounts or rebates on the agreed price must be allocated by separate elements. If the amount of the charge is variable, minimum amounts should be recognized, unless there is a significant risk of cancellation. Contract security costs are capitalized and depreciated over the period during which the benefits of the contract are spent. The Bank does not offer card products or any other type of complex products (packages) that would require separation of recognition in terms of IFRS 15. Therefore, it is estimated that the application of IFRS 15 will not have a significant impact on the Bank's financial statements.
- IFRS 16 Lease (effective for annual periods beginning on or after 1 January 2019); The new standard sets out principles for the recognition of measurement, presentation and disclosure of leasing. In all lease operations, a financing element is also contained, as the user acquires the right to use the asset at the beginning of the lease period, and the payment is made during the period. Accordingly, IFRS 16 excludes the classification of leases on operating and financial leasing as set out in IAS 17 and instead introduces a unique leasing model. The Lessee is obliged to recognize:
  - assets and liabilities for all types of leases with a term longer than 12 months, unless the fixed asset is of small value
  - the impairment of the value of the asset is separated from interest on the lease in the income statement.

  In accordance with IFRS 16, the leasing provider continues to classify leases as operational and financial and to differentiate these two types of lease. The Bank currently assesses the impact of the new standard on its financial statements.
  - IFRIC 23 interpretations - uncertainty regarding tax treatment (effective for annual periods beginning on or after 1 January 2019)
  - Amendments to IAS 19 - Amendment, Restriction or Settlement Plan (effective for annual periods beginning on or after 1 January 2019)
  - The cycle of annual improvements to IFRS 2015- 2017 - Amendments to IFRS 3 Business Combination, IFRS 11 Joint Arrangements, IAS 12 Income Taxes and IAS 23 Borrowing Costs (effective for annual periods beginning on or after 1 January 2019)
  - Amendments to IFRS 10 and IAS 28 - Selling or Contribution of Investors to Associates or Joint Investment (effective for annual periods beginning on or after 1 January 2019)
  - IFRS 17 Insurance Contracts (effective for annual periods beginning on January 1, 2021)

For the aforementioned standards and interpretations, that have not been published yet, the Bank's Management considers that it will not have a material effect on the Bank's financial statements, except for the application of IFRS 9 Financial Instruments, which impact is explained in detail in the context of the IFRS note 9 Financial Instruments and IFRS 16 Lease, whose impact the Bank is currently appraising.

IFRS 9 "Financial Instruments"

In July 2014, the International Accounting Standards Board published the final version of IFRS 9 "Financial Instruments". IFRS 9 "Financial Instruments" is effective for annual periods beginning on or after 1 January 2018. IFRS 9 also replaces the IAS 39 "Financial Instruments: Recognition and Measurement" standard.

iii. Classification - financial assets

IFRS 9 is based on a new approach to the classification and valuation of financial assets, which reflects the business model that is managed by a specific asset, as well as the characteristics of contracted cash flows. In accordance with IFRS 9, three basic categories of financial assets are: financial assets at amortized cost, financial assets at fair value through other results (hereinafter: FVOCI) and financial assets at fair value through profit and loss (hereinafter: FVTPL). The Standard eliminates existing categories under IAS 39 "Financial Instruments: Recognition and Measurement", that is, held-to-maturity financial assets, loans and receivables, financial assets at fair value through profit or loss and available-for-sale.

Initially, the financial asset is measured at fair value plus the transaction costs directly related to the asset acquisition transaction, except in the case of financial assets FVTPL in which these costs are recognized through the cost of the income statement.

A financial asset is measured at amortized cost unless it is designated as FVTPL and meets the following criteria:
- the objective of a business model of the asset is holding the asset in order to collect contracted cash flows and
- contractual terms of a financial asset lead to rise of cash flows that represent only payments of principal and interest on the principal balance on specified dates.

A financial asset is evaluated as FVOCI only if it meets both of the following criteria and is not designated as FVTPL:
- the objective of the business model of the asset is to keep the asset in order to collect contracted cash flows and sales and
- contractual terms of a financial asset lead to cash flows that represent only payments of principal and interest on the equity balance at specified dates.

On the day of the initial recognition of the equity instrument that is not held in the portfolio for trading purposes, the Bank may irrevocably select the presentation of subsequent changes in fair value through the other result (OCI).

Subsequently, gains or losses on the financial assets of the FVOCI will be recognized through other results, other than income or expense on impairment of financial assets and exchange rate differences, until the moment when the recognition of a financial asset ceases or when it is reclassified.

All other financial assets – i.e. financial assets that do not meet the criteria for classification as subsequently measured at either amortised cost or FVOCI – are classified as subsequently measured at fair value, with changes in fair value recognised in profit or loss. In addition, the Bank has the option at initial recognition to irrevocably designate a financial asset as at FVTPL if doing so eliminates or significantly reduces a measurement or recognition inconsistency – i.e. an 'accounting mismatch' – that would otherwise arise from measuring assets or liabilities, or recognising the gains and losses on them, on different bases.

A financial asset is classified into one of these categories on initial recognition.

Business model assessment

For the purpose of assessing the business model, the Bank analyzes the current Bank's Strategy, as well as the Bank's financial contracts itself. On the basis of the above, there are conclusions relevant to the classification, valuation and impairment of financial assets. Things that are analyzed are:

- the performance of the business model and its financial assets;
- how the performance of the portfolio is assessed and reported by the Bank's management;
- risks that affect the performance of the business model and its financial assets, as well as the way in which these risks are managed;
- the frequency, volume and type of sales, the reasons for the sale in previous periods (in situations where the aforementioned events occurred in the Bank, because in the previous operations of the Bank there were no such events). Also, expectations for the future period are also taken into account. Sales information is viewed as isolated events, but as part of a wider assessment by the Bank, as the stated objective for the management of financial assets is achieved and how the cash flows are realized.

Analysis of Contractual Cash Flow Characteristics

The key requirements of IFRS 9 are:

- An estimate of how an asset should be classified is based on a bank's business model for managing a financial asset, as well as the characteristics of contractual cash flows of a financial asset.
- In accordance with the analysis of the Bank's business model, the assessment of client's placements is at amortized cost, cash flows must consist exclusively of principal and interest payments, "SPPI" criteria, (Solely payments of principle and interest").
- The interest must consist only of compensation for the time value of money, credit risk, other basic credit risks, administrative costs and profit margin. Any other component would potentially be a violation of the SPPI "criteria.
- The loan should have the characteristics of the basic lending arrangement in order to be valued at amortized cost.
- In order to meet these characteristics, the Bank has performed a detailed analysis of contractual clauses.

In order for a bank's loan portfolio to be measured at amortized cost, it is necessary to meet the requirement that the cash flows of each product consist exclusively of principal and interest payments (SPPI criterion, "Solely Payments of Principle and Interest"). The precise definitions of the terms of principal and interest are the subject of the Bank's accounting policies, and it is important to note that in the context of the fulfillment of the criteria SPPI, interest must consist only of compensation for the time value of money, credit risk, other basic credit risks, administrative costs and profit margin. Therefore, the basic test involves checking the principle that cash flows consist exclusively of principal and interest payment and there is the consistency with the basic credit arrangement.

General preliminary conclusion of the conducted analysis on all current contracts on 1 January 2018. is that the SPPI criterion is fulfilled and that cash flows for all current placements consist exclusively of principal and interest payments.

Evaluation of the effect of applying the new classification

The Bank's assessment is that thee Standard will affect the classification and redistribution of financial assets in the Bank's books on 1 January 2018 according to preliminary analysis, in the following way:

- Securities that so far were classified as available for sale under IAS 39, from now will be classified as FVOCI under IFRS 9.
- Loans and receivables from banks, other financial organizations and customers classified as loans and receivables that were measured at amortized cost under IAS 39 will continue also under IFRS 9.

- Cash and contractual right, which implies - receiving cash or another financial asset from another entity or exchanging financial assets or financial liabilities with another entity under potentially favorable terms that are measured at the amortized cost under IAS 39 will continue also under IFRS 9.
- Financial guarantees, or contracts that require specific payments by the issuer to compensate for the loss of holders arising from the default of a particular debtor, who has matured in accordance with the original or modified terms of a debt instrument, are measured at amortized cost under IAS 39 and will also continue under IFRS 9.

By analyzing balance sheet positions and credit portfolios as at 1 January 2018, the Bank has preliminarily determined that there are no financial assets whose contractual terms do not entail cash flows that represent only payment of principal and interest, therefore it will require measurement at fair value or change in classification in accordance with IFRS 9. Therefore, the classification of financial assets under IFRS 9 at first application, according to a preliminary analysis, will not have any impact on the way in which financial assets are measured.

ii. Impairment - Financial assets

IFRS 9 replaces IAS 39, "incurred losses" model with a new "forward-looking" model of expected losses. The above will require significant estimates of the impact of changes in economic factors on expected loan losses, which will be determined on the basis of weighted probability.

The new impairment model will apply to financial assets that are measured at amortized cost or at fair value through other result (FVOCI), expect share capital.

In accordance with IFRS 9, impairment is valued on one of the following basis:

- 12-month expected loan losses - these are expected loan losses that arise if the default status occurs within 12 months of the reporting date, and
- lifetime expectancy loss - loan losses that are the result of possible default events during the life expectancy of a financial instrument.

Valuation of life expectancy losses is applied if the loan risk of a financial asset on the reporting date is significantly increased in relation to the initial recognition date of that asset, if it is opposite than the valuation of 12-month credit losses is applied. The bank may determine that the credit risk of the financial asset has not been significantly increased, if the asset has a low loan risk on the day of reporting.

The method of calculating the impairment

Impairment of assets is the difference between the gross book value of receivables and the present value of the expected future cash flows under that receivable.

The probable loss on off-balance sheet items is the estimated amount of losses on off-balance sheet items representing the present value of estimated non-recoverable future cash outflows based on assumed off-balance sheet liabilities of clients. Non-recoverable future cash outflows are determined as the difference between the amount of expected cash outflows based on off-balance sheet liabilities and the amount expected to be charged on that basis.

The process of calculating the amount of the impairment of the assets and the probable loss on the basis of off-balance sheet items is a set of activities during which qualitative and quantitative data on the Bank's clients are collected, and then analyzed. The final result of this process is to calculate the amount of the impairment of the assets that is accounted on the expense, and in favor of the impairment of those assets, and calculate the amount of the probable loss on the basis of off-balance sheet items, recorded on the expense, and in favor of the provision for losses on off-balance sheet items.

Definition of default status

The default status is assigned if one of the following conditions is met:

• The Bank finds it unlikely that the debtor will fully settle his obligation towards the Bank, without taking into account the possibility of realization of credit protection instruments;
• The debtor is in default status more than 90 days

Significant increase in credit risk

The Bank assesses for each reporting period whether there has been a significant increase in credit risk for all financial instruments. If the impairment for a financial instrument is measured at an amount equal to the expected credit loss over the life of the previous reporting period, but it is determined on the current reporting date that the conditions are no longer met, the Bank shall impose an impairment for the amount equal to the expected twelve-month loan losses on the current reporting date.

Levels of credit risk

The Bank will determine the level of credit risk for each exposure on the basis of various data that is determined to predict the risk of non-fulfillment of obligations and apply an experiential credit assessment. The Bank will use these credit risk assessments to identify credit risk increases in accordance with IFRS 9. Credit risk assessment will be determined using certain qualitative and quantitative factors that indicate the risk of non-fulfillment of obligations.

All exposures will be allocated to certain credit risk assessments when initial recognition is based on available customer information. Exposures will be subjected to constant monitoring, which may involve shifting one exposure from one credit risk to another.

The Bank has defined three stages in which the Bank's placements may be classified, depending on the initial assessment of placements, as well as changes that can be identified during the repayment of placements. The characteristics of the each stage are as follows:

a) Stage 1 - Performing - clients with identified significant unfavorable change in credit quality.
b) Stage 2 - Underperforming - Clients with a significant decline in credit quality,
c) Stage 3 - Non-performing - impaired financial assets including purchased or authorized assets that were impaired at the time of the initial recognition.

Since different levels of impairment result in different ways of calculating the expected loan losses (the 12-month expected credit losses are accounted for receivables in Stage 1, while for the receivables in Stage 2 and Stage are calculated 3 the "life time" expected credit losses), the Bank is developed an adequate impairment methodology.

Determining whether this is a significant increase in credit risk

Indicators of a significant increase in credit risk, that is, the criteria for transferring a financial asset from Stage 1 to Stage 2 for which the Bank has defined are:

1. Delay in the settlement of matured liabilities in an uninterrupted period longer than 30 days,
2. Existence of Status Intensified, ie. classification of placements on the Watch list (the criteria for assigning to the Watch list are defined in the Procedure for managing placement with increased credit risk and bad asset management),
3. In case of restructuring of receivables that are not considered problematic due to increased credit risk,
4. In the case of a fall in the level of the rating defined in the Methodology for assessing the impairment of assets and the amount of probable loss on off-balance sheet items, in the segment relevant for determining stages 1, 2 and 3.

Impairment measuring elements

The key elements for calculating impairment are PD, LGD and EAD parameters.

Generating PD structure

Probability of default (PD), or the probability of the debtor to fall into the default status during the period of the financial instrument, is one of the basic parameters used in the calculation of the allowance for impairment in accordance with IFRS 9 and as such has undergone significant changes in relation to an approach in accordance with IAS 39.

Principles for assessing the PD parameter for calculating the segment of legal and natural persons: The Bank's approach to the creation of multi-annual PDs is generally based on an internal rating approach and take into account “Point in time” and the forward-looking, in order to ensure compliance with the requirements of IFRS 9.

For exposures to countries and financial organizations, with external credit rating of renowned external rating agencies (Fitch, Moody's, S & P), the Bank, in terms of migration and default exposure to these institutions, during assessing the impairment and default risk exposure based on financial instruments, relies on research and data from the renowned external rating agencies.

The Loss given default, or LGD is the estimate of a loss for a single financial instrument, assuming default status. LGD is one of the key components for calculating credit risk parameters in the calculation of expected credit losses.

Namely, in its assessment of loan losses assessed in accordance with Methodology and IFRS 9, the Bank wants to reflect the possibility of collecting regular cash flows, as well as collateral and other collateral, directly linked to a financial instrument.

In this regard, the Bank applies the general concept of a separate LGD secured and LGD unsecured depending on the level of securitization of individual placements.

EAD, or exposures in the case of a default status, represents an estimate of book value in accordance with IFRS 9 at the moment of default, taking into account the profile of contracted cash flows as well as possible additional withdrawals from approved lines before the default.

As the EAD is one of the key components of the credit risk parameters for the purpose of calculating the expected credit losses, the Bank approaches the modeling of both exposure and the period on which is needed to model exposures in the default case.

The maximum period the Bank takes into account in measuring the expected credit losses is the maximum contractual period during which the Bank is exposed to credit risk.

The Bank's approach, in accordance with the above, in the context of the EAD's calculation, depends on whether the Bank has contracted cash flows and the agreed maturity date.

Accordingly, for instruments where there are contractual cash flows, and where the maturity date is clearly stated, the Bank takes into account the contracted cash flows according to the repayment plan as relevant. In financial instruments for which there are no defined cash flows, as well as the agreed maturity dates, the Bank determines it on the basis of empirical experience.

Effect assessment

The Bank's assessment is that the calculation of impairment in accordance with the Bank's methodology, which represents the first application of IFRS 9, will be reflected in the financial position of the Bank in the following manner:

- Financial instruments that are measured at amortized cost:
  - Increase in the amount of impairment, calculated in accordance with IFRS 9, in relation to the amount calculated in accordance with IAS 39 as at 31 December 2017, in the amount of RSD 591 thousand on the basis of results of the previous years.
- Financial instruments that are measured at fair value through other comprehensive income (FVOCI):
  - Increase in the allowance for impairment calculated in accordance with IFRS 9 (in accordance with IAS 39, there was no allowance for impairment for available-for-sale financial instruments) in the amount of RSD 3,402 thousand on the results of previous years and in favor of the other comprehensive results.

The above changes in the book value of financial assets and financial liabilities will be recognized directly in the equity as at 1 January 2018.

Based on currently effective tax regulation, there are no tax effects as result of IFRS 9 first time adoption. It is not possible to predict if tax regulation will be changed during 2018.

In respect of impact of IFRS 9 first time adoption, following should be taken into consideration:

- The assessment made is preliminary as not all transition work requirements have been finalized and therefore may be subject to adjustment;
- The new standard will require the Bank to revise its accounting processes and internal controls, and these changes are not yet complete;
- The Bank has not finalized the testing and assessment of controls over its new IT systems. Consequently, the related impacts presented below may change when implementation is finalized;
- The systems and the associated controls that are in place to comply with the new requirements have not been operational for a full reporting period;
- The new accounting policies, assumptions, judgements and estimation techniques employed are subject to change until the Bank finalizes its first financial statements that include the date of initial application.

iii. Classification - financial liabilities

IFRS 9 largely retains the existing requirements in IAS 39 for the classification of financial liabilities.

However, under IAS 39 all fair value changes of liabilities designated as at FVTPL are recognized in profit or loss, whereas under IFRS 9 these fair value changes are generally presented as follows:

- the amount of change in the fair value that is attributable to changes in the credit risk of the liability is presented in OCI and
- the remaining amount of change in the fair value is presented in profit or loss.

iv. Derecognition of financial assets and contract modification

In some circumstances, re-contracting or modifying contractual cash flows of a financial asset may lead to the cessation of recognition of an existing financial asset in accordance with this standard. When the modification of a financial asset results in the cessation of recognition of an existing financial asset and the subsequent recognition of a modified financial asset, the modified asset is considered a "new" financial asset for the purpose of this standard.

In such situations, the Bank performs a quantitative and qualitative assessment and assesses whether there is a significant difference between the cash flows of the original financial asset and the cash flows of a modified or replaced financial asset. If there is a significant difference in cash flows, contractual rights from the original financial asset are considered as expired and a new asset must be recognized under new onditions.

v. Impact on capital planning

The Bank's estimate is that the previously shown increase in the impairment as of 01 January 2018, due to the first application of IFRS 9, should not have a material effect on the regulatory capital and indicators of capital adequacy of the Bank. Namely, the shown increase in the impairment represents a relatively small amount, especially when taking into account the amount of regulatory capital that Bank owns, and the fact that the indicators of capital adequacy of the Bank are high, i.e. multiple above regulatory and internal limits.

Namely, a preliminary impact assessment is that an increase in the impairment as of 01 January 2018, due to the first application of IFRS 9, may reduce regulatory capital by RSD 3,918 thousand, or the overall indicator of capital adequacy of the Bank by 0.08 pp

vii. Transition to new standard

The Bank plans to take advantage of the exemption, with which is allowed not to adjust comparative data for previous years on the basis of changes relating to classification and valuation, as well as impairment. Differences in the book value of financial assets and financial liabilities arising from the application of IFRS 9 will be recognized within equity as at 1 January 2018.

3. Official Reporting Currency

The Financial Statements of the Bank are presented in RSD thousands. Serbian Dinar is the official reporting currency in the Republic of Serbia.

4. Summary of Significant Accounting Policies and Estimates

4.1 Accounting Policies

4.1.1 Transactions in Foreign Currency

The Financial Statements are presented in Serbian Dinar (RSD), which is the functional currency of the Bank and the currency of the Bank's country of incorporation. Transactions in foreign currencies are translated into the functional currency at the middle exchange rate at the date of the transaction.

Foreign exchange rates determined on the Interbank Foreign Exchange Market used in the translation of balance sheet items in currencies at 31 December 2017 for major currencies are:

	31 December 2017	**31 December 2016**
USD	99.1155	117.1353
EUR	118.4727	123.4723

Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated into the functional currency at the middle exchange rate at that date.

Non-monetary assets and liabilities denominated in foreign currencies are translated into the functional currency at the middle exchange rate at the date of initial recognition, except for non-monetary items denominated in foreign currencies that are measured at fair value. The exchange differences relating to these items are part of the change in fair value and they are recognized in the income statement or recorded directly in equity depending on the classification of the non-monetary item.

Foreign exchange differences arising on translation are recognized in the income statement.

4.1.2 Cash and Cash Equivalents

For the purposes of the cash flow statement, cash and cash equivalents consists of:
1) Cash on hand,
2) Non-restricted placements with the National Bank of Serbia,
3) Non-restricted placements on nostro accounts with other banks.

Below is an overview of the differences between cash and cash equivalents in the cash flow statement and Cash and balances with the Central Bank in the Balance Sheet:

In thousands of RSD	Balance sheet	Cash flows	Difference
In RSD			
Gyro account	50,431	50,431	-
Cash on hand	5,736	5,736	-
Liquidity surpluses deposited with the NBS	180,000	180,000	-
Interest receivables from NBS	30	-	30
	236,197	**236,167**	**30**
In foreign currency			
Cash on hand	30,154	30,154	-
Foreign currency account (line item Loans and receivables from banks and other financial institutions)	-	806,414	(806,414)
Mandatory reserve at NBS	116,474	-	116,474
	146,628	**836,568**	**(689,940)**
Balance as at 31 December 2017	**382,825**	**1,072,735**	**(689,910)**

4.1.3 Classification and Measurement of Financial Instruments

The Bank classifies the financial assets in the following four categories:
1) Loans and advances,
2) Held-to-maturity investments,
3) Financial assets at fair value through profit or loss
4) Available-for-sale financial assets.

4.1.3.1 Initial Recognition

The Bank recognizes financial assets or financial liabilities in its statement of financial position when it becomes a party to the contractual provisions of the instrument. Upon initial recognition the Bank measures financial assets and liabilities at fair values. Financial instruments not measured at fair value through profit or loss are initially recognized at fair value plus transaction costs and minus fees that are directly attributable to the acquisition or issue of the financial instrument.

4.1.3.2 Subsequent Measurement of Financial Assets

For each of the above categories the following applies:

1) Loans and receivables

The Bank has classified the following as Loans and advances:
a) Loans to clients,
b) All receivables from clients, banks, etc.,

This category is measured at amortized cost using the effective interest rate method and is periodically tested for impairment, in compliance with the procedures described under 4.1.10.

The effective interest rate method is a method of calculating the amortized cost of a financial instrument and of allocating the interest income or expense during a specified period. The effective interest rate is the rate that exactly discounts the expected future cash payments or receipts through the contractual life of a financial instrument or, where appropriate, for a brief period of the financial instrument to the net carrying value of the financial asset or financial liability.

2) Held-to-Maturity Investments

Non derivative financial assets with fixed or determinable payments and fixed maturity that the Bank has the positive intention and ability to hold until maturity can be classified as held to maturity investments. Held to maturity investments are measured at amortized cost using the effective interest rate method and are tested for impairment at each reporting date. In cases when objective evidence exists that an impairment loss has occurred, the carrying amount of the financial asset is reduced to the recoverable amount, and the difference is recognized in profit or loss.

As at the balance sheet date, the Bank has not reported any outstanding balance under this position.

3) Financial Assets at Fair Value through Profit or Loss

Financial assets in this category are as follows:
a) Financial assets acquired primarily for the purpose of selling in the near term, to obtain short term profit (financial assets held for trading),
b) Financial assets that the Bank designated, at the initial recognition, as financial assets at fair value through profit or loss.

This classification is used under following circumstances:
a) When management monitors and manages the financial instruments on a fair value basis in accordance with a documented risk management or investment strategy.
b) When the designation eliminates an accounting mismatch which would otherwise arise from measuring financial assets and liabilities on a different basis (i.e. amortized cost) in relation to another financial asset or liability (i.e. derivatives that are measured at fair value through the profit or loss).
c) When a financial instrument contains an embedded derivative that significantly modifies the cash flows or where separation of these derivatives from the main financial instruments is not prohibited.

4) Available-for-sale Financial Assets

Available-for-sale financial assets are financial assets that have not been classified in any of the previous categories. This category is measured at fair value. Changes in fair value are recognized directly in equity until the financial asset is sold. Upon sale, the cumulative gains and losses previously recognized in equity are recognized in profit or loss. The financial assets included in this category are reviewed at each balance sheet date to determine whether there is any indication of impairment. For investments in securities, a significant and prolonged decline in their fair value below their acquisition cost is considered as an objective evidence of impairment.

The Bank considers any decrease exceeding 20% of the cost of the investment to be “significant”.

The Bank considers a decrease to be “prolonged” if such decrease in the fair value is below cost for a continuous period exceeding one year.

The above criteria are assessed in conjunction to the general market conditions. In case of impairment, the cumulative loss already recognized in equity is reclassified in profit and loss.

When a subsequent event causes a decrease in the amount of impairment loss recognized on an available-for-sale financial asset, the impairment loss is reversed through profit or loss, providing that it can be objectively related to such event that occurred after the recognition of the impairment loss. The impairment losses recognized for investments in shares are not reversed through profit or loss.

4.1.3.3 Reclassification of Financial Assets

Reclassification of non-derivative financial assets is permitted in the following cases:

1) Reclassification out of the “held-for-trading” category to one of category “investments held to maturity” or “available-for-sale financial assets” category is permitted in some rare cases only and then the financial assets are no longer held for sale in the foreseeable future.
2) Reclassification out of the “held-for-trading” category to “Loans and advances” is only permitted, if the financial assets meet the definition of Loans and advances and that there is the intention to hold them for the foreseeable future or until maturity.
3) Reclassification out of the “available-for-sale” category to the “Loans and advances” category is permitted for financial assets that comply with the definition of Loans and advances and the Bank intends to hold the financial asset for the foreseeable future or until maturity.
4) Reclassification out of the “available-for-sale” category to the “held to maturity” category is permitted for financial assets that comply with the relevant characteristics of the “held-to-maturity investments” and the Bank has the intention and ability to hold that financial asset until maturity.
5) Reclassification out of the “held-to-maturity” category to the “available-for-sale” category occurs when the Bank has no longer the intention or the ability to hold these instruments until maturity. In case of a sale or reclassification of a significant amount of held-to-maturity investments, the remaining investments in this category are mandatorily transferred to the available-for-sale category. Over the period of two years from such reclassification, the Bank may not classify any securities as held-to-maturity. Exceptions apply in cases of sales or reclassifications of investments that:
   a) Are very close to maturity,
   b) After the Bank has collected substantially the entire amount of financial asset’s original principal through scheduled payments or prepayments,
   c) Are caused by some specific, non-recurring event that is beyond the control of the Bank.

4.1.3.4 Derecognition of Financial Assets

The Bank derecognizes a financial asset when:
1) The cash flows from the financial asset expire,
2) The contractual right to receive the cash flows of the financial assets is transferred and at the same time both risks and rewards of ownership are transferred,
3) Loans and advances or investments in securities are no longer recoverable and consequently are written off.

In case of transactions, where despite the transfer of the contractual right to recover the cash flows from financial assets both the risk and rewards remain with the Bank, no derecognition of these financial assets occurs. The amount received based on such the transfer is recognized as a financial liability. The accounting practices followed by the Bank in such transactions are analyzed further under 4.1.16.

In case of transactions whereby the Bank transfers the risks and rewards of the financial assets, but retains control over them, the financial assets are recognized to the extent of the Bank’s continuing involvement.

If the Bank does not retain control of the assets then such assets should be derecognized, and in their position the Bank recognizes, distinctively, the assets and liabilities which are created or retained during the transfer.

4.1.3.5 Subsequent Measurement of Financial Liabilities

The Bank classifies financial liabilities in the following categories for measurement purposes:

1) Financial liabilities measured at fair value through profit or loss,
   a) This category includes financial liabilities held for trading, that is:
      i) Financial liabilities acquired or incurred principally with the intention of selling or repurchasing in the near term for short term profit, or
      ii) Derivatives not used for hedging purposes.

Liabilities arising from either derivatives held for trading or derivatives used for hedging purposes are presented as “derivative financial liabilities” and are measured according to the principles set out under 4.1.4.

b) This category also includes financial liabilities which are designated by the Bank as at fair value through profit or loss upon initial recognition, in compliance with the principles set out for financial asset, under 4.1.3.2, item 3.

2) Financial liabilities carried at amortized cost

The liabilities classified in this category are measured at amortized cost using the effective interest method.

Liabilities to credit institutions and customers, debt securities issued by the Bank and other loan liabilities are classified in this category.

In cases where the financial liabilities included in this category are designated as the hedged item in a hedge relationship, the accounting principles applied are those set out under 4.1.4.

4.1.3.6 Derecognition of Financial Liabilities

The Bank derecognizes a financial liability (or part thereof) when its contractual obligations are discharged or cancelled or expired.

In cases that a financial liability is exchanged with another one with substantially different terms, the exchange is accounted for as an extinguishment of the original financial liability and the recognition of a new one.

The same applies in cases of a substantial modification of the terms of an existing financial liability or a part thereof.

The terms are considered substantially different if the discounted present value of the cash flows under the new terms (including any fees paid or any fees received), discounted using the original effective interest rate is at least 10% different from the present value of the remaining cash flows of the original financial liability.

The difference between the carrying amount of the financial liability (or part of the financial liability) extinguished or transferred to another party and the consideration paid, including any non-cash assets transferred or liabilities assumed, is recognized in profit or loss.

4.1.3.7 Netting (“Offsetting”) of Financial Assets and Financial Liabilities

Financial assets and liabilities are offset and the net amount is presented in the balance sheet, only in cases where the Bank has both the legal right and the intention to settle them on a net basis, or to realize the asset and to settle the liability simultaneously.

The Bank did not offset financial assets and financial liabilities on the balance sheet date.

4.1.4 Derivatives

Derivatives are financial instruments that upon recognition have a minimal or zero value that subsequently changes in accordance with a particular underlying instrument (foreign exchange rate, interest rate, index or other variable).

Derivatives are recognized as assets when their fair value is positive and as liabilities when their fair value is negative. Derivatives are used for either hedging or trading purposes and they are measured at fair value irrespective of the purpose for which they have been transacted.

4.1.4.1 FX Swaps

These types of swaps are entered into primarily to hedge the exposures arising from customer loans and deposits. As there is no documentation to support hedge accounting, the FX swaps are classified as trading instruments.

The result arising from these derivatives is recognized as interest and foreign exchange differences, in order to match with the interest element and foreign exchange differences resulting from the loans and deposits, and as other gains less losses on financial transactions.

4.1.5 Fair Value Measurement

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, in the principal market for the asset or liability or, in the absence of a principal market, in the most advantageous market for the asset or liability.

The Bank measures the fair value of assets and liabilities traded in active markets based on available quoted market prices. A market is regarded as active if quoted prices are readily and regularly available from an exchange, dealer, broker or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis.

The fair value of financial instruments that are not traded in an active market is determined by the use of valuation techniques, appropriate under the circumstances, and for which sufficient data to measure fair value are available, maximizing the use of relevant observable inputs and minimizing the use of unobservable inputs.

4.1.5.1 Financial Instruments

For financial instruments, the best evidence of fair value at initial recognition is the transaction price, unless the fair value can be derived by other observable market transactions relating to the same instrument, or by a valuation technique using only observable inputs. In these cases, if the fair value differs from the transaction price, the difference is recognized in income statement. In all other cases, fair value is adjusted to defer the difference with the transaction price. After initial recognition, the deferred difference is recognized as a gain or loss only to the extent that it arises from a change in a factor that market participants would take into account when pricing the instrument.

4.1.5.2 Non Financial Assets and Liabilities

The most important category of non-financial assets for which fair value is estimated is real estate property.

The process predominantly followed for the determination of fair value are listed below:
1) Assignment to the engineer – valuer,
2) Setting of additional data,
3) Autopsy – Inspection,
4) Data processing – Calculations,
5) Preparation of the valuation report.

The fair value measurement of a property takes into account a market participants' ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use.

4.1.6 Property, Plant and Equipment

This caption includes additions or improvements of leased property and equipment.

Property, plant and equipment are initially recognized at cost which includes any expenditure directly attributable to the acquisition of the asset. Subsequently, property, plant and equipment are measured at cost less accumulated depreciation and impairment losses.

Subsequent expenditures are recognized on the carrying amount of the item when it increases future economic benefit only. Expenditure on repairs and maintenance is recognized in profit or loss, as an expense as incurred.

Depreciation is charged on a straight line basis over the estimated useful lives of property, plant and equipment and it is calculated on the asset's cost minus residual value.

In 2017 calculation of depreciation of fixed assets with the following estimated useful life was carried out:

Description	Estimated useful life (in years)	Rate per annum (%)
Furniture	Max 5	20
Electronic systems	From 3 to 5	from 20 to 33.33
Other	From 3 to 5	from 20 to 33.33

In 2016, calculation of depreciation of fixed assets was carried out using the same rates.

In 2017 calculation of depreciation for leasehold improvements was carried out using an estimated useful life with a rate in the range of 20.35% to 28.63% (in 2016 rate in the range of 20.00% to 27.91%).

The residual value of property and equipment and their useful lives are periodically reviewed and adjusted if necessary at each reporting date.

Property, plant and equipment are reviewed at least once a year to determine whether there is an indication of impairment (impairment test) and if they are impaired, the carrying amount is adjusted to its recoverable amount and the difference is recorded in profit or loss. If there is an indication that some event might have caused the impairment, the Bank is performing the impairment test even more often than once per year.

Gains and losses from the sale of property and equipment are recognized in profit or loss.

4.1.7 Investment Property

This category includes buildings or portions of buildings that are held to earn rental income or for the purpose of increase of their value. Investment property is initially recognized at cost which includes any expenditure directly attributable to the acquisition of the asset.

At the balance sheet date, the Bank has not reported any outstanding balance under this position.

4.1.8 Intangible Assets

In this category, the Bank has included software and licenses, which is measured at cost less accumulated amortization, and impairment losses.

The cost of separately acquired software comprises of its purchase price and any directly attributable cost of preparing the software for its intended use.

Amortization is charged over the estimated useful life of the software, which the Bank estimates at a maximum of 15 years. The Bank's core system is estimated at 7 years in 2017 and 2016 (rate 14.29%)

Amortization of licenses shall be calculated at the rate of 33.33% and 20% (in 2016 were used the same depreciation rates as in 2017)

Expenditure incurred to maintain software programs is recognized in the income statement as incurred.

Software that is considered to be an integral part of hardware (hardware cannot operate without the use of the specific software) is classified under "Property, plant and equipment".

Intangible assets are amortized using the straight line method, excluding those with indefinite useful life, which are not amortized.

All intangible assets are tested for impairment. No residual value is estimated for intangible assets.

4.1.9 Lease

The Bank enters into leases either as a lessee. When all the risks and rewards incident to ownership of an asset are substantially transferred to the lessee they are classified as finance leases. All other lease agreements are classified as operating leases.

The accounting treatment followed depends on the classification of the lease, which is as follows:

4.1.9.1 When the Bank is the Lessee

1) Finance Leases:

For finance leases, where the Bank is the lessee, the leased asset is recognized as "Property, plant and equipment" and a respective liability is recognized in "Other liabilities".

At the commencement of the lease, the leased asset and liability are recognized at amounts equal to the fair value of leased property, or (if lower) at the present value of the lease payments. The discount rate used in calculating the present value of the lease payments is the interest rate implicit in the lease or, if this is not available, the Bank's borrowing rate for similar financing.

Subsequent to initial recognition the leased assets (recognized as "Property, plant and equipment") are depreciated over their useful lives unless the duration of the lease is less than the useful life of the leased asset and the Bank does not expect to obtain ownership at the end of the lease, in which case the asset is depreciated over the term of the lease. The lease payments are apportioned between the finance charge and the reduction of the outstanding liability.

As at the balance sheet date, the Bank has not reported any outstanding balance under this position.

2) Operating Lease:

For operating leases, the Bank as a Lessee does not recognize the leased asset but charges in general administrative expenses the lease payments on an accrual basis. Bank are operating leases for office space and cars.

4.1.10 Impairment of Loans and advances

The Bank has created a methodology for group impairment, taking into consideration the current regulatory act of the National Bank of Serbia (and the accompanying guidelines and other documents), International Accounting Standards, the characteristics of the Bank operations and other relevant factors.

For the reporting date of 31 December 2017, the entire amount of the impairment of balance sheet assets and provisions for losses on off-balance sheet items, is based on group assessment.

The Bank performs assessment of impairment of balance sheet assets and probable losses arising from off-balance sheet items on an aggregate basis for all receivables in which impairment or losses cannot be directly linked to the receivable, but which based on experience can be estimated as present in the loan portfolio.

Assessment of impairment of balance sheet assets on individual basis includes determining the existence of objective evidence of impairment, assessment of the present value of future cash flows and the calculation of the amount of that impairment for each individual receivables from debtor that is included in such assessment.

Objective evidence of impairment of balance sheet assets on an individual basis, of:

- if the debtor's financial condition indicates significant problems in his business;
- if there are data of settlement of liabilities, the frequent delays in payment of interest and / or principal, or the non-fulfilment of other contractual provisions;
- if the bank, due to financial difficulties of the debtor, essentially change the terms of repayment claims in relation to those originally agreed;
- if it becomes certain that it will be launched bankruptcy proceedings against the debtor or other of its financial reorganization.

4.1.11 Impairment of Non-Financial Assets

The Bank assesses at least once per annum non-financial assets for impairment, particularly property, plant and equipment, investment property and intangible assets. In assessing whether there is an indication that an asset may be impaired, both external and internal sources of information are considered, of which the following are indicatively mentioned:

1) The asset's market value has declined significantly, more than would be expected as a result of the passage of time or normal use;
2) Significant changes with an adverse effect have taken place during the period or will take place in the near future, in the technological, economic or legal environment in which the Bank operates or in the market to which the asset is dedicated;
3) Significant adverse changes in foreign exchange rates;
4) Interest rates have increased during the period, and such increases are likely to affect the discount rate used in calculating an asset's value in use;
5) The carrying amount of the net assets of the Bank is more that its market capitalization;
6) Evidence is available of obsolescence or physical damage of an asset.

An impairment loss is recognized in profit or loss when the recoverable amount of an asset is less than its carrying amount.

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

Fair value less costs to sell is the amount received from the sale of an asset (less the cost of disposal) in an orderly transaction between market participants.

Value in use for property, plant and equipment is the present value of the future cash flows expected to be derived from an asset or cash–generating unit through their use and not from their disposal. Value in use incorporates the value of the asset as well as all the improvements which render the asset perfectly suitable for its use by the Bank.

4.1.12 Income Tax

Income tax consists of current and deferred tax.

Current tax for a period includes the expected amount of income tax payable in respect of the taxable profit for the current reporting period, based on the tax rates enacted at the balance sheet date.

Deferred tax is the tax that will be paid or for which relief will be obtained in future periods due to the different period that certain items are recognized for financial reporting purposes and for taxation purposes.

It is calculated based on the temporary differences between the tax base of assets and liabilities and their respective carrying amounts in the financial statements.

Deferred tax assets and liabilities are calculated using the tax rates that are expected to apply when the temporary difference reverses, based on the tax rates (and laws) enacted at the balance sheet date (in 2017 and 2016:15 percent).

A deferred tax asset is recognized to the extent that it is probable that future taxable profits will be available against which the asset can be utilized.

Income tax, both current and deferred, is recognized in profit or loss except when it relates to items recognized directly in equity. In such cases, the respective income tax is also recognized in equity.

4.1.13 Non-Current Assets Held for Sale

Non-current assets that are expected to be recovered through a sale transaction, along with the related liabilities, are classified as held-for-sale.

The above classification is used if the asset is available for immediate sale in its present condition and its sale is highly probable. The sale is considered highly probable when the following conditions are met:
1) It has been decided by the Management,
2) An active program to locate a buyer has been launched,
3) The asset has to be actively marketed for sale, at a price which is reasonable in relation to its current fair value, and
4) The sale is expected to be completed within one year.

Non-current assets that are acquired exclusively with a view to their subsequent disposal are classified as held for sale at the acquisition date when the one-year requirement is met and it is highly probable that the remaining criteria will be met within a short period following the acquisition (usually within three months).

Non-current assets held for sale consist mainly of assets acquired through the enforcement of security over loans and advances.

Prior to their classification as non-current assets held for sale, such assets are remeasured in accordance with the respective accounting standard.

Assets held for sale are initially recognized and subsequently measured at each balance sheet date at the lower of their carrying amount and fair value less cost to sell.

Any loss arising from the subsequent measurement is recorded in profit or loss and can be reversed in the future.

Assets in this category are not depreciated. Gains or losses from the sale of these assets are recognized in the income statement.

Non-current assets that are acquired through enforcement procedures based on Loans and advances but are not available for immediate sale or are not expected to be sold within a year are included in "Other Assets" and are measured at the lower of cost (or carrying amount) and fair value.

Non-current assets held for sale, that the Bank subsequently decides either to use or to lease, are reclassified to the categories of "Property, plant and equipment" or "Investment property".

For reclassification purposes, such assets are measured at the lower of their recoverable amount and their carrying amount (before they were classified as held for sale, adjusted for any depreciation, amortization or revaluation that would have been recognized had the assets not been classified as held for sale).

As at the balance sheet date, the Bank has not reported any outstanding balance under this position.

4.1.14 Employee Benefits

A defined benefit plan is a pension plan that defines an amount of pension benefit that is to be paid to the employee on retirement.

As at each balance sheet date, the Bank is estimating the long-term provisions for retirement pay as the present value of the expected future payments to employees, based on an actuarial valuation.

The net liability recognized in the profit or loss is the present value of the defined benefit obligation (which is the expected future payments required to settle the liabilities resulting from employee service in the current and prior periods).

The present value of the defined benefit liability is calculated based on the return of high quality corporate bonds with a corresponding maturity to that of the obligation, or based on the return of government bonds in cases when there is no deep market in corporate bonds.

Interest on the net defined benefit liability, which is recognized in profit or loss, is determined by multiplying the net defined benefit liability by the discount rate used to discount post-employment benefit obligation, as determined at the beginning of the financial year, taking into account any changes in the net defined benefit liability.

Service cost, which is also recognized in profit or loss, consists of:

1. Current service cost, which is the increase in the present value of the defined benefit obligation resulting from employee service in the current period;
2. Past service cost that is the change in the present value of the defined benefit obligation for employee service/services provided in previous periods, resulting from the changes (introduction or withdrawal to a defined benefit plan) or a curtailment (a significant reduction in the number of employees covered by a plan by the Bank);
3. Any gain or loss on settlement.

Prior to determining the past service cost and gain or loss on settlement, the Bank remeasures the net defined benefit liability using the current actuarial assumptions, curtailment or settlement.

Past service cost is directly recognized to profit or loss at the earliest of the following dates:
1. When the plan is changed or when curtailment occurs; or
2. When the Bank recognizes restructuring costs (in compliance with IAS 37) or when the benefits are terminated.

Likewise, the Bank recognizes a gain or loss on the settlement when the settlement occurs.

Remeasurements of the net defined benefit liability, which comprise of:
1. Actuarial gains and losses;
2. Any change in the effect of the limitation of assets, excluding amounts included in net interest on the net defined benefit liability, are recognized directly in other income and cannot be recognized in profit or loss in subsequent periods.

When the Bank decides to terminate the employment contract before retirement or the employee accepts the Bank's offer (which includes certain benefits) in exchange for termination of employment, the liability and the relative expense for termination benefits are recognized at the earlier of the following dates:

1. When the Bank can no longer withdraw the offer of those benefits; and
2. When the Bank recognizes restructuring costs that involve the payment of termination benefits.

4.1.15 Provisions and Contingent Liabilities

A provision is recognized if, as a result of a past event, the Bank has a present legal or contractual obligation that can be estimated reliably, and it is certain that an outflow of economic benefits will be required to settle the obligation.

Provisions are, also, recognized in cases of restructuring plans based on the management attempts either to change the corporate activity or the manner in which it is conducted.

The recognition of a provision is accompanied with the relevant program authorized by the Management and with the suitable actions of disclosure.

The amount recognized as a provision shall be the best estimate of the expenditure required to settle the present obligation at the end of the reporting period.

Where the effect of the time value of money is material, the amount of the provision is equal to the present value of the expenditures expected to settle the obligation.

Amounts paid for the settlement of an obligation are set against the original provisions for these obligations.

Provisions are reviewed at the end of each reporting period.

If it is no longer probable that an outflow of resources embodying economic benefits will be required to settle the obligation, the provision is reversed.

Additionally, provisions are not recognized for future operating losses.

Future events that may affect the amount required to settle the obligation, for which a provision has been made, are taken into account where sufficient objective evidence exists that they will occur.

Reimbursements (refunds) from third parties relating to a portion of or the entire estimated cash outflow are recognized as assets, only when it is very certain that they will be received.

The amount recognized for the reimbursement (refund) must not exceed the amount of the provision.

The expense recognized in profit or loss relating to the provision is presented net of the amount of the reimbursement (refund).

The Bank does not recognize in the statement of financial position contingent liabilities which relate to:

1) Contingent liabilities resulting from past events that will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not entirely within the control of the Bank, or
2) Present liabilities resulting from past events and:
    a) It is not probable that an outflow of resources embodying the economic benefits will be required to settle the liability; or
    b) The liability amount cannot be estimated reliably.

4.1.16 Repo operations and pledge on securities

The Bank purchases securities under agreements to resell on a certain future date, at a fixed price (repos).

Securities purchased subject to commitments to resell them at future dates are not recognized as investments. These are recognized as “Loans and advances” from banks or clients, in the amount paid.

The difference between the purchase and resale price is recognized as interest income, on accrual basis.

Securities sold under agreements to repurchase continue to be recognized in the balance sheet and are measured in accordance with the accounting policy of the category that they have been classified in and are presented as investments.

The proceeds from the sale of the securities are reported as liabilities to either banks or customers.

The difference between the sales price and the repurchase price is recognized as interest expenses on accrual basis.

Securities acquired by the Bank under securities resale agreements are not recognized in the balance sheet except when these are sold to third parties whereby the liability to deliver the security is recognized and measured at fair value.

As at the balance sheet date, the Bank has not reported any outstanding balance under this position.

4.1.17 Equity

4.1.17.1 Distinction between Debt and Equity

Financial instruments issued by the Bank are classified as equity in cases where, based on the substance of such transaction, the Bank does not undertake a contractual obligation to pay cash or another financial asset or to exchange financial instruments under conditions that are potentially unfavorable for the issuer.

In cases where the Bank is required to issue equity instruments in exchange for the funding obtained, the number of equity instruments must be fixed and determined on the initial contract, in order for the obligation to be classified as equity.

4.1.17.2 Incremental Costs of Share Capital Increase

Incremental costs directly attributable to the issue of new shares are presented in equity as a deduction, net of tax, from retained earnings.

4.1.17.3 Share Premium

Share premium is the difference between the nominal value of shares and actually received consideration in case of a share capital increase. The share premium additionally includes the difference between the nominal value of issued shares and the market value of such shares, in cases of exchanges of shares as consideration for acquisition of a business (company) by the Bank.

4.1.17.4 Retained Result

Retained result is previous years' result for which General Assembly have not made any decision on distribution.

4.1.18 Interest Income and Expense

At accounts: revenue from interest on loans, deposits, securities, other investments and assets in RSD and foreign currency, shall disclose accrued income from regular and default interest in the current accounting period, regardless of the time it falls due for payment.

At accounts: expense from interest on loans, deposits, securities, other investments and assets in RSD and foreign currency, shall disclose accrued income from regular and default interest in the current accounting period, regardless of the time it falls due for payment.

Interest income and expense is recognized in the income statement for all interest bearing financial assets and liabilities. Interest income and expense are recognized on accrual basis and measured by using the effective interest rate.

The effective interest rate method includes all paid or received fees and costs, which are integral part of effective interest rate. Interest on impaired financial assets is determined in the manner specified under 4.1.10.

4.1.19 Fee and Commission Income and Expenses

Accounts of income from fees and commissions in RSD and foreign currency, shall disclose income from fees and commissions accounted for in the current accounting period irrespective of the time of their collection, such as fees for RSD and foreign payment transactions, fees for warranty processing, etc.

Accounts of expenditure fee and commission expenses, in RSD and foreign currency, shall disclose accrued fees and commission expenses in the current accounting period irrespective of the time of their payments, such as fees for RSD and foreign currency payments, commissions of other banks, CSD, etc.

Fee and commission income is recognized in the income statement on accrual basis in the period when the relevant service was provided.

Fees and commissions income and expense that are integral part of effective interest rate are included in the calculation of effective interest rate and accordingly reported within interest income or interest expenses.

4.1.20 Related Parties

Pursuant to IAS 24, a related party is a person or entity that is related to the entity that is preparing its financial statements. For the Bank in particular, related parties are considered to be:

A. The parent company, and entities that constitute for the Bank or the parent company:
   - A branch,
   - A joint venture.

B. The person and a close member of that person's family, if such person is a member of the key management personnel.

The Bank considers all the members of the Board of Directors and of the Executive Board to be the key management personnel as well as members of the other boards of the Bank.

Close family members of the above mentioned persons are considered to be:
- Spouses or domestic partners of such persons,
- The first degree relatives of that person's spouse or domestic partner, and
- Dependents of that person or dependents of that person's spouse or domestic partner.

In addition to that, the Bank discloses all transactions and outstanding balances with entities which are controlled or jointly controlled by the above mentioned persons. This disclosure concerns stakes and shares of the above mentioned persons in entities that exceed 20%.

4.1.21 Comparative figures

To the extent considered necessary, the comparatives are adjusted to facilitate changes in presentation of the current year amounts.

Comparative figures relate to the year 2016 covering the period 1 January to 31 December 2015.

4.1.22 Assessments, the criteria for decision-making and important sources of uncertainty

The Bank, in the context of applying accounting policies and preparing financial statements in accordance with the International Financial Reporting Standards (IFRS), makes estimates and assumptions that affect the amounts recognized as income, expenses, assets or liabilities. The use of estimates and assumptions is an integral part of recognizing amounts in the financial statements that mostly relate to the following:

4.1.22.1 Fair Value of Assets and Liabilities

For assets or liabilities traded in active markets, the determination of their fair value is based on quoted, market prices. In all other cases the determination of fair value is based on valuation techniques that use observable market data to the greatest extent possible. In cases where there is no active market, the fair value is determined using data that are based on internal estimates and assumptions, such as, for example, determination of expected cash flows, discount rates, prepayment probabilities or potential counterparty default.

4.1.22.2 Impairment of Financial Assets

The Bank, when performing impairment tests on Loans and advances, makes estimates in compliance with the amount and timing of future cash flows. Given that these estimates are affected by a number of factors, such as the financial position of the borrower, the net realizable value of any collateral or the historical loss ratios per portfolio, actual results may differ from those estimated. Similar estimates are used in the assessment of impairment losses of financial assets as available for sale or held to maturity.

4.1.22.3 Impairment of Non-Financial Assets

The Bank, at each balance sheet date, assesses for impairment the non – financial assets, and in particular property, plant and equipment, investment property and other intangible assets. Internal estimates are used to a significant degree to determine the recoverable amount of the assets, i.e. the higher between the fair value less costs to sell and the value in use.

On the balance sheet date the Bank has no impairment of non-financial assets.

4.1.22.4 Income Tax

The Bank recognizes the amounts of current and deferred income tax based on estimates concerning the amount of taxable profits, based on which the amounts of tax expected to be paid or recovered in the current and future periods are determined. Estimates are affected by factors such as the practical implementation of the relevant legislation, the expectations regarding the existence of future taxable profit etc. Future tax audits, changes in tax legislation and the amount of taxable profit actually, may result in tax payments other than those recognized in the financial statements of the Bank.

4.1.22.5 Employee Benefits

Long-term provisions for retirement pays are made based on actuarial valuations that include assumptions regarding the discount rate, future changes of salaries and pensions. Any change in these assumptions affect the amount of liabilities recognized.

4.1.22.6 Provisions and Contingent Liabilities

The Bank recognizes a provision when it estimates that it has a present legal or contractual obligation that can be estimated reliably, and it is almost certain that an outflow of economic benefits will be required to settle the obligation. In contrast, when it is probable that an outflow of resources will be required, or when the amount of liability cannot be measured reliably, the Bank does not recognize a provision, but it provides disclosures for contingent liabilities, taking into consideration their materiality.

The estimation for the probability of the outflow, as well as for the amount of the liability are affected by factors which are not controlled by the Bank, such as court decisions, the practical implementation of the relevant legislation and the probability of default of the counterparty (for the cases related to the exposure to off-balance sheet items).

The estimates and judgments applied by the Bank in making decisions and in preparing the financial statements are based on historical information and assumptions which are considered appropriate at present. The estimates and judgments are reviewed on an ongoing basis in order to take into account current market conditions. The effect of any changes in estimates is recognized in the period in which the estimates are revised.

5. Financial risk review

In compliance with the nature of its business activity, the Bank established an adequate risk management system, which pertains to the management of types of risks, and especially so for the most important risks that may arise during operation.

Risk Management Objectives and Principles

The Bank established the risk management process through:

- A specified risk management strategy;
- Clearly defined risk management policies and procedures that include risk identification, measuring, monitoring, reporting and control;
- Adequately established organizational structure that clearly defines the roles and responsibilities of individuals involved in undertaking of risks, risk management and supervision of risk management adequacy;
- Independence of the organizational units tasked with risk management from those tasked with other business activities;
- Effective information system intended for use by the management, which provides information flow from the operational level to top management, as well as the reporting system for any deviations identified;
- Continuous independent supervision of the risk management system.

Responsibilities

The Board of Directors, Supervisory Board, Executive Board, Asset and Liability Committee are responsible for establishing of the system and for the supervision of the risk management system in compliance with the regulations of the National Bank of Serbia, policy and principles of the Bank and risk management best practices.

With the aim to set up a consolidated risk management system and to provide for the functional and organizational independence of the risk management function from the regular business activities, in addition to the legally prescribed management bodies, individual Boards and Committees of the Bank are responsible for risk management, in compliance with the Rules on their operations.

Bodies of the Bank continuously monitor the changes in legal regulations as well, they analyze the impact of such changes to the risk levels on the level of the Bank and undertake measures to bring the operations and procedures with newly adopted regulations within the controlled risk.

In addition to the above, the introduction of new products, activities, lines of business and systems is followed by required analyses with the aim to determine their impact on the risk portfolio of the Bank.

Bodies of the Bank responsible for risk management jointly establish the risk management principles and methodology, based on the following:

- Regulations and decisions passed by the legislative authorities, and principally by the National Bank of Serbia;
- Appetite for risk-taking, adopted as an internal act of the Bank (part of the Strategy for Risk Management) by the Board;
- Needs of the good business practice, with the aim to adequately identify, measure and estimate the risks, as well as to manage the risks to which the Bank is exposed.

Risk Measurement and Reporting

Organizational units responsible for monitoring of individual risk types and other expert services continuously monitor the indicators of individual categories of risks within their specific competencies and perform measuring, control and reporting to the competent Boards/Committees of the Bank, in compliance with the risk management system established by means of the most important internal acts regulating risk management.

Overview of Risk Types

In compliance with the Risk Management Strategy, the Bank has classified the potential operating risks in the following categories:

A. **Credit risk** and risks related to credit risk (concentration risk, country risk, FX credit risk, residual risk)
B. **Liquidity risk**,
C. **Market risk**, interest risk in banking book, foreign exchange risk,
D. **Capital management.**

In addition to the above listed risks, the following risks may arise as well:
– Strategic risk,
– Reputational risk,
– Compliance risk,
– Operational risk,
– Other risks that are difficult to quantify.

5.A. Credit risk

Credit risk is the risk of negative effects on the financial result and capital of the Bank caused by borrower's default on its obligations to the Bank.

The basic goal of credit risk management within the Bank is to reduce the possibility of occurrence of negative effects on the financial result and capital of the Bank due to the failure of the debtors to meet their obligations towards the Bank. In order to control the acceptance of the credit risk and adequate management of such risks, the Bank has established an adequate credit process which includes the approval of placements and credit risk management, which are regulated by Bank's procedures.

The credit risk management process includes:
– identification,
– evaluation and measuring,
– monitoring and
– reporting about the credit risk.

Credit Risk Management

The Bank manages the credit risk from individual borrowers, portfolio risk, transaction risk, i.e., it manages the collaterals separately, through the management of:
- Default risk – the risk of defaulting by the borrower;
- Risk from the changes in asset value – the risk of losses in the value of assets;
- FX credit risk – the risk of defaulting by the borrower due to a significant rise in the foreign exchange rate;
- Concentration risk that originates from the exposure to entities from the high exposures group, as well as the concentration risk that originates from the concentration of exposure to individual risk factors pertaining to: the economic sector, geographical area, product type and loan hedging activities and the similar.

Credit risk is adequately managed through risk identification, measuring, control, monitoring and reporting.

With the aim to achieve an effective credit risk management framework, the Bank has defined the basic components as follows:
- Establishing and supervision of the system by the Board of Directors and senior management,
- Clear allocation of competencies and responsibilities in the management process,
- Adequate implementation of management system and relevant policies and procedures.

The credit risk management process includes the following:

- Risk identification in compliance with the adopted procedures,
- Risk measuring and assessment by using the prescribed methodologies,
- Risk monitoring and control in accordance with the established procedures, as well as the application of relevant risk mitigation techniques, by using the loan hedging instruments,
- Reporting on exposure to credit risk.

Supervision by the Board of Directors and Senior Management

The Board of Directors of the Bank approved the credit risk management strategy and policies. The Board of Directors adopts the risk profile of the Bank and supervises the implementation of the process of adequate credit risk management, to ensure that the total credit risk exposure of the Bank is maintained on a safe level and matched to available capital both under the regular conditions and in crisis and any disturbances in the market.

Credit risk management of the Bank is based on the implementation of the following basic principles:

- Conservative approach to credit risk management,
- Management through defined control levels,
- Credit policy cycles in conjecture with segmentation of clients, products, economic sectors, geographic locations, currencies and maturity dates,
- Focus on the target market in compliance with the strategy,
- Diversification of credit exposure, and
- Risk pricing.

The Executive Board of the Bank, as well as other bodies are responsible for the development and establishing of credit policies and credit administration procedures within the relevant organizational units of the Bank, as a part of the general credit risk management system and for the adequate implementation and permanent supervision of such system.

Prior to the approval of any investment, competent decision-making levels perform assessments of the risk profile of the client/transaction, and following that, the continuous monitoring of the value of receivables and collaterals' values and adequacy is performed.

Limit Setting

The Bank actively participates in the management of its exposure to credit risks by means of defining and setting the exposure limits for individual borrowers and for the group of related borrowers, such that using various factors of risk concentration credit limits are revised from time to time.

Credit Risk Supervision and Control

Supervision of credit risk pertains to continuous supervision of individual loans, including the off-balance sheet exposure to borrowers and supervision of the entire portfolio of the Bank.

The system established for the credit risk supervision includes the following:

- The time dimension of the supervision in accordance with the nature of the credit risk (from daily to quarterly),
- Different supervisory procedures on predefined decision making levels,
- Continuous independent internal control of the lending process,
- Separate credit risk management on the level of clients and on the portfolio level, as well as on the level of transactions,
- Collateral management, and
- Management of risk investments.

The Bank conducts this activity with the aid of a system that ensures daily supervision of the quality of credit portfolio and implements corrective measures if and when the creditworthiness of a client deteriorates.

This system is created to ensure reliable monitoring of placements' servicing in accordance with the specified deadlines, adequacy of impairments, maintenance of the total risk profile within the limits set by the management and compliance with the regulatory limits by the Bank. Credit monitoring system is created to provide support to the senior management in the supervision of the quality of the entire credit portfolio and its trends.

Credit Risk Identification

The credit risk identification is the basic step in the credit risk management aiming to detect credit risk in a timely manner.

The identification of exposure to a specific risk starts at the moment of submitting of the loan application. The analysis of individual placements includes the analysis of the qualitative and quantitative indicators of the client, as well as the identification of other client's risk factors.

The approval process consist of the defined steps which may differ depending on the type of the client, the characteristics, type and the purpose of placement, the security instruments and include following steps:

- The preparation of the proposals for credit placement;
- The collection and verification of the credit documents;
- Credit analysis;
- Risk assessment;
- Placement approval;
- Control of the accompanying documents and other conditions;
- Disbursement of the funds.

Credit Risk Assessment and Measurement

The Bank has defined the mechanism of independent, continuous assessment of credit risk management process. The result of such assessment is documented in an adequate manner, and is a part of the reporting system to the Board of Directors and senior management.

Management of Non-Performing Loans

The Bank has a defined and established system that enables prior identification of non-performing loans where there is a number of acceptable options for corrective measures. As soon as a loan is designated as non-performing, the course of the management of such loan changes and it is included in the implementation of special corrective procedures.

With the aim to reduce the risk of defaulting by the clients, the Bank may undertake the following measures to regulate the receivables:

- Rescheduling and restructuring,
- Activation of collaterals,
- Sales and assignment of receivables,
- Settlements,
- Initiation of court procedures and other measures.

In case that the measures undertaken should fail to produce adequate results, the proposal for permanent write-off of outstanding receivable will be made in the collection procedure on the specified decision-making levels.

The assessment of the credit risk is being performed during the review of the requirements for a specific placement, the requests for the change of conditions, terms of use and repayment of certain loan, as well as during the regular annual report about the business operations of the client. The assessment of the credit risk is based on the analysis of financial situation of the debtor, the timeliness of debtor's settlement of the obligations towards the Bank, qualitative data collected about the client and the quality of collateral instruments.

The process of measuring the credit risk is based on regulatory approach according with the classification of the debtor's receivables, as well as the assessment of the provisions for losses per off-balance positions, in line with the regulations of the National Bank of Serbia.

Restructuring

Restructuring of loans relates to any change in contractual terms concluded between the Bank and the client in changing the repayment schedule of the exposure in order to respond to any potential increase in current or future delays for such placement. The decision to restructure the credit exposure is always based on the client's liability toward the Bank. The Bank does not have any restructured loans as at balance sheet date.

Credit Risk Mitigation

In order to mitigate the credit risk, during the approval of the placement, security instruments are requested. The type of the requested security instrument depends on the evaluated credit risk of each client. The security conditions that follow each placement depend on the creditworthiness of the debtor, the type and the degree of exposure to the credit risk, the maturity and the amount of placement.

Credit Risk Monitoring

After the approval of the placement, the clients are being monitored through regular and extraordinary monitoring aiming to ensure timely identification of the warning signs.

In order to prevent any increase in the credit risk, monitoring process is established to identify clients for which it is necessary to take measures to prevent their migration from the status of non-problematic clients to the status of clients under intensive monitoring or of problematic clients.

The status of the client is defined based on the combination of the basic indicators (number of days of delay, account freezing, etc.), financial indicators and the professional opinion of the employees involved in the risk management process.

By monitoring the portfolio at the level of the individual placements and at the level of the entire credit portfolio, the Bank performs a comparison against the previous periods, identifies the tendencies and causes of changes in the level of exposure to the credit risk.

The Bank is required to maintain the level of reserves at an adequate level to be able to absorb expected and unexpected credit losses related to the credit portfolio.

Assessment of impairment of balance sheet financial assets

Impairment of placements (provisioning) is determined based on the assessment indicating the cash flows that will not be realized, and in principle it is the difference between the carrying amount less the determined uncollectible percentage and the recoverable amount – expected cash flows discounted by using the effective interest rate.

Recoverable amount is the present value of the expected future cash flows (inflows), discounted by using the effective interest rate.

The most important factors taken into account in impairment assessment of a financial asset or a group of financial assets include objective evidence that can include: significant difficulties of the client, non-compliance with the agreed conditions, high probability of bankruptcy or some other change in the organizational and financial status of the client, deteriorating of an active market for the financial asset.

Financial assets subject to impairment assessment are classified in two separate groups: the receivables that are assessed for impairment: (a) individually – for receivables where there is objective evidence of impairment and according to the amount of material receivables and (b) collectively – for receivables that are not assessed individually.

Individual Assessment

Individual assessment is performed for individually significant receivables where there is objective evidence that the receivables will not be collected by the Bank in the originally agreed amount or within the originally agreed deadlines, or for the receivables where there is objective evidence of impairment.

When assessing impairment the possibility of implementation of the customer's business plan is taken into account, its ability to improve performance in the event of financial difficulties, the value at which collateral may realize and timing of realization of collateral, the availability of financial support customers, the ability to charge overdue receivables, as well as the timing of the expected cash flows.

When it is estimated that collection from ordinary activities of the client is not possible, during the individual assessment expected income from the realization of collateral is taken into account.

Assessment of impairment of balance sheet assets on individual basis includes determining the existence of objective evidence of impairment, assessment of the present value of future cash flows and the calculation of the amount of that impairment for each individual claim against the debtor that is included in this assessment.

Objective evidence of impairment of balance sheet assets on an individual basis, exist:

- if the debtor's financial condition indicates significant problems in his business activities;
- if there is information of default, frequent delays in payment of interest and / or principal, or the non-fulfilment of other contractual provisions;
- if the bank, due to financial difficulties of the debtor, significantly changes repayment terms in relation to those originally agreed;
- if it becomes certain that bankruptcy proceedings will be initiated against the debtor or other type of financial reorganization.

The selection of the collateral (collateral) is closely connected with the assessment of credit risk, which depends on the financial status of the debtor, the amount of credit exposure, maturity, purpose of the loan and the ways in which the loan is repaid.

Collective Assessment

The Bank has developed a methodology for group impairment, given the current regulatory act of the National Bank of Serbia (and the accompanying guidelines and other documents), International Accounting Standards, the characteristics of the Bank and other relevant factors.

The evaluation group basis, inter alia, takes into account the internal rating of the loan portfolio in the following 8 categories: A1, A2, B1, B2, V1, V2, G1, D. Category A1 represents the highest quality category, while D represent the worst category in the loan portfolio of the Bank .

The Bank performs assessment of impairment of balance sheet assets and probable losses arising from off-balance sheet items on an aggregate basis for all receivables in which impairment or losses cannot be directly linked to the receivable, but which based on experience can be estimated as present in the loan portfolio.

The Bank performs the specified assessment on a group basis:

- For claims for which assessment on individual basis determines no objective evidence of impairment of balance sheet assets or probable losses on off-balance sheet items, or if based on individual assessment no amount of impairment of balance sheet assets and probable losses arising from off-balance sheet items is identified;
- For claims that belong to the group of small claims.

Notwithstanding the above rule, the Bank's assessment of impairment of balance sheet assets and probable loss on off-balance sheet items for claims that belong to the group of small claims, in accordance with the methodology, may be carried out on an individual basis.

In the implementation of such collective assessment, the Bank grouped receivables based on similar credit risk characteristics that reflect the debtor's ability to meet its obligations in accordance with contractual terms.

Assessment of impairment of balance sheet assets at group level is a joint estimation of future cash flows of individual groups of receivables on the basis of data on losses from previous periods for receivables, with credit risk characteristics similar to those in the group.

The assessment of probable loss on off-balance sheet items on a group basis is a joint assessment of the recoverability of future cash outflows for off-balance sheet liabilities for group off-balance sheet items with similar characteristics.

Assessment of Provisioning for Off-Balance Sheet Items

Assessment of provisioning for off-balance sheet items (guarantees, avals, letters of credit, etc.) is performed in compliance with the adopted criteria, individually and on collective basis.

Evidence based on which the Bank performs individual impairment assessments of the items of off-balance sheet assets are payments from the Bank accounts for obligations undertaken for guarantees, avals and letters of credit and other off-balance sheet items that can potentially be activated at the expense of the Bank.

Assessment of provisioning for off-balance sheet items on individual basis is performed in the same manner as for the receivables in the balance sheet assets, by using the same software application, bearing in mind that the majority such cases involve an intervention from the part of the Bank, i.e., the transfer of an off-balance sheet item in the balance sheet.

For off-balance sheet items for the reporting date of 31 December 2017, the entire amount of the provision for losses on off-balance sheet items is based on group assessment, bearing in mind that no objective evidence of impairment had been established.

5.A. i. Analysis of loan portfolio quality

The table below shows the structure of credit portfolio of the Bank, at levels of quality.

Maximum credit exposure

	Loans and advances to customers		Loans and advances to banks and other financial institutions		Other assets		Off-balance sheet items	
In thousands of RSD	**2017**	**2016**	**2017**	**2016**	**2017**	**2016**	**2017**	**2016**
Gross exposure:	**2,211,271**	**2,519,937**	**1,706,183**	**1,734,433**	**3,276**	**2,465**	**2,034,772**	**2,540,998**
Category A1	-	82,641	1,078,269	1,734,433	160	176	139,797	73,736
Category A2	619,439	962,144	-	-	989	1,482	99,678	62,560
Category B1	383,059	211,538	627,914	-	694	155	599,296	1,307,665
Category B2	1,073,693	656,902	-	-	11	594	1,154,423	485,413
Category V1	115,286	500,248	-	-	2	11	40,012	611,624
Category V2	19,794	92,172	-	-	6	7	-	-
Category G1	-	14,292	-	-	-	37	-	-
Category D	-	-	-	-	1,414	3	1,566	-
Not exposed to credit risk	-	-	-	-	11,598	10,776	2,207,507	2,577,552
Allowance for impairment of balance sheet assets	(10,628)	(10,227)	(122)	(2)	(640)	(8)	-	-
Provisions for losses on off-balance sheet items	-	-	-	-	-	-	(2,787)	(1,391)
Net exposure	**2,200,643**	**2,509,710**	**1,706,061**	**1,734,431**	**14,234**	**13,233**	**4,239,492**	**5,117,159**

The table below shows the structure of credit portfolio of the Bank, by days of delay.

As at 31 December 2017

In thousands of RSD	**Not in delay**	**Less than 30 days**	**31-60 days**	**61-90 days**	**More than 90 days**	**Total gross**
Balance sheet items						
Loans and advances to customers	2,177,975	13,503	19,793	-	-	**2,211,271**
Loans and advances to banks and other financial institutions	1,706,183	-	-	-	-	**1,706,183**
Other assets	2,812	328	-	-	136	**3,276**
Total	**3,886,970**	**13,831**	**19,793**	**-**	**136**	**3,920,730**

As at 31 December 2016

In thousands of RSD	**Not in delay**	**Less than 30 days**	**31-60 days**	**61-90 days**	**More than 90 days**	**Total gross**
Balance sheet items						
Loans and advances to customers	2,449,781	70,156	-	-	-	**2,519,937**
Loans and advances to banks and other financial institutions	1,734,433	-	-	-	-	**1,734,433**
Other assets	2,412	36	-	-	17	**2,465**
Total	**4,186,626**	**70,192**	**-**	**-**	**17**	**4,256,835**

The table below shows the amount of impairment of the credit portfolio of the Bank, including the matured and undue part of the loan portfolio.

As at 31 December		**Loans and advances to customers**		**Loans and advances to banks and other financial institutions**		**Other assets**		**Off – balance sheet items**	
In thousands of RSD	***Note***	**2017**	**2016**	**2017**	**2016**	**2017**	**2016**	**2017**	**2016**
Maximum exposure to credit risk									
Gross exposure		**2,211,271**	**2,519,937**	**1,706,183**	**1,734,433**	**3,276**	**2,465**	**2,034,772**	**2,540,998**
Thereof:									
Matured		33,761	8,361	-	32	-	131	-	-
The corresponding impairment		(5,089)	(64)	-	-	-	(7)	-	-
Undue		2,177,510	2,511,576	1,706,183	1,734,401	3,276	2,334	2,034,772	2,540,998
The corresponding impairment		(5,539)	(10,163)	(122)	(2)	(639)	(1)	-	-
Total impairment		**(10,628)**	**(10,227)**	**(122)**	**(2)**	**(640)**	**(8)**	**-**	**-**
Provisions for losses on off-balance sheet items		**-**	**-**	**-**	**-**	**-**	**-**	**(2,787)**	**(1,391)**
Net exposure	***20, 21, 24, 31***	**2,200,643**	**2,509,710**	**1,706,061**	**1,734,431**	**2,636**	**2,457**	**2,031,985**	**2,539,607**

The table below shows the analysis of credit risk exposure arising from transactions with derivatives:

5.A. ii. Derivatives

In thousands of RSD	Nominal value	Fair value
31 December 2017		
Receivables arising from derivatives	602,108	607,908
Derivative liabilities arising from derivatives	(592,364)	(592,364)
31 December 2016		
Receivables arising from derivatives	2,338,430	2,463,128
Derivative liabilities arising from derivatives	(2,200,276)	(2,200,276)

The fair value of financial assets through profit or loss held for trading (financial derivatives) is calculated using a model that discounts cash flows to their present value using market interest rates and exchange rates, and is classified into a level 2 for measuring fair value.

5.A. ii. Collateral and other credit enhancements

Collateralization of credit exposures serves as an important risk mitigation factor and enhances the incentives for borrowers to repay their financial obligations.

Collateral provides additional security and the Bank generally requests that corporate borrowers provide it.

The collateral has to be permitted by law and deemed appropriate by the Credit Committee. The collateral serves as a guarantee that the Bank, as the creditor, can recover the credit exposure and as a means of motivating the borrower to repay the credit exposure.

The Bank makes agreement with the client in which the client agrees to register certain collateral with the Bank in order to cover various credit facilities that the client intends to utilize during the term of validity of the agreement.

The lending decision is primarily based on assessment of the business and the creditworthiness of the borrower and his/her ability to repay the requested credit exposure, as well as on other factors related to credit risk. Nevertheless, the Bank aims to secure its claims against the clients it finances with high-quality collateral.
The Bank will require that the financed asset will serve as collateral for the credit exposure.

The choice of the collateral is closely related to the credit risk assessment, which depends on the financial status of the borrower, the credit exposure amount, the maturity, the purpose of the credit exposure and the manner in which it is to be repaid.

Collateral *In thousands of RSD*	**Market value as at 31 December 2017**	**Market value as at 31 December 2016**
Land	82,102	125,942
Residential buildings	86,568	46,673
Office building	494,940	160,181
Deposits	14,133	24,347
Equipment	491,664	25,558
Supplies	278,923	369,063
Receivables	210,819	265,815
Pledge on shares	10	71
Corporative guarantee	21,325	185,208
Total:	**1,680,484**	**1,202,858**
Loans and advances from customers	2,211,271	2,519,937
Coverage of collateral	76.0%	47.7%

Collateral Management

The Collateral Management Policy regulates in greater detail the methods and procedures for collateral management with the aim to minimize the credit risk for the Bank. The purpose of this Policy is to describe the characteristics of the collaterals accepted by the Bank, as well as to specify the necessary activities within the regular monitoring of collateral acceptance. This document describes the allocation of responsibilities among individual organizational units of the Bank, aimed at efficient performance of the collateral management process.

Collaterals are presented in the financial statements at their fair (as last assessed) value, which is at the same time the subject of continuous monitoring process and periodical assessments. Collateral classification (table under point 5.A. iii. Collateral and other security) in the overview is performed based on the criteria specified in the Decision on the Classification of Balance Sheet Assets and Off-Balance Sheet Items.

5.A. iii. Concentrations of Credit Risk

Exposure to risks per regions, industrial sectors and types of clients is presented in the Tables below, to present the exposure to concentration risk. Depending on the general economic trends and the trends observable in individual industrial sectors, the Bank performs diversification of investments in industrial sectors that are resistant to the influence of the negative economic trends.

At 31 December		**Loans and advances to banks and other financial institutions.**		**Loans and advances to customers**		**Other assets**		**Off-balance sheet items**	
In thousands of RSD	Note	**2017**	**2016**	**2017**	**2016**	**2017**	**2016**	**2017**	**2016**
Maximum exposure to credit risk	*20, 21, 24, 31*								
Concentration by sector									
Corporate:									
Agriculture, forestry and fishing		-	-	123,201	157,151	-	15	668,805	-
Mining, manufacturing, water supply		-	-	296,430	363,759	32	77	243,931	607,877
Electricity supply		-	-	-	-	-	-	142,521	-
Construction		-	-	334,177	358,809	5	10	730,715	52,826
Wholesale and retail trade and other		-	-	1,268,291	1,575,892	297	533	142,371	1,597,963
Transportation and storage		-	-	109,315	64,326	989	1,637	83,464	220,594
Real estate		-	-	79,855	-	39	7	1,567	61,736
Other		-	-	2	-	1,438	176	-	2
Financial institutions		1,706,183	1,734,433	-	-	476	-	21,398	-
Total		**1,706,183**	**1,734,433**	**2,211,271**	**2,519,937**	**3,276**	**2,465**	**2,034,772**	**2,540,998**
Concentration by location									
Serbia		1,706,183	1,248,714	2,211,271	2,519,937	3,276	2,458	2,034,772	2,540,998
Europe		-	474,005	-	-	-	7	-	-
The rest of the world		-	11,714	-	-	-	-	-	-
Total		**1,706,183**	**1,231,491**	**2,211,271**	**2,519,937**	**3,276**	**2,465**	**2,034,772**	**2,540,998**

The maximum exposure to a single entity or group of related entities, as at 31 December 2017 amounted to: 18.20% of regulatory capital, which is in line with the NBS the prescribed regulatory value.

5.B. Liquidity risk
i. Exposure to liquidity risk

Liquidity risk is the potential for the occurrence of certain unfavorable events with adverse effects on the financial result and equity of the Bank, as the inability of the Bank to meet its liabilities due at the time of their maturity, due to the inadequate structure of its sources, i.e. because its placements are not marketable.

Liquidity ratio is a ratio between the sum of Bank's liquid first- and second-degree receivables, on the one hand, and the sum of the Bank's sight liabilities or liabilities without determined maturity and the Bank's liabilities with maturity within one month from the date of liquidity ratio calculation, on the other hand.

Narrow liquidity ratio is the ratio between the sum of Bank's liquid first-degree receivables, on the one hand, and the sum of the Bank's sight liabilities or liabilities without determined maturity and the Bank's liabilities with maturity within one month from the date of liquidity ratio calculation, on the other hand.

The bank's first-degree liquid receivables shall include cash and receivables where the agreed maturity falls within one month from the date of calculation of liquidity ratio, as follows:

- vault cash, gyro-account balances, gold and other precious metals;
- funds in the accounts with banks with available credit rating of the chosen credit rating agency equivalent to credit quality 3 or better, determined in accordance with the decision on capital adequacy of banks (investment rank);
- deposits with the National Bank of Serbia;
- checks and other monetary receivables in the process of execution;
- irrevocable credit facilities approved to the bank;
- shares and debt securities quoted on the stock exchange.

Liquid first-degree receivables of the bank shall also include 90% of the fair value of securities denominated in RSD with no foreign currency clause, issued by the Republic of Serbia with minimum maturity of three months or 90 days, which the bank has classified as securities that are traded or securities available for sale.

As at 31 December 2017 the Bank had investments in securities denominated in RSD and issued by the Republic of Serbia in the amount of RSD 1,387,095 thousand.

Bank's second-degree liquid receivables shall include other bank receivables falling due within one month from the date of calculation of liquidity ratio.

Receivables classified into G and D categories according to the decision on classification of balance-sheet assets and off-balance sheet items shall not be included in the calculation of the bank's liquidity ratio.

Bank's sight liabilities or liabilities without agreed maturity shall constitute a part of its liabilities as follows:
- 40% of sight deposits of banks;
- 20% of sight deposits of other depositors;
- 10% of savings deposits;
- 5% of guarantees and other sureties;
- 20% of unfunded committed irrevocable credit lines.

Other Banks liabilities falling due within one month from the date of calculation of liquidity ratio shall be considered bank liabilities with agreed maturity.

The Bank expresses the level of liquidity through the liquidity ratio and narrow liquidity ratio.

The Bank shall maintain its liquidity level in a way that:

Liquidity ratio:

– equals at least 1.0 when calculated as an average of liquidity ratios for all business days in a month,
– is not lower than 0.9 for more than three consecutive business days,
– equals at least 0.8 when calculated for a single business day.

Also, the Bank shall maintain the level of liquidity with the narrow liquidity ratio as follows:

Narrow liquidity ratio:

– equals at least 0.7 when calculated as an average of liquidity ratios for all business days in a month,
– is not lower than 0.6 for more than three consecutive business days,
– equals at least 0.5 when calculated for a single business day.

Liquidity coverage ratio

The liquidity ratio (LCR) is the ratio of the bank's liquidity layer to the liquidity of the bank and the net outflow of its liquid assets that would occur after the next 30 days from the date of calculating this indicator under the assumed stress conditions.

The Management Board shall establish a system of liquidity risk management and supervises that system in accordance with an acceptable risk profile. Above leadership is responsible for the implementation appropriate policies and procedures in line with the strategic direction and a penchant for risk defined by the Board.

Liquidity risk management in the Bank is defined by Policy and Procedure for liquidity. ALCO committee is responsible for managing of liquidity risk. The Bank uses the following tools for measuring and managing liquidity risk:

- liquidity report with the standard analysis of the liquidity gap,
- liquidity ratios movements
- narrow liquidity ratio movements
- ratio loans/deposits
- Liquidity plan
- Liquid assets coverage ratio.

The Asset and Liability Committee (ALCO) has special competencies in the liquidity risk management process, and specifically it:

– Manages liquidity risk;
– Monitors and analyses liquidity ratios;
– Analyses the assumptions of the stress tests and perform their adoption;
– Defines liquidity ratios (internal limits and triggers for reporting);
– Gives proposals to Executive Board in the short and long-term investments and bank borrowings;
– Analyses the movement of the Bank's liquidity, including liquidity gap analysis and decision-making in order to reduce liquidity risk;
– Approved for no separate liquidity gap analysis to be carried out for the currency in which the Bank has more than 5% of liabilities;
– Decides on the establishment and the amount of liquidity reserves;
– Analyses other parameters that may have an effect on the liquidity of the Bank and make decisions in order to reduce liquidity risk.

The Liquidity Risk Management Strategy, includes the monitoring of liquidity risk in compliance with the following principles:

- Adjusting the structure of assets and liabilities according to their maturity and currencies,
- Diversification of financing sources as per their maturity and currencies,
- Ensuring access to interbank market of currencies and capital,
- Establishing of adequate liquidity provisions' levels.

Liquidity risk management, as a part of the Bank management, includes the systems for identification, measuring, supervision and control of Bank exposure to liquidity risk. The Bank performs timely identification and quantification of primary sources of liquidity risk for the Bank on transaction level and on the levels of credit and deposit portfolios, under the regular conditions for operation, as well as under conditions of higher risk and market disturbances, as well as on the occasion of approval of new business processes, products and activities.

Liquidity ratio	**2017**	**2016**
At 31 December	3.84	12.15
Average for the period (December)	3.21	13.61
Maximum for the period (December)	3.84	16.69
Minimum for the period (December)	2.95	11.51
Narrow liquidity ratio		
At 31 December	2.90	9.59
Average for the period (December)	2.25	10.97
Maximum for the period (December)	2.90	13.09
Minimum for the period (December)	1.99	9.32

The Bank devotes particular attention to the liquidity measures defined by Basel III regulations, which the National Bank of Serbia prescribed as mandatory in 2017. The Liquidity Coverage Ratio (LCR) is monitored on a monthly basis as a ratio of the Bank's liquidity buffer and net outflow of liquidity over a period of 30 calendar days.

Liquidity Coverage Ratio	
On the 31st. December 2017	898%
On the 30th. September 2017	585%
On the 30th. June 2017	293%

ii. Maturity analysis for financial assets and financial liabilities

The tables below set out the remaining maturities of the Bank's financial liabilities and financial assets.

31 December 2017 In thousands of RSD	*Note*	Amount	Gross amount	Less than 1 month	1–3 months	3 months –1 year	1–5 years	More than 5 years
Assets								
Cash and balances with the central bank	*17*	382,825	382,825	382,825	-	-	-	-
Financial assets at fair value through profit or loss held for trading	*18*	5,800	5,800	3,480	2,320	-	-	-
Financial assets available for sale	*19*	1,387,095	1,387,095	-	-	150,465	1,236,630	-
Loans and advances to banks and other financial institutions	*20*	1,706,061	1,706,183	1,706,183	-	-	-	-
Loans and advances to customers	*21*	2,200,643	2,211,271	149,598	189,386	849,478	1,022,809	-
		5,682,424	**5,693,174**	**2,242,086**	**191,706**	**999,943**	**2,259,439**	**-**
Liabilities								
Deposits and liabilities to banks, other fin. inst. and central bank	*25*	41,250	41,250	41,250	-	-	-	-
Deposits and other liabilities to customers	*26*	2,258,537	2,258,537	1,024,109	820,114	293,094	121,220	-
Subordinated liabilities	*27*	1,184,958	1,184,958	-	-	-	-	1,184,958
		3,484,745	**3,484,745**	**1,065,359**	**820,114**	**293,094**	**121,220**	**1,184,958**
Liquidity gap		**2,197,679**	**2,208,429**	**1,176,727**	**(628,408)**	**706,849**	**2,138,219**	**(1,184,958)**

31 December 2016 In thousands of RSD	*Note*	Amount	Gross amount	Less than 1 month	1–3 months	3 months –1 year	1–5 years	More than 5 years
Assets								
Cash and balances with the central bank	*17*	875,578	875,578	875,578	-	-	-	-
Financial assets at fair value through profit or loss held for trading	*18*	124,698	124,698	-	-	124,698	-	-
Financial assets available for sale	*19*	2,050,876	2,050,876	-	-	1,263,738	787,138	-
Loans and advances to banks and other financial institutions	*20*	1,734,431	1,734,433	1,734,433	-	-	-	-
Loans and advances to customers	*21*	2,509,710	2,519,937	53,837	319,387	1,756,608	315,876	74,229
		7,295,293	**7,305,522**	**2,663,848**	**319,387**	**3,145,044**	**1,103,014**	**74,229**
Liabilities								
Deposits and liabilities to banks, other fin. inst. and central bank	*25*	30,839	30,839	30,839	-	-	-	-
Deposits and other liabilities to customers	*26*	3,444,564	3,444,564	1,043,948	-	2,388,270	-	12,346
Subordinated liabilities	*27*	1,235,022	1,235,022	-	-	299	-	1,234,723
		4,710,425	**4,710,425**	**1,074,787**	**-**	**2,388,569**	**-**	**1,247,069**
Liquidity gap		**2,584,868**	**2,595,097**	**1,589,061**	**319,387**	**756,475**	**1,103,014**	**(1,172,840)**

iii. Liquidity reserves

To use Risk liquidity management, the Bank formed liquidity reserves. The bank holds liquidity reserves in the form of cash, equivalents cash and/or placing the National Bank of Serbia.

In thousands of RSD	**31 December 2017**	**31 December 2016**
National bank of Serbia	820,847	1,357,842
Other banks	1,156,382	1,219,778
Liquidity reserves	**1,977,229**	**2,577,620**

5.C. Market risk

Market risks – the possibility of occurrence of negative effects on financial result and the capital of the Bank due to changes in the value of balance sheet items and off-balance items of the Bank resulting from the movement of prices on the market.

Include the interest rate risk, foreign exchange risk, price risk of debt and equity securities and commodity risk. The Bank has exposure to interest rate risk and foreign exchange risk.

Interest rate risk is the Bank's exposure risk to the adverse change of interest rates.

The foreign exchange risk is the possibility of occurrence of negative effects on financial result and the capital of the bank due to changes in the foreign exchange rate.

ALCO Committee is responsible for managing market risks.

Interest Rate Risk

Interest rate risk is the risk of negative effects on the financial result and equity of the Bank due to the variations in interest rates. The interest rate risk occurs in cases where there are discrepancies between the items that are subject to interest rate adjustments over a certain period.

The Bank controls the interest rate risk by monitoring the ratio of interest-bearing assets and liabilities for which interest is paid and their share in the total assets, i.e. liabilities, through the management of:

- Repricing risk,
- Risk of economic value of capital,
- Basis risk,
- Optionality, and
- Yield curve risk.

Revenue Forecasts - The Bank manages the interest risk by analyzing the maturity matching of revenues and expenditure.

Economic Value Forecasts - Net present value of capital is the present value of future cash flows. In economic value forecasts, the potential for long-term impact of the interest rates on the capital of the Bank is taken into account.

The interest rate risk occurs due to (1) the different timings of interest rate change and cash flow; (2) changes in the correlation rate between different yield curves that impact the activities of the Bank; (3) changes in the correlation rate in maturity classes, and (4) options related to interest embedded in the products of the Bank.

The risk from the change of interest rates is measured and monitored by analyzing the risk of exposure to the changes in interest rates, which shows the structure and the level of interest-sensitive assets and interest-sensitive liabilities in different maturity intervals.

ii. Exposure to interest rate risk – Non-trading portfolios

The following is a summary of the Bank's interest rate gap position of financial assets and financial liabilities of the Bank, from the interest rate perspective, relating on non-trading portfolios (interest rate gap position):

31 December 2017 ***In thousands of RSD***	**Note**	**Carrying amount**	**Less than 1 month**	**1-3 month**	**3–12 months**	**1–5 years**	**More than 5 years**	**Non-interest bearing**
Cash and balances with the central bank	17	382,825	230,387	-	-	-	-	152,438
Financial assets at fair value through profit or loss held for trading	18	5,800	3,480	2,320	-	-	-	-
Financial assets available for sale	19	1,387,095	150,465	-	-	1,236,630	-	-
Loans and advances to banks and financial institutions	20	1,706,061	1,559,433	-	-	-	-	146,628
Loans and advances to customers	21	2,200,643	140,724	183,774	1,768,530	100,151	-	7,464
		5,682,424	**2,084,489**	**186,094**	**1,768,530**	**1,336,781**	**-**	**306,530**
Deposits and other liabilities to banks, other fin. inst. and central bank	25	41,250	-	-	-	-	-	41,250
Deposits and other liabilities to customers	26	2,258,537	1,003,389	462,105	651,102	119,348	-	22,593
Subordinated liabilities	27	1,184,958	-	-	1,139,572	-	45,386	-
		3,484,745	**1,003,389**	**462,105**	**1,790,674**	**119,348**	**45,386**	**63,843**
Interest rate risk gap		**2,197,679**	**1,081,100**	**(276,011)**	**(22,144)**	**1,217,433**	**(45,386)**	**242,687**

31 December 2016 ***In thousands of RSD***	**Note**	**Carrying amount**	**Less than 1 month**	**1-3 month**	**3–12 months**	**1–5 years**	**More than 5 years**	**Non-interest bearing**
Cash and balances with the central bank	17	875,578	381,079	-	-	-	-	494,499
Financial assets at fair value through profit or loss held for trading	18	124,698	-	-	124,698	-	-	-
Financial assets available for sale	19	2,050,876	300,439	-	-	1,750,437	-	-
Loans and advances to banks and financial institutions	20	1,734,431	1,729,495	-	-	-	-	4,936
Loans and advances to customers	21	2,509,710	385,056	306,835	1,693,792	-	123,050	977
		7,295,293	**2,796,069**	**306,835**	**1,818,490**	**1,750,437**	**123,050**	**500,412**
Deposits and other liabilities to banks, other fin. inst. and central bank	25	30,839	-	-	-	-	-	30,839
Deposits and other liabilities to customers	26	3,444,564	1,040,657	-	2,349,143	-	12,347	42,417
Subordinated liabilities	27	1,235,022	-	-	1,234,724	-	-	298
		4,710,425	**1,040,657**	**-**	**3,583,867**	**-**	**12,347**	**73,554**
Interest rate risk gap		**2,584,868**	**1,755,412**	**306,835**	**(1,765,377)**	**1,750,437**	**110,703**	**426,858**

The Bank is exposed to the changes in levels of market interest rates that impact its financial position and cash flows. As the result of these changes, the interest rate margin can increase or decrease.

Interest rates are based on market interest rates and the Bank performs adjustments of interest rates. The interest rate risk management activity is aimed at achieving optimum net income from interest, maintenance of market interest rate on a consistent level, in compliance with the business strategy of the Bank.

ALCO manages the liquidity gaps of assets and liabilities based on: the macroeconomic analyses and forecasts; forecasts of conditions for achieving liquidity, as well as based on the analysis and forecasts of the market trends in interest rates.

Interest rate risk is the adverse change in the price of active interest rates compared against the level of passive interest rates, as well as the potential for the reduction of the optimum difference between the average active and passive interest rates.

ii. Exposure to interest rate risk -Non-trading portfolio

The table below shows the impact of the effect of potential changes interest rate on income of the Bank as at 31 December 2017.

The effects of potential changes in interest rates are related to interest bearing assets and liabilities in the balance sheet.

Risk calculation illustrates the effect of the interest rate on interest-sensitive assets and passive. The scenario includes a 50BP parallel rise and fall and 100BP parallel growth and falling interest rates.

	Effect on interest earning (cumulatively over a period of 1 year)					
In thousands of RSD	Interest increase of 50 b.p.			Interest decrease of 50 b.p.		
	Total	Foreign currencies	RSD	Total	Foreign currencies	RSD
31 December 2017	5,016	4,632	384	(5,016)	(4,632)	(384)

	Effect on interest earning (cumulatively over a period of 1 year)					
	Interest increase of 100 b.p.			Interest decrease of 100 b.p.		
	Total	Foreign currencies	RSD	Total	Foreign currencies	RSD
31 December 2017	10,032	9,264	768	(10,032)	(9,264)	(768)

	Effect on economic value of equity in thousands of RSD					
	Interest increase of 50 b.p.			Interest decrease of 50 b.p.		
	Total	Foreign currencies	RSD	Total	Foreign currencies	RSD
31 December 2017	(7,016)	3,147	(10,163)	7,016	(3,147)	10,163

	Effect on economic value of equity					
	Increasing of 100BP Interest increase			Decreasing of 100BP Interest decrease		
	Total	Foreign currencies	RSD	Total	Foreign currencies	RSD
31 December 2017	(14,031)	6,294	(20,325)	14,031	(6,294)	20,325

The table below shows the impact of the effect of potential changes in interest rate on income of the Bank as at 31 December 2016.

In thousands of RSD	Effect on interest earning (cumulatively over a period of 1 year)					
	Interest increase of 50 b.p.			Interest decrease of 50 b.p.		
	Total	Foreign currencies	RSD	Total	Foreign currencies	RSD
31 December 2016	4,501	(2,775)	7,276	(4,501)	2,775	(7,276)

	Effect on interest earning (cumulatively over a period of 1 year)					
	Interest increase of 100 b.p.			Interest decrease of 100 b.p.		
	Total	Foreign currencies	RSD	Total	Foreign currencies	RSD
31 December 2016	9,003	(5,549)	14,552	(9,003)	5,549	(14,552)

	Effect on economic value of equity in thousands of RSD					
	Interest increase of 100 b.p.			Interest decrease of 100 b.p.		
	Total	Foreign currencies	RSD	Total	Foreign currencies	RSD
31 December 2016	(10,988)	90	(11,078)	10,988	(90)	11,078

	Effect on economic value of equity					
	Increasing of 100BP Interest increase			Decreasing of 100BP Interest decrease		
	Total	Foreign currencies	RSD	Total	Foreign currencies	RSD
31 December 2016	(21,975)	180	(22,155)	21,975	(180)	22,155

iii. Exposure to currency risks

Foreign currency risk is the risk from the negative effects of adverse changes in foreign exchange rates to the financial result and equity of the Bank. It pertains to the impact of the inauspicious trends in foreign exchange rates on the value of open foreign currency position.

Foreign Currency Position:

31 December 2017 ***In thousands of RSD***	**EUR**	**USD**	**RSD**	**Total**
Cash and balances with the central bank	144,856	1,772	236,197	**382,825**
Financial assets at fair value through profit or loss held for trading	-	-	5,800	**5,800**
Financial assets available for sale	-	-	1,387,095	**1,387,095**
Loans and advances to banks and financial institutions	1,634,485	-	71,576	**1,706,061**
Loans and advances to customers	1,500,069	-	700,574	**2,200,643**
Intangible assets	-	-	211,679	**211,679**
Property, plant and equipment	-	-	114,390	**114,390**
Other assets	-	10,021	4,213	**14,234**
Total assets	3,279,410	11,793	2,731,524	6,022,727
Deposits and other liabilities to banks, other financial institutions and central bank	-	-	41,250	**41,250**
Deposits and other liabilities to customers	1,452,099	17,742	788,696	**2,258,537**
Subordinated liabilities	1,184,958	-	-	**1,184,958**
Provisions	-	-	5,971	**5,971**
Deferred tax liabilities	-	-	13,391	**13,391**
Other liabilities	49,910	-	-	**49,910**
Equity	-	-	2,468,710	**2,468,710**
Total liabilities and equity	2,686,967	17,742	3,318,018	**6,022,727**
Foreign currency swap	(592,364)	-	592,364	**-**
Net foreign currency position 31 December 2017	**79**	**(5,949)**	**5,870**	**-**

31 December 2016 ***In thousands of RSD***	**EUR**	**USD**	**RSD**	**Total**
Cash and balances with the central bank	481,502	5,507	388,569	**875,578**
Financial assets at fair value through profit or loss held for trading	-	-	124,698	**124,698**
Financial assets available for sale	-	-	2,050,876	**2,050,876**
Loans and advances to banks and financial institutions	1,233,531	500,718	182	**1,734,431**
Loans and advances to customers	2,217,725	-	291,985	**2,509,710**
Intangible assets	14,292	-	224,645	**238,937**
Property, plant and equipment	-	-	150,423	**150,423**
Other assets	-	147	13,086	**13,233**
Total assets	3,947,050	506,372	3,244,464	**7,697,886**
Deposits and other liabilities to banks, other financial institutions and central bank	-	-	30,839	**30,839**
Deposits and other liabilities to customers	518,463	2,848,785	77,316	**3,444,564**
Subordinated liabilities	1,235,021	-	1	**1,235,022**
Provisions	-	-	4,841	**4,841**
Deferred tax liabilities	-	-	14,710	**14,710**
Other liabilities	-	-	35,173	**35,173**
Equity	-	-	2,932,737	**2,932,737**
Total liabilities and equity	1,753,484	2,848,785	3,095,617	**7,697,886**
Foreign currency swap	2,200,276	(2,338,430)	138,154	**-**
Net foreign currency position 31 December 2016	**(6,710)**	**(3,983)**	**10,693**	**-**

With the aim to protect against the foreign exchange risk, the Bank monitors the foreign exchange rates' trends in the financial market on the daily basis, implements the policy of low exposure to the foreign exchange risk. The Asset Management Division monitors the trends in the foreign exchange market on the daily basis and manages the foreign exchange position of the Bank in its entirety and per individual significant currencies.

Asset and Liability Committee proposes measures to the Executive Board of the Bank for adjustments of FX assets and liabilities to provide for favorable foreign exchange position on each currency segment. An independent market risk department performs independent analysis of the foreign exchange management process through monitoring of the compliance with the established system of limits.

Foreign exchange risk management is supplemented with the monitoring of:

- Impact of increase/decrease of FX items of assets/liabilities to the open position and foreign exchange risk indicator, and
- Sensitivity of income statement of the Bank to different scenarios of variations in foreign exchange rates. Sensitivity of income statement is the effect of assumptions regarding the changes in foreign exchange rates to net income from fluctuations in foreign exchange rates.

iii. Exposure to currency risks

In thousands of RSD	**2017 EUR**	**2017 USD**
Exposure to foreign currency risk:		
USD	-	(5,949)
EUR	79	-

The effect of increasing the rate of 10% on net income

In thousands of RSD	**EUR**	**USD**
Exposure to foreign currency risk:		
USD	-	(595)
EUR	8	-

The effect of decreasing the rate of 10% on net income

In thousands of RSD	**EUR**	**USD**
Exposure to foreign currency risk:		
USD	-	595
EUR	(8)	-

The effect of growth rate of 10% of the economic value of capital: 0.19%
The effect of reducing rate of 10% of the economic value of capital: (0.16%).

In thousands of RSD	**2016 EUR**	**2016 USD**
Exposure to foreign currency risk:		
USD	-	(3,983)
EUR	(6,710)	-

The effect of increasing the rate of 10% on net income

In thousands of RSD	**2016 EUR**	**2016 USD**
Exposure to foreign currency risk:		
USD	-	(398)
EUR	(671)	-

The effect of decreasing the rate of 10% on net income

	2016	2016
In thousands of RSD	**EUR**	**USD**
Exposure to foreign currency risk:		
USD	-	398
EUR	671	-

The effect of growth rate of 10% of the economic value of capital: 0.05%.
The effect of reducing the rate of 10% of the economic value of capital: (0.05%).

iv. Other market risks

Other market risks include the price risk on debt securities, price risk on equity securities and – the commodity risk, in compliance with the Decision regulating the Bank's capital adequacy.

During 2017, given the nature of its operations and the fact that it had no items in the trading book, the Bank was not exposed to any other market risks.

Once it introduces products exposed to this kind of risk, the Bank shall previously provide the prerequisites for such products (HR-technical equipment, written procedures for daily monitoring of trading book items, procedures for measuring of capital requirements for these risks, and item valuation methods in financial instruments included in calculation and subject to prior approval of the National Bank of Serbia, etc.) subject to consent of the Bank's competent boards.

Operational risk

The operational risk is the risk of negative effects on the Bank's financial result and capital due to failures in employees' performance, inadequate internal procedures and processes, inadequacy of information and other systems management in the Bank, and any other unforeseeable external events.

In the operational risk management, the Bank implements quantitative and qualitative measures based on collection of data on losses arising from operational risk, per categories defined according to sources of losses, and based on adopted internal acts.

The role of the operational risk management is to identify, estimate, control and mitigate the possibilities for the arising and impact of operational risks and losses. The Bank cannot eliminate all operational risks, but it may use the process of operational losses recording and analysis to identify flaws in its processes, products and procedures, and to improve them in order to reduce the frequency and negative effects of operational losses on Bank's operations and profitability. The Bank manages the operational risk so as to minimize the effects of adverse and unsuccessful internal processes, people and systems, or external events, on the Bank's financial result.

Database of on the basis of which the loss occurred or could have occurred, according to the prescribed limit, as a consequence of operational risk per categories defined according to sources of losses, shall be filled by entering the data based on identified risks per types of operations, by persons in charge of operational risk management.

Bank's exposure to operational risks shall be particularly attentively treated when introducing new products, activities, lines of business or systems, when required analyses are to be made by organisational units which participate in introduction of new products, activities, lines of business or system, and the Risk Management Department which is directly in charge of operational risk management.

For the assessment of exposure the Bank uses internal methods developed in line with best practice in the area of operational risk management.

Bank's investment risks

The Bank's investment risks include the risks of investing in capital of other legal entities and fixed assets. In compliance with the regulations of the National Bank of Serbia, the amount of Bank's investments and the amount of regulatory capital are monitored, to ensure that the Bank's investment in any non-financial sector entity does not exceed 10% Bank's capital, and that the Bank's total investments in non-financial sector entities and in Bank's fixed assets do not exceed 60% Bank's capital. The exposure to the risk of Bank's investments in other legal entities and fixed assets is monitored by way of informing the organizational unit or body of the Bank in charge of fixed assets procurement and investments in legal entities of the current status of exposure and amount of capital, in order to act timely in accordance with the set limits.

In 2017, the Bank took care of compliance of investment risks and conducted appropriate activities to ensure the compliance of investments with the indicators stipulated by the National Bank of Serbia. Additional monitoring of the Bank's investment risks indicators is performed in risk management division, finance division and compliance control functions, reported to the Bank's management bodies. The Bank has no items under investment property.

Exposure risk

The Bank's exposure risks (which also represent part of the concentration risk) include the risks of Bank's exposure to a single entity or to a group of related entities, as well as the risks of Bank's exposure to an entity related to the Bank. Monitoring of the Bank's exposure to the risk of exposure to a single entity or a group of related entities, and to entities related to the Bank, is performed at the moment of a request initiation, at the moment of financing, and after completed financing. Monitoring of Bank's exposure to this risk is a mandatory part of procedures in the investment approval phase, meaning that the board which approves of the investment avails with information concerning the total level of Bank's exposure to a client or to a group of related entities against the Bank's total capital.

In accordance with regulations and Bank's internal acts, the competent board issues approval on Bank's exposure to the exposure risk per individual clients or per groups of related entities and entities related to the Bank. Additional monitoring of the Bank's exposure indicators is performed in risk management division and finance division, with reporting to the Bank's management bodies.

Country risk

The risk related to the country of origin of the entity to which the Bank is exposed implies negative effects which might influence its financial result and capital, due to Bank's inability to collect debts from such entity for reasons resulting from political, economic or social conditions in such entity's country of origin.

The Bank's placements are mostly to customers from the Republic of Serbia, while being exposed to the country risk mostly concerning the part of funds held at times on accounts with foreign banks. The Bank's policy of country risk management is to continuously monitor the exposure to the country risk against adopted limits, defined according to the country rating as determined by competent institutions (OECD), with regular reporting of existing exposures to the management bodies.

D. Capital management
i. Regulatory capital

In thousands of RSD	*Note*	31 December 2017	31 December 2016
Ordinary share capital	26	3,631,200	3,631,200
Loss up to the amount of equity		(1,189,845)	(704,472)
Intangible assets	22	(211,679)	(238,937)
Required reserve for estimated losses on balance sheet assets and off-balance sheet items	12	(19,669)	(117,033)
Unrealized losses on securities available for sale		(185)	(653)
Total share capital		**2,209,822**	**2,570,105**
Subordinated liabilities	27	1,184,728	1,234,723
Part of revaluation reserves of the Bank		-	5,996
Total additional capital		**1,184,728**	**1,240,719**
Total regulatory capital		**3,394,550**	**3,810,824**

The bank continuously manages the capital in order to:

- ensure compliance with capital requirements defined by the National Bank of Serbia (NBS),
- maintain an adequate level of capital for continuous operation by the “going concern” principle,
- maintain the capital base which enables coverage of risks it is exposed to while ensuring further business development.

Capital adequacy, as well as the use of the Bank’s capital is monitored on monthly basis by the Bank management. The Bank manages its capital structure and may make adjustments in the light of changes in economic conditions and risk characteristics inherent in its activities.

The National Bank of Serbia has defined the following limits for capital:

- Minimum monetary amount of capital of EUR 10 million; and
- Capital adequacy ratio not lower than 8%.

In accordance with the Decision on Capital Adequacy of Banks, ("Official Gazette of the Republic of Serbia", No. 103/2016) the methodology of capital adequacy calculation has been determined.

The Bank is required to calculate the following indicators:

- The Core Capital Adequacy ratio, which represents the percentage ratio of core capital and the risky assets of the bank;
- The Supplementary Capital Adequacy ratio, which represents the percentage ratio of supplementary capital and the risky assets of the bank;
- The Capital Adequacy ratio, which represents the percentage ratio of all capital and the risky assets of the bank;

The Bank must maintain the capital adequacy ratios at levels not lower than:

- 4,50 %, for the core capital adequacy ratio;
- 6,00 %, for the supplementary adequacy ratio;
- 8,00 %, for the capital adequacy ratio.

The Bank's Capital is the sum of core capital and supplementary capital minus deduction items from the capital defined in this Decision.

Risk assets represent the sum of total credit risk weighted assets and capital requirements for market risks and capital requirements for operational risk determined in the manner prescribed by the aforementioned decision, multiplied by the reciprocal value of the capital adequacy indicator. The Bank uses a standardized approach to calculate credit risk weighted assets. The Bank's credit risk weighted assets represent the sum of the balance sheet items and off-balance sheet items multiplied by the corresponding credit risk weightings.

The value of the balance sheet assets position for the purpose of calculating credit risk weighted assets is equal to the gross value of those positions minus the allowance for impairment and the required reserve for estimated losses. The value of off-balance sheet items for the purpose of calculating assets weighted by credit risk is equal to the gross value of these items minus provisions for losses on off-balance sheet assets and for the required reserve for estimated losses, multiplied by the corresponding conversion factors.

In conformity with the Decision on the Bank's Capital Adequacy, the Bank must, besides the minimum amount of EUR 10 million equity, maintain capital at any time and at the level required to cover all risks to which it is exposed or may be exposed in its business, at the least in the sum of the following capital requirements:

- Capital requirement for credit risk and the counterparty risk for all Bank's business activities and the capital requirement for settlement / delivery risk for trading book activities;
- Capital requirement for the price risk of trading book activities;
- Capital requirement for the foreign exchange risk and for the commodity risk of all business activities of the Bank; and
- Capital requirement for the operational risk of all business activities of the Bank.

The Bank’s total capital consists of the core capital and supplementary capital and deductible items.

Core Capital consists of Common Equity tier 1 and additional tier 1 equity.

The Core Capital of the Bank consists of the following elements, reduced by the elements of the deductible items:

- shares and other equity instruments that meet the requirements of item 8. of the Decision;
- corresponding issuance premiums along with basic equity instruments, i.e. the value paid above the nominal value of these instruments;
- bank retained profit;
- revaluation reserves and other unrealized gains;
- profit reserves and other reserves of the bank, except reserves for general banking risks;
- reserves for general banking risks.

Deductions from the Core Capital are:

- Current year and previous year losses, as well as unrealized losses;
- Intangible assets, including goodwill, reduced by the amount of deferred tax liabilities that would cease to exist in case of impairment or cessation of recognition of intangible investments in accordance with the IFRS / IAS;
- Deferred tax assets that are dependent on the future profitability of the bank, in accordance with the regulations;
- Negative value received by calculations in accordance with item 134. This decision is for banks that have received approval for the implementation of IRB access;
- Pension fund assets with defined benefits in the balance sheet of the bank;
- Direct, indirect and synthetic investments in the Bank's own core capital instruments, including instruments that the bank is or may be required to repurchase under a contractual obligation;
- Direct, indirect and synthetic investments in core capital instruments of individuals in the financial sector that have mutual investments in the bank, which were performed to present a larger amount of the bank's capital;

- The applicable amount of direct, indirect and synthetic investments of the bank in the core capital instruments of individuals in the financial sector in which the bank does not have a significant investment, in accordance with items 19 and 20 of the Decision;
- The applicable amount of direct, indirect and synthetic investments of the bank in core capital instruments of an individual in the financial sector in which the bank has significant investments, in accordance with item 19 of the Decision;
- The value for which the deductible items from the supplementary capital of the bank exceed the value of the supplementary capital of the bank;
- The amount of exposure that meets the requirements of risk weighting of 1.250%, for which the bank decides to deduct from the Core Capital instead of applying that weight;
- The amount of tax relating to the elements of the Core Capital that can be predicted at the time of the capital calculation, unless the bank has previously corrected the amount of the elements of the Core Capital in the amount in which these taxes reduce the amount by which the elements of the Core Capital can be used to cover the risk; or losses;
- Amount of required reserves for estimated losses on balance sheet assets and off-balance sheet items of the bank.

The Bank's Capital in its entirety consists of Core Capital of the bank and deductions from the supplementary capital.

The Capital adequacy decision determines the protective layers of capital as follows:

- protective layer for the preservation of capital;
- countercyclical protective layer of capital;
- protective layer of capital for a globally systemically important bank;
- protective layer of capital for a systemically important bank;
- protective layer of capital for structural system risk.

As of 31 December 2017, the Bank established protective layers for the preservation of capital and for structural systemic risk. The protective layer for the preservation of capital was determined in the amount of 2.5% of the Bank's risky assets, while the protective layer for structural system risk was determined at the level of 3% of the total foreign exchange and foreign exchange indexed placements approved in accordance to the economy and population in the Republic of Serbia.

The Bank classifies the exposures from the banking book, exposures from the trading book for which it is obliged to calculate the capital requirements of counterparty risks, and other exposures from the trading book, provided that the conditions specified in the a/m Decision are fulfilled, into one of the following categories, and thereby estimates the risk of:

1) Exposure to countries and central banks;
2) Exposure to territorial autonomies and local self-government units;;
3) Exposure to public administrative bodies;
4) Exposure to international development banks;
5) Exposure to international organizations;
6) Exposure to banks;
7) Exposure to corporates;
8) Exposure to natural persons;
9) Exposure secured by mortgage on real estate property
10) Exposure to defaults;
11) High-risk exposures;
12) Exposure based on covered bonds;
13) Exposure to securities;
14) Exposure to banks and companies with short-term credit rating;
15) Exposure from investments in open-end investment funds;
16) Exposure to equity investments;
17) Other exposures.

The Bank has established and continuously developed the process of internal capital adequacy assessment.

6. Fair values of financial instruments

A. Valuation models (assessments)

The Bank measures fair values using the following fair value hierarchy, which reflects the significance of the inputs used in making the measurements.

Level 1: Inputs that are quoted market prices (unadjusted) in active markets for identical instruments.

Level 2: Inputs other than quoted prices included within Level 1 that are observable either directly (i.e. as prices) or indirectly (i.e. derived from prices). This category includes instruments valued using: quoted market prices in active markets for similar instruments; quoted prices for identical or similar instruments in markets that are considered less than active; or other valuation techniques in which all significant inputs are directly or indirectly observable from market data.

Level 3: Inputs that are unobservable. This category includes all instruments for which the valuation technique includes inputs not based on observable data and the unobservable inputs have a significant effect on the instrument's valuation. This category includes instruments that are valued based on quoted prices for similar instruments for which significant unobservable adjustments or assumptions are required to reflect differences between the instruments.

Fair value of financial assets and liabilities

The Bank's business policy is to disclose information on the fair value of assets and liabilities when there is official market information and when the fair value significantly differs from the book value.

The market price, provided that there is an active market, is the best proof of a financial instrument's fair value. However, market prices are not available for a number of Bank's financial assets and liabilities. Therefore, when market prices of financial instruments are unavailable, the fair value of assets and liabilities is estimated using the present value or other valuation techniques based on currently prevailing market conditions.

In the Republic of Serbia, the market experience is insufficient, the same as the stability and liquidity in purchase and sale of debts and other financial assets and liabilities, since the official market information is not available at all times. Consequently, the fair value is impossible to be reliably determined in the absence of an active market.

The following methods and assumptions were used for the estimate of the fair value of Bank's financial instruments as at 31 December 2017:

- The fair values of cash and cash equivalents, short-term deposits, other loans and advances and other assets, transaction deposits, trade payables and other short-term liabilities, match their respective book values primarily due to short-term maturity of such financial instruments.
- Loans and advances from banks and other financial organizations tend to have short-term maturities and carry an interest rate that reflects current market conditions. Consequently, the Bank considers that the value of listed financial instruments approximates their market value.
- The fair value of loans and investments to customers and deposits and other liabilities to customers is calculated by discounting cash flows using market interest rates of comparable maturities and currency structure. The fair value of financial assets through profit or loss held for trading (financial derivatives) is calculated using a model that discounts cash flows to their present value using market interest rates and exchange rates, and is classified into level 2 for measuring fair value.
- Bonds of the Republic of Serbia are measured using available prices on the secondary market and are classified in Level 2 of the fair value measurement.

In the opinion of the Bank's management, the amounts in the enclosed financial statements reflect the value which is, under the circumstances, the most credible and useful for the reporting purposes.

E. Financial instruments not measured at fair value

The following table sets out the fair values of financial instruments:

31 December 2017 *In thousands of RSD*	Level 1	Level 2	Level 3	Total fair values	Total carrying amount (gross)
Assets					
Cash and balances with the central bank	-	382,825	-	382,825	382,825
Loans and advances to banks and other financial institutions	-	-	1,706,061	1,706,061	1,706,061
Loans and advances to customers	-	-	2,128,898	2,128,898	2,200,643
Financial assets at fair value through profit or loss held for trading	-	5,800	-	5,800	5,800
Financial assets available for sale	-	1,387,095	-	1,387,095	1,387,095
Liabilities					
Deposits and other liabilities to banks, other financial institutions and central bank	-	-	41,250	41,250	41,250
Deposits and other liabilities to customers	-	-	2,181,306	2,181,306	2,258,537
Subordinated liabilities	-	-	1,152,818	1,152,818	1,184,958

31 December 2016 *In thousands of RSD*	Level 1	Level 2	Level 3	Total fair values	Total carrying amount (gross)
Assets					
Cash and balances with the central bank	-	875,577	-	875,577	875,578
Loans and advances to banks and other financial institutions	-	-	1,734,433	1,734,433	1,734,431
Loans and advances to customers	-	-	2,471,665	2,471,665	2,509,710
Financial assets at fair value through profit or loss held for trading	-	124,698	-	124,698	124,698
Financial assets available for sale	-	2,050,876	-	2,050,876	2,050,876
Liabilities					
Deposits and other liabilities to banks, other financial institutions and central bank	-	-	30,839	30,839	30,839
Deposits and other liabilities to customers	-	-	3,430,863	3,430,863	3,444,564
Subordinated liabilities	-	-	1,188,237	1,188,237	1,235,022

7. Net interest income

In thousands of RSD	1 January – 31 December 2017	1 January – 31 December 2016
a) Interest income		
Deposited excess liquidity with NBS	5,500	17,989
Interest income on loans to REPO transaction with NBS in RSD	287	2,036
Interest income from domestic banks based on a overnight deposit	1,015	867
Deposits in foreign currency with NBS	2,258	929
Securities of the Republic of Serbia in RSD	38,787	49,446
Mandatory reserves in RSD with NBS	5,218	2,441
Short-term loans to corporates	67,814	42,769
Long-term loans to corporates	70,024	17,042
Interest income from foreign banks	118	-
Total interest income	**191,021**	**133,519**
b) Interest expenses		
Foreign currency accounts with NBS	(2,961)	(1,124)
Subordinated liabilities of foreign legal entities, in foreign currency	(3,164)	(2,676)
Short-term deposits of legal entities in foreign currencies	(51,287)	(28,709)
Overnight of legal entities in RSD	(2,866)	(269)
Interest expense on overnight domestic banks deposits in RSD	(173)	-
Short-term special purpose deposits of legal entities in RSD	(12,750)	(565)
Interest expense on short-term bank deposits	(40)	-
Short-term deposits of insurance organizations in RSD	(452)	(718)
Interest expense on individual time deposits in foreign currency.	(709)	-
Other	-	(4)
Total interest expenses	**(74,402)**	**(34,065)**
Net interest income	**116,619**	**99,454**

8. Net fee and commission income

In thousands of RSD	1 January – 31 December 2017	1 January – 31 December 2016
a) Fee and commission income		
Fees and commissions on guarantees	11,541	3,518
Income from fees from non-residents	2,976	4,690
Fees from legal entities from domestic payment operations	5,562	3,893
Fees from legal entities by remittance	1,841	3,038
Card fees and commissions	229	-
Escrow account maintenance fees	280	-
Other	737	418
Total fee and commission income	**23,166**	**15,557**
b) Fee and commission expenses		
Fees and commissions to NBS	(1,692)	(1,272)
Fees and commissions to other banks	(2,153)	(1,412)
Card fees and commissions	(8)	-
Other	(203)	(107)
Total fee and commission expenses	**(4,056)**	**(2,791)**
Net fee and commission income	**19,110**	**12,766**

9. Net gains on financial assets held for trading

In 2017, derivatives were presented at fair value, based on which decrease was recorded in net loss on financial assets held for trading in the amount of RSD 118,897 thousand (in 2016 on this basis there was net gain of RSD 124,698 thousand)

Part of the income from the change in value of derivatives held for trading relating to increase in fair value, arising from exchange differences, compensates the amount of foreign exchange losses and the effects of foreign currency clause.

10. Net income/ (expense) on foreign exchange rate differences and effects of foreign currency clause

In thousands of RSD	1 January – 31 December 2017	1 January – 31 December 2016
Net income/ (expense) from foreign exchange rate differences		
from cash	(22,975)	(17,545)
from given loans and placements	(189,395)	67,426
from swap transaction	(124,146)	(841)
from buying/selling foreign currency	917	4,977
from other receivables	(18,085)	2,027
from impairment	3,793	116
from foreign currency	503,846	(152,546)
from received loans	49,996	(12,015)
from other liabilities	1,734	(183)
from state securities	(4,261)	-
from other position	393	(11)
from passive interest	(2,607)	(1,258)
Net income/(expense) from foreign exchange rate differences	**199,210**	**(109,853)**
Net income/(expense) from the effect of contractual foreign currency clause		
from loans and placements	(67,886)	6,386
from impairment value	407	-
from other line items	62	(156)
Net Income/(expense) from contractual foreign currency clause	**(67,417)**	**6,230**
TOTAL INCOME/(EXPENSE) FROM FOREIGN EXCHANGE DFFERENCES AND FOREIGN CONTRACTUAL CURRENCY CLAUSE	**131,793**	**(103,623)**

11. Other operating income

In thousands of RSD	1 January – 31 December 2017	1 January – 31 December 2016
Income from reversal of provision expenses	-	6.804
Revenues on the basis of damages	12	7
Income from services rendered to non-resident individuals	3,703	-
Income from supplier returns	130	-
Other income	375	-
Other operating income	**4,220**	**6,811**

12. Net expenses on impairment of financial assets and credit risk-weighted off-balance sheet items

a) Impairment losses

As at 31 December 2017 the Bank had expenses from impairment of financial assets and the credit risk off balance sheet items.

	1 January – 31 December 2017	5 February – 31 December 2016
Losses from impairment:		
- balance sheet items	(1,413)	(10,237)
- off-balance sheet items	(1,473)	(1,391)
	(2,886)	**(11,628)**

b) Special reserve for estimated losses

Based on categorization of placements determined in conformity with the regulations of the National Bank of Serbia as at 31 December 2016, the required reserve for estimated losses based on total exposure of the Bank to the credit risk is assessed:

	31 December 2017	31 December 2016
Required reserves from gains for estimated losses in balance-sheet assets and off-balance sheet items:		
- balance sheet items	16,410	92,280
- off-balance sheet items	3,259	24,753
	19,669	**117,033**

As at 31 December 2017, the required reserve for estimated losses which might arise from balance sheet assets and off-balance sheet items, calculated in accordance with the Decision of the National Bank of Serbia, ("Official Gazette of the Republic of Serbia", No. 94/2011, 57/2012, 123/2012, 43/2013, 113/2013, 135/2014, 25/2015, 38/2015, 61/2016, 69/2016, 91 / 2016, 101/2017 and 114/2017), amounts to RSD 19,669 thousand (31 December 2016 amounts to RSD 117,033 thousand).

13. Salaries, salary compensations and other personal expenses

In thousands of RSD	1 January – 31 December 2017	5 February – 31 December 2016
Cost of net earnings	(209,432)	(193,474)
Taxes and contributions on salaries	(25,068)	(22,951)
The cost of compensation for members of the BoD	(6,914)	(9,299)
Income/(expenses) from cancellation/(creation) provisions for annual leave and pension (IAS 19)	266	(558)
Other personal expenses	(2,503)	(4,459)
Salaries, salary compensations and other personal expenses	**(243,651)**	**(230,741)**

14. Depreciation and amortisation expenses

In thousands of RSD	1 January – 31 December 2017	5 February – 31 December 2016
The cost of depreciation of property, plant and equipment	(43,300)	(39,928)
Amortization of intangible assets	(43,041)	(34,242)
Depreciation expenses	**(86,341)**	**(74,170)**

15. Other expenses

In thousands of RSD	1 January – 31 December 2017	5 February – 31 December 2016
Facility expenses	(63,499)	(62,180)
ICT expenses	(87,448)	(68,342)
Professional services	(29,299)	(31,953)
Marketing	(49,180)	(46,205)
Insurance expenses	(10,071)	(5,438)
Deposit insurance agency	(3,196)	(1,632)
Retirements and impairment expenses	(12,209)	-
Other administrative expenses	(51,757)	(48,332)
Total other expenses	**(306,659)**	**(264,082)**

The Bank pays the rent to legal entities for its business premises under concluded lease agreements. The agreed lease periods are five years. The rent includes currency clause, and it is payable on monthly basis. Costs of business premises lease in 2017 amounted to the total of RSD 63,499 thousand (31 December 2016 amounted to RSD 62,180 thousand). In this category of costs, there are also the costs of maintenance of the premises (as defined in the Lease Agreement) as well as utility costs and all other expenses that are directly related to the use of the premises of the Bank.

16. Income Tax

a) Income tax components

	In thousands of RSD 31 December 2017	31 December 2016
Tax expenses for the period on the basis of deferred tax	1,319	(2,799)
	1,319	**(2,799)**

b) Deferred tax liabilities

Deferred tax liabilities relating to temporary differences between the carrying value of fixed assets and intangible assets and their tax base, due to the application of different rates of depreciation and revaluation of fixed assets. As at 31 December 2017, there were recorded deferred tax liabilities in the amount of RSD 13,391 thousand (31 December 2016 amounted of RSD 14,710 thousand).

c) Overview of tax loss carried forward from preceding periods

Year of loss	Amount of loss	Amount of used loss	Remaining losses carried forward	Year up to which loss can be carried forward
2015	317,942	-	317,942	2020
2016	485,393	-	485,393	2021
2017	536,116	-	536,116	2022
Total	**1,339,451**	-	**1,339,451**	

According to the Corporate Income Tax Law, since 27 March 2010, the time limit for tax loss carried forward is decreased from 10 to 5 years. The Bank did not recognize the carried forward tax losses as deferred tax assets as at 31 December 2017, due to uncertainty of income earning in the following years against which these losses could be used.

d) Deferred tax components

As at 31 December 2017, deferred taxes were calculated and corresponding bookings were entered. The deferred tax components are as follows:

	In thousands of RSD	
	31 December 2017	**31 December 2016**
Deferred tax liabilities	(13,748)	(15,103)
Deferred tax assets on provisions for retirement	357	393
	(13,391)	**(14,710)**

17. Cash and balances with the central bank

In thousands of RSD	**31 December 2017**	**31 December 2016**
Gyro account	50,431	292,250
Cash on hand in RSD	5,736	7,307
Deposited excess liquidity with NBS	180,000	89,000
Interest receivables from NBS	30	12
RSD cash	**236,197**	**388,569**
Cash on hand in foreign currency	30,154	13,371
Mandatory reserve in foreign currency with NBS	116,474	473,638
Foreign currency cash	**146,628**	**487,009**
Balance as at 31 December	**382,825**	**875,578**

The RSD mandatory reserve is the minimum RSD reserve allocated in compliance with the Decision of the National Bank of Serbia on Bank's Mandatory Reserve with the National Bank of Serbia ("Official Gazette of the Republic of Serbia", 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).

The RSD base for calculation of the mandatory reserve is comprised of the daily average of reservable RSD liabilities in preceding calendar month, excluding the currency clause-indexed RSD liabilities.

RSD liabilities are comprised of liabilities in respect of RSD deposits, credits and securities, and other RSD liabilities excluding RSD deposits received under transactions performed by the bank on behalf and for the account of third parties, that are not in excess of the amount of investment made from such deposits.

The National Bank of Serbia pays interest to banks on the amount of average daily balance of allocated RSD mandatory reserve in the accounting period not exceeding the amount of gross calculated RSD mandatory reserve, for all days of the accounting period – at the interest rate set by the decision on interest rates applied by the National Bank of Serbia in the implementation of monetary policy.

The Bank is obliged to maintain throughout an accounting period an average daily balance of allocated RSD mandatory reserve at the amount of calculated RSD mandatory reserve. The calculated RSD mandatory reserve for December 2017 was RSD 108,682 thousand (December 2016 was RSD 290,012 thousand and was compliant with the aforementioned Decision of the National Bank of Serbia. The interest rate on the amount of allocated RSD mandatory reserve during 2017, on annual level, amounted to 1.75%.

The required foreign currency reserve is the minimum reserve in foreign currency allocated in compliance with the Decision of the National Bank of Serbia on Bank's Mandatory Reserve with the National Bank of Serbia ("Official Gazette" of the Republic of Serbia nos. 3/2011, 31/2012, 57/2012, 78/2012, 87/2012,107/. 62/2013, 125/2014, 135/2014, 4/2015, 78/2015 and 102/2015) stipulating that banks shall calculate the foreign currency mandatory reserve at the rate of:

- 20% – on the foreign currency base portion comprised of liabilities maturing in less than two years, and/or 730 days and, exceptionally, at 100% rate for the foreign currency base portion comprised of currency clause-indexed RSD liabilities maturing in less than two years and/or 730 days,

- 13% – on the foreign currency base portion comprised of liabilities maturing in more than two years, and/or 730 days and, exceptionally, at 100% rate for the foreign currency base portion comprised of currency clause-indexed RSD liabilities maturing in more than two years and/or 730 days.

Foreign currency liabilities are the liabilities in respect of foreign currency deposits, credits and securities and other foreign currency liabilities, as well as deposits, credits and other foreign currency funds received from abroad under transactions performed by the bank on behalf and for the account of third parties.

The bank allocates the mandatory reserve calculated on the foreign currency base to the foreign currency account of the National Bank of Serbia. The bank is obliged to maintain throughout an accounting period the average daily balance of allocated foreign currency mandatory reserve at the amount of calculated foreign currency mandatory reserve. The National Bank of Serbia does not pay any interests on the amount of achieved average balance of allocated foreign currency reserve. The foreign currency base for calculation of the mandatory reserve is comprised of the daily average reservable balance of foreign currency liabilities in the preceding calendar month and the average daily reservable balance of currency clause-indexed RSD liabilities in the preceding calendar month.

The bank which achieved the average daily balance of allocated foreign currency mandatory reserve at the amount in excess of the calculated one – pays to the National Bank of Serbia the interest on the amount of difference between the achieved daily balance of allocated foreign currency mandatory reserve and calculated foreign currency mandatory reserve, for all days of the accounting period, at the interest rate set by the decision on interest rates applied by the National Bank of Serbia in the procedure of implementing the monetary policy. Daily average balance of allocated foreign currency mandatory reserve in the accounting period exceeds the calculated foreign currency mandatory reserve in the period.

As at 31 December 2017, the Bank's foreign currency mandatory reserve was compliant with the Decision of the National Bank of Serbia.

18. Financial assets at fair value through profit or loss held for trading

Financial assets at fair value through profit or loss held for trading include effects of fair value change of derivatives through the income statement:

19. Financial assets available for sale

The bank as at 31 December 2017 in its portfolio had government bonds and treasury bills amounting to RSD 1,387,095 thousand (in 2016 RSD 2,050,876 thousand).

In thousands of RSD	**31 December 2017**	**31 December 2016**
Bonds of Republic of Serbia	691,307	825,952
Treasury bills	695,788	1,224,924
Balance as at 31 December	**1,387,095**	**2,050,876**

20. Loans and advances from banks and other financial institutions

In thousands of RSD	31 December 2017	31 December 2016
Regular foreign currency accounts with foreign banks	867,914	474,005
Cash balances with the Central Securities Registry	4,839	4,939
Avista dedicated foreign currency deposits in foreign currency at NBS	473,838	502,758
Special purpose guarantee deposit in foreign currency VISA	10,025	11,714
OVERNIGHT investments with domestic banks in foreign currency	-	370,417
Short-term deposits with domestic banks in foreign currency	349,493	370,417
Accruals for interest calculated on the basis of RSD required reserves (NBS)	74	183
Allowance for impairment	(122)	(2)
Balance as at 31 December	**1,706,061**	**1,734,431**

Changes in allowance for impairment:

In thousands of RSD	**31. 12.2017.**	**31. 12.2016.**
Balance as at 31 December of previous year	**(2)**	**-**
Increase during the year	(120)	(2)
Balance as at 31 December	**(122)**	**(2)**

21. Loans and advances to customers

In thousands of RSD	31 December 2017	31 December 2016
Receivables from loans to customers	2,211,168	2,523,197
Receivables from interests and fees	7,141	3,281
Total	**2,218,309**	**2,526,478**
Deferred loan origination fee	(7,038)	(6,541)
Impairment provision for loans and advances to customers	(10,628)	(10,227)
Balance as at 31 December	**2,200,643**	**2,509,710**

Structure of loans and advances to customers

In thousands of RSD	**31.12.2017.**	**31.12.2016.**
Interests and fees	**7,141**	**3,281**
Short-term placements	**907,200**	**2,030,855**
In RSD and with currency clause	907,200	1,213,993
In foreign currency	-	816,862
Long-term placements	**1,303,968**	**492,342**
In RSD and with currency clause	711,604	492,342
In foreign currency	592,364	-
Gross placements to customers	**2,211,168**	**2,523,197**
Deferred loan origination fee		
Short-term placements	**(2,111)**	**(3,800)**
In RSD and with currency clause	(2,111)	(3,800)
In foreign currency	-	-
Long-term placements	**(4,927)**	**(2,741)**
In RSD and with currency clause	(4,927)	(2,741)
In foreign currency	-	-
Total deferred loan origination fee:	**(7,038)**	**(6,541)**
Allowance for impairment		
Interests and fees	(45)	(7)
Short-term placements	(7,833)	**(9,873)**
In RSD and with currency clause	(7,833)	(7,705)
In foreign currency	-	(2,168)
Long-term placements	(2,750)	**(347)**
In RSD and with currency clause	(2,297)	(347)
In foreign currency	(453)	-
Total allowance for impairment	**(10,628)**	**(10,227)**
Net investments to customers		
Interests and fees	**7,096**	**3,274**
Short-term placements	**897,256**	**2,017,182**
In RSD and with currency clause	897,256	1,202,488
In foreign currency	-	814,694
Long-term placements	**1,296,291**	**489,254**
In RSD and with currency clause	704,380	489,254
In foreign currency	591,911	-
Total net Loans and advances to customers:	**2,200,643**	**2,509,710**

Changes in allowance for impairment:

In thousands of RSD	31 December 2017	31 December 2016
Balance as at 31 December previous year	**(10,227)**	**-**
Increase during the year	(401)	(10,227)
Balance as at 31 December	**(10,628)**	**(10,227)**

Loans and advances to customers

In 2017, the Bank continued with credit activities by granting short-term and long-term loans to legal entities. In the mentioned period, the approved loans were: (a) short-term loans: in RSD with interest rate ranging from 4.00% to 12.00%, in foreign currency with interest rate of 2.00% and in RSD with a currency clause with interest rate ranging from 2.00% to 3.90%; and (b) long-term loans, such as: in RSD, with interest rate ranging from 5.80% to 6.64%, in foreign currency with interest rate from 2.329% and in RSD with currency clause in the range of 2.03% to 5.73% and in foreign currency at the interest rate of 2.35%

22. Intangible assets

Structure and changes in intangible assets during 2017 are presented in the table below:

In thousands of RSD	Software	Licenses	Intangible assets in progress	Total
Purchase value				
Balance as at 1 January 2016	**210,017**	**15,638**	**2,957**	**228,613**
Purchase during the year	-	-	55,354	55,354
Transfer from investments in progress	43,715	7,322	(51,037)	-
Balance as at 31 December 2016	**253,732**	**22,960**	**7,274**	**283,966**
Balance as at 1 January 2017	**253,732**	**22,960**	**7,274**	**283,966**
Purchase during the year	-	-	15,783	15,783
Transfer from investments in progress	19,977	-	(19,977)	-
Balance as at 31 December 2017	**273,709**	**22,960**	**3,080**	**299,749**
Impairment				
Balance as at 1 January 2016	**10,004**	**783**	**-**	**10,787**
Amortisation	30,918	3,324	-	34,242
Balance as at 31 December 2016	**40,922**	**4,107**	**-**	**45,029**
Balance as at 1 January 2017	**40,922**	**4,107**	**-**	**45,029**
Amortisation	38,212	4,829	-	43,041
Balance as at 31 December 2017	**79,134**	**8,936**	**-**	**88,070**
Net book value as at 31 December 2017	**194,575**	**14,024**	**3,080**	**211,679**
Net book value as at 31 December 2016	**212,810**	**18,853**	**7,274**	**238,937**

The Bank does not possess any intangible assets estimated to have an unlimited useful life as at 31 December 2017. Further to the estimate of the Bank's management, as at 31 December 2017 there are no indications that the value of intangible assets is impaired.

23. Property, plant and equipment

The structure and changes in property, plant and equipment during 2017 are shown in the table below:

In thousands of RSD	Equipment and other fixes assets	Investments in fixed assets of other legal entities	Fixed assets in progress	Total
Purchase value				
Balance as at 1 January 2016	**104.441**	**68.128**	**1.101**	**173.670**
Purchase during the year	-	-	26.981	26.981
Transfer from investments in progress	16.824	9.513	(26.337)	-
Balance as at 31 December 2016	**121.265**	**77.641**	**1.745**	**200.651**
Balance as at 1 January 2017	**121.265**	**77.641**	**1.745**	**200.651**
Purchase during the year	-	-	11.369	11.369
Impairment during the year	-	(7.189)	-	(7.189)
Transfer from investments in progress	9.937	128	(10.065)	-
Balance as at 31 December 2017	**131.202**	**70.580**	**3.049**	**204.831**
Impairment				
Balance as at 1 January 2016	**6.055**	**4.245**	**-**	**10.300**
Depreciation	24.771	15.157	-	39.928
Balance as at 31 December 2016	**30.826**	**19.402**	**-**	**50.228**
Balance as at 1 January 2017	**30.826**	**19.402**	**-**	**50.228**
Amortisation	27.012	16.288	-	43.300
Decrease	-	(3.087)	-	(3.087)
Balance as at 31 December 2017	**57.838**	**32.603**	**-**	**90.441**
Net book value as at 31 December 2017	**73.364**	**37.977**	**3.049**	**114.390**
Net book value as at 31 December 2016	**90.439**	**58.239**	**1.745**	**150.423**

The Bank does not possess any property, plants and equipment estimated to have an unlimited useful life. As at 31 December 2017, the Bank is in possession of the assets it avails with and has no encumbrance on property. Further to the estimate of the Bank's management, as at 31 December 2017 there are no indications that the value of fixed assets and investments in leased business premises is impaired. Part of the investment in leased office space has been written off, because the management of the Bank made the decision to rent a smaller area of office space in a relation to 2017. Investments in office space that will no longer be used, in the amount of RSD 7,189 thousand. The net book value of written-off investments was RSD 4,102 thousand.

24. Other assets

Other assets include:

In thousands of RSD	31 December 2017	31 December 2016
Receivables from advances paid for current assets	486	395
Receivables from advances paid for fixed assets	1,195	1,923
Prepaid costs	1,427	2,217
Petty inventory in use	616	2,823
Fees from legal entities and receivables from employees	448	147
Receivables in the calculation, fees refunded by the client	1,148	-
Deferred other costs	10,065	-
Other	104	6,250
Other assets	**15,489**	**13,755**
Impairment of other assets	(1,255)	(522)
Balance as at 31 December	**14,234**	**13,233**

Changes on Impairment:

In thousands of RSD	31 December 2017	31 December 2016
Balance as at 31 December of previous year	**(522)**	**(367)**
Increase during the year	(733)	(155)
Balance as at 31 December	**(1,255)**	**(522)**

25. Deposits and other liabilities to banks, other financial institutions and central bank

In thousands of RSD	31 December 2017	31 December 2016
Transaction deposits	173	110
Short-term deposits	40,000	30,001
Liabilities for fees and commissions to NBS	75	10
Liabilities for fees and commissions to other banks etc.	1,002	718
Balance as at 31 December	**41,250**	**30,839**

26. Deposits and other liabilities to customers

In thousands of RSD	31 December 2017	31 December 2016
Corporate and retail		
Transaction deposits in RSD	197,587	64,736
Short-term deposits in RSD	471,500	-
Long-term deposits on loans in RSD	1,282	24,347
Overnight	76,788	509
Transaction deposits in foreign currency	382,803	950,202
Long-term deposits on loans in foreign currency	12,937	11,217
Short-term deposits in foreign currency	1,109,224	2,363,869
Accrued interest	3,134	-
Other liabilities in foreign currency	3,282	29,684
Balance as at 31 December	**2,258,537**	**3,444,564**

Short-term deposit are term deposits denominated in RSD and foreign currency with maturity up to 12 mouths. These deposits have interest rates ranging from 1.30% - 2.2% per annum (on foreign currency deposits) or from 0.30 to 4.30% (on RSD deposits).

Long-term foreign currency deposits from individuals were collected at the interest rate from 1.40% to 1.50% annually.

Changes in deposits and other liabilities to banks, other financial organizations and the central bank and customers during the year are presented below:

	2017	2016
Initial state		
Deposits and other liabilities to banks, other financial institutions and central bank	30,839	82
Deposits and other liabilities to other customers	3,444,564	76,939
Initial state as at 1 January	**3,475,403**	**77,021**
Net (outflow)/inflow from deposits	(648,705)	3,215,506
Foreign exchange differences	(503,846)	152,546
Deferred interest and other non-cash transactions	(23,065)	30,330
Final state		
Deposits and other liabilities to banks, other financial institutions and central bank	41,250	30,839
Deposits and other liabilities to other customers	2,258,537	3,444,564
Final state as at 31 December	**2,299,787**	**3,475,403**

27. Subordinated liabilities

Loans received in foreign currency

The Bank has long-term subordinated liabilities to Aflaj INVESTMENT LLC. , with contract of six mouth income payment, with annual interest rate of 6M Euribor increased for 0.50%, which amounted to 0.23% as at 31 December 2017 (31 December 2016 it amounted to 0.35%).

The structure of received loans per creditors, with balance as at 31 December 2017, is presented in the following table:

Creditor name	Agreed amount	Currency	31 December 2017 in EUR	Interest rate p.a.	Maturity date	Balance as at 31 December 2017 in 000 RSD
AFLAJ INVESTMENT LLC, Abu Dhabi	5,000,000	EUR	5,000,000	6m euribor+0,5%	30.10.2025.	592,364
AFLAJ INVESTMENT LLC, Abu Dhabi	5,000,000	EUR	5,000,000	6m euribor+0,5%	02.11.2025.	592,364
Deferred liabilities for accrued interest						230
Total						1,184,958

Creditor name	Agreed amount	Currency	31 December 2016 in EUR	Interest rate p.a.	Maturity date	Balance as at 31 December 2016 in 000 RSD
AFLAJ INVESTMENT LLC, Abu Dhabi	5,000,000	EUR	5,000,000	6m euribor+0,5%	30.10.2025.	617,362
AFLAJ INVESTMENT LLC, Abu Dhabi	5,000,000	EUR	5,000,000	6m euribor+0,5%	02.11.2025.	617,362
Deferred liabilities for accrued interest						298
Total						**1,235,022**

28. Provisions

In thousands of RSD	31 December 2017	31 December 2016
Provisions for retirement benefits	2,378	2,620
Provisions for employees' annual leave	806	830
Provisions for losses on off-balance sheet assets	2,787	1,391
Total	**5,971**	**4,841**

Changes in total provisions:

	Provisions for retirement benefits, in accordance with IAS 19	Provisions for employees' annual leave, in accordance with IAS 19	Provisions for losses on off-balance sheet assets IAS 39
Balance as at 1 January 2016	**2,474**	**418**	**-**
Increase	146	412	1,391
Decrease	-	-	-
Balance as at 31 December 2016	**2,620**	**830**	**1,391**
Balance as at 1 January 2017	**2,620**	**830**	**1,391**
Increase	-	-	1,396
Decrease	(242)	(24)	-
Balance as at 31 December 2017	**2,378**	**806**	**2,787**

The trends in provisions for potential losses in retirement pays and other purposes are presented in the above table. Provisions for retirement pay to employees are formed based on actuarial valuation, with balance on the balance sheet date, and these are recognized in the amount of the present value of expected future payments.

In compliance with its Rules of Procedure, the Bank is obliged to pay out retirement pays at the amount of two average gross salaries in the Republic of Serbia in the month preceding the month of payment, as per latest published information of the republic statistical authority.

The value of expected outflows was assessed using the average monthly salary in the Republic of Serbia in December 2017 and 7% (in 2016 was 7%), discount rate which represents an adequate rate according to IAS 19 "Employee Benefits" in the absence of a developed market of high-quality corporate bonds, which is the return on 10-year treasury bonds of the Republic of Serbia. The provision is assessed based on the Bank's Rules of Procedure and an assumed average salary increase at the rate of 3% (in 2016 was 4%) p.a, which is equal to the target inflation rate projected by NBS.

29. Other liabilities

In thousands of RSD	31 December 2017	31 December 2016
Suppliers	4,554	3,951
Guarantee commissions	2,736	3,033
Fees (to use a billboard, to highlight a company)	64	-
Prepaid expenses for legal fees	31,424	26,465
Taxes and contributions	1,392	1,671
Other liabilities arising from suspended accounts of legal entities - non-residents	9,622	-
Other	118	53
Total	**49,910**	**35,173**

30. Equity and reserves

As at 31 December 2017, the subscribed paid-in share capital of the Bank amounted RSD 3,631,200 thousand, consisted of 3,631,200 ordinary shares with par value of RSD 1 thousand.

Shareholder Structure

Duingraaf Financial Investments B.V., Hoogoorddreef 15, 1101BA Amsterdam, the Netherlands, is 100% shareholder of the Bank as at 31 December 2016.

Shareholder name:	**31 December 2017** No. of shares	**31 December 2017** % ownership	**31 December 2016** No. of shares	**31 December 2016** % ownership
Duingraaf Financial Investments B.V., Amsterdam, The Netherlands	3,631,200	100%	3,631,200	100%

The share capital structure is presented in the table below:

In thousands of RSD

	31 December 2016		**31 December 2015**	
	Amount in thousand RSD	**%**	**Amount in thousand RSD**	**%**
Ordinary shares	3,631,200	100.00	3,631,200	100.00
Balance as at 31 December	3,631,200	100.00	3,631,200	100.00

Provisions for estimated losses

The provisions for estimated credit risk losses contained in the Bank's credit portfolio are calculated in accordance with the Decision of the National Bank of Serbia on Classification of Bank Balance Sheet Assets and Off-Balance Sheet Items ("Official Gazette of RS" no. 94/2011, 57/2012, 123/2012, 43/2013, 113/2013, 135/2014, 25/2015, 38/2015, 61/2016, 69/2016, 91/2016, 101/2017 and 114/2017).

As at 31 December 2017, a special reserve for estimated losses that may arise on the basis of assets and off-balance sheet items, calculated in accordance with the Decision of the National Bank of Serbia, amounts to RSD 19,669 thousand (on 31 December 2016, it amounted to RSD 117,033 thousand).

The Bank's regulatory capital includes only the negative effects of the fair value changes of financial assets available-for-sale in the amount of RSD 468 thousand.

Positive effects of revaluation reserves on the basis of changes in the fair value of financial assets available for sale in the amount of RSD 20,879 thousand, the Bank does not include in its regulatory capital.

Capital adequacy and Bank's business indicators stipulated under the Law on Banks

The Bank is obliged to harmonize the scope and structure of its business and risk-weighted placements with business indicators stipulated under the Law on Banks and relevant decisions of the National Bank of Serbia made pursuant to the named Law.

The achieved business indicators of the Bank as at 31 December 2017 were as follows:

1. Capital adequacy indicators

In thousands of RSD	**31 December 2017**	**31 December 2016**
Core capital	2,209,823	2,570,105
Supplementary capital	1,184,727	1,240,719
Deductibles from capital	-	-
Capital	**3,394,550**	**3,810,824**
Assets weighted with credit risk multiplied by reciprocal value of the adequacy of capital	4,472,244	3,350,751
Exposure to foreign currency risk multiplied by the reciprocal value of the capital adequacy	-	-
Exposure to operational risk	308,656	96,933
Total risk assets	282	-
Capital adequacy indicator	**4,781,182**	**3,447,684**
Assets weighted with credit risk multiplied by reciprocal value of the adequacy of capital	**71.00%**	**110.53%**

1. Business indicators	**Prescribed**	**Realized in 2017**	**Realized in 2016**
1. Capital (expressed in EUR)	Minimum EUR 10 million	28,652,593	30,863,797
2. Capital adequacy	Minimum 8% u 2017. 12% u 2016.	71.00%	110.53%
3. The indicator of the basic capital adequacy	Minimum 4,5%	46.22%	n/a
4. Equity capital adequacy indicator	Minimum 6%	46.22%	n/a
5. Bank's investments in non-financial sector and in non-current asset	Maximum 60%	3.37%	3.95%
6. Sum of large exposures	Maximum 400%	77.73%	44.80%
7. Average monthly liquidity indicators (December)	Minimum 1	3.19	13.61
8. Foreign currency risk ratio	Maximum 20%	0.18%	0.28%
9. Exposure of the Bank to a single entity or a group of related entities	Maximum 25%	18.20%	21.05%

31. Off-balance sheet items

In thousands of RSD	31 December 2017	31 December 2016
Guarantees, securities, secured property and commitments	**2,034,772**	**2,540,998**
Payment guarantees:	**325,655**	**286,700**
In RSD	309,382	286,700
In foreign currency	16,273	-
Performance guarantees:	**871,799**	**193,877**
In RSD	69,362	66,998
In foreign currency	802,437	126,879
Other forms of guarantee:	**2,400**	**2,400**
In RSD	2,400	2,400
In foreign currency	-	-
Revocable and irrevocable commitments for unwithdrawn loans and placements in RSD:	**834,918**	**2,058,021**
revocable	654,901	1,547,604
irrevocable	180,017	510,417
Derivatives	**1,863,712**	**2,392,205**
Other off-balance sheet items	**343,795**	**185,347**
Other irrevocable commitments under guarantees	338,139	185,208
Checks, bills, policies, authorities and others	42	44
Other	5,614	95
Total off-balance sheet items	**4,242,279**	**5,118,550**

32. Related party relationships

The following table presents the total balance sheet exposure and exposure to related parties, as well as income and expenses from related parties which influence the Bank's business operations:

In thousands of RSD		
BALANCE SHEET	**31 December 2017**	**31 December 2016**
Liabilities		
Subordinated loan	1,184,728	1,234,723
PROFIT AND LOSS ACCOUNT	**2017**	**2016**
Interest expenses from subordinated loans	(3,164)	(2,676)

Gross and net income of the President and members of the Board of Directors and the Executive Board in 2017 and 2016 were as follows:

In thousands of RSD	2017	2016
Gross income	**66,123**	**66,001**
Executive board	59,209	58,979
Board of directors	6,914	7,022
Net income	**55,380**	**55,362**
Executive board	51,010	50,924
Board of directors	4,370	4,438

Remuneration of the Executive Board in 2017 relates to the payment of three members for the full-year, (in 2016 relates to the payment of two members: one member for eleven months and one for five months) and remuneration of two members of the Board of the directors for the whole year (same in 2016). The above benefits relate to short-term employee benefits.

33. Commitments to lease

The Bank rents office space through operational leasing.

Future payments under operating leases where the Bank emerges as the lessee are shown in the following table:

In thousands of RSD	31 December 2017	31 December 2016
Operating leasing payments		
One year period	43,686	63,094
Period from 1 to 5 years	66,265	160,897
Period over 5 years	-	-
Total	**109,951**	**223,991**

34. Litigation

On 31 December 2017, there are no court litigations that the Bank leads against third parties.

On 31 December 2017, there are two court litigations against the Bank. Based on evidence so far produced in the proceedings, it is estimated that litigation will be settled in the Bank's favor, with an estimate of 70% success. For these reasons, and in accordance with applicable accounting standards, the Bank has not allocated any funds for the needs of the provision.

In addition to the aforementioned two litigations, a misdemeanor procedure with a possible negative outcome is charged against the Bank in the amount of 100,000 RSD.

35. Reconciliation of receivables and payables

In accordance with Article 18 of the Accounting Law ("Official Gazette of the Republic of Serbia", No. 62/2013), the Bank performed reconciliation of receivables and payables with its debtors and creditors. The Bank sent clients confirmation requests or statements of outstanding items, in order to reconcile outstanding receivables / payables as at 31 December 2017.

The total reconciled amount refers to:

- Receivables in the amount of RSD 2,351,833 thousand, which is 33.14% of receivables,
- Liabilities in the amount of RSD 430,394 thousand, which is 16.70% of liabilities.

The total amount of unconfirmed receivables is RSD 3,906,398 thousand, and unconfirmed liabilities in the amount of 1,447,516 thousand RSD.

The reason they outstanding balances remain unconfirmed in the total amount of 1,447,516 thousand RSD is that clients did not confirm balances on their current accounts at the Bank, as well as deposits, and customer receivables in the total amount of RSD 1,081,100 thousand, that clients do not keep in their off-balance sheet records their obligations on the basis of the credit limits, which Bank has approved.

36. Subsequent events

There were no significant events after the end of the reporting period that could require adjustments to or disclosures in notes to the accompanying financial statements of the Bank for 2017.

Belgrade, April 10, 2018

Dragana Bojin
Head of Accounting Department

Ilinca Rosetti
President of the Executive Board

Saša Mićević
Member of the Executive Board

TRANSLATION

ANNUAL REPORT FOR 2017
MIRABANK A.D. BELGRADE

April 2018

1 Introduction

1.1 Macroeconomic Environment

In 2014 Serbia's economy was in serious trouble. Following the 2008 global financial crisis, the country's economy stagnated, while weak public institutions, collapsing tax receipts, and overspending by government and state-owned enterprises resulted in a rapid build-up of public debt. Recognizing the unsustainable situation, the authorities adopted an ambitious program of fiscal adjustment, financial sector strengthening, and broad-based economic reforms.

After three years of effort, the economy has turned around. The fiscal accounts, with the second-largest deficit in Europe in 2014, recorded a surplus in 2017. Economic confidence has improved with noticeable investment both from foreign and domestic sources. Unemployment is near historic lows, and falling. Banks are solid, and nonperforming loans are now below their pre-crisis levels.

In 2017 Serbia witnessed significant progress in establishing macroeconomic stability, mainly reflected in considerable improvement of public finances on the back of good fiscal results as well as significant decline in public debt. Inflation has been stabilised at a low level, while appreciation pressures on the dinar prevailed throughout major part of the year. Labour market also recorded moderate improvements, but achieved economic growth was below the initial expectations and considerably lower in comparison to average growth in the region, to a large extent due to temporary factors, such as the impact of adverse weather conditions on the agriculture and energy sectors.

In spite of the fact that exports recorded strong growth throughout 2017, the country's external position has not improved. The current account deficit significantly expanded relative to the previous year, due to unfavourable trend of imports growing faster than exports established in 2017. Deterioration of the external deficit was primarily influenced by its high value during the first quarter, of 8.7% of GDP, mostly caused by higher energy imports at the beginning of the year. Also, the strong dinar appreciation in the second half of the year did not have a positive impact on the external trade. On the other hand, stable foreign direct investment inflow was more than sufficient to cover fully the current account deficit, while remittance inflow was somewhat higher relative to 2016.

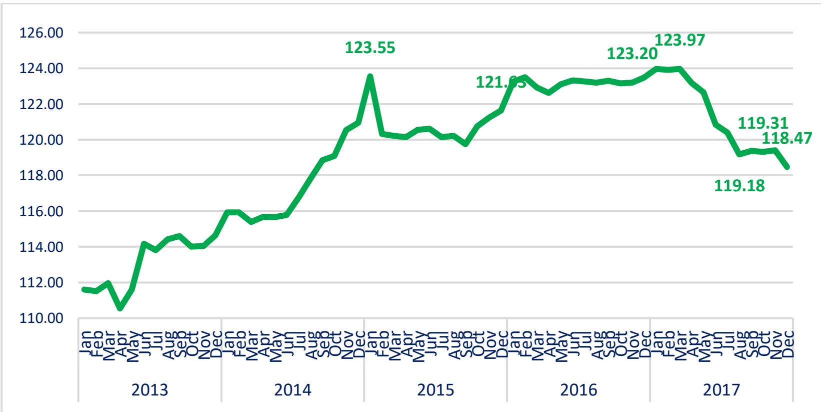


Chart 1: RSD/EUR Exchange Rate; Source: NBS

In 2017, the dinar nominally appreciated against the euro by 4.2% and against the US dollar by 18.2%, while the NBS intervened in the foreign exchange market by selling EUR 630 million and buying EUR 1.35 billion in order to avoid excessive daily fluctuations of the exchange rate.

TRANSLATION NOTE: This is a translation of the original document issued in the Serbian language. All due care has been taken to produce a translation that is as faithful as possible to the original. However, if any questions arise related to interpretation of the information contained in the translation, the Serbian version of the document shall prevail.

In January – October 2017, Serbia recorded a net FDI inflow in the amount of nearly EUR 2 billion, which is around 26% more than in the same period of the previous year, while the full year projection of net FDI inflow was revised up and amounts to EUR 2.1 billion.

By sector, the FDI structure has improved significantly during the past several years on the back of increased FDI inflow into tradable sectors, with good diversification across the manufacturing industry, driving exports up further and improving the country's external position. According to the NBS data, within manufacturing, most FDI inflows went to the production of basic metals, food, motor vehicles, chemicals and pharmaceuticals, bolstering production output and exports of these industries.

Owing to the successful implementation of fiscal consolidation which commenced in 2015, public finances experienced strong improvement, while the results achieved by the Government in key structural reforms were positively assessed by the International Monetary Fund (IMF) and confirmed by successful completion of the last, eighth review of the precautionary stand-by arrangement. The progress in reforms contributed to the reduction of fiscal risks and strengthened the potential for growth of the Serbian economy. Nevertheless, in order to keep economic development sustainable in the long run, it is necessary to continue with institutional reforms and enhance administrative capacities, as well as to complete the privatisation and restructuring of the remaining state-owned enterprises.

Overall business and investment climate improvement has been confirmed by further advancement in the 2018 Doing Business ranking of the World Bank, with Serbia holding 43rd position, which is an improvement in comparison to the previous year when it was ranked 47th.

The greatest progress was made in the domain of procedures for issuing construction permits, property registration in the real estate cadastre and starting and registering a business.

At the end of 2017, rating agencies Fitch and Standard and Poor's upgraded Serbia's credit rating from 'BB-' to 'BB' with stable outlook, while further headway in the EU membership negotiations process was made through opening six new chapters, bringing the number of chapters opened so far to 12 out of 35 in total, of which two have been provisionally closed.

Overhaul state-owned enterprises: Serbia restructured its inefficient railway company, introduced better debt collection in the main electricity and gas companies, and successfully privatized others, such as the Smederevo steelworks, but many state-owned enterprises still need work for successful resolution or unsubsidized free market viability. The sectors most in need of overhaul are mining and petrochemicals: companies such as the Resavica coal mine, the RTB Bor copper complex, and petrochemical producers Petrohemija, MSK, and Azotara. Several state-owned financial institutions—for example, the BPS and Komercijalna banks and Dunav insurance company—are also in need of reform or privatization.

Positive trends in the economy are expected to continue in the period ahead, including a moderate acceleration of growth which will be based on further strengthening of private consumption and intensified investment activity. The final outcome will depend on the developments in the international economic environment, as well as success in further public sector reforms and improvement in general business conditions.

1.2 Serbian Banking Sector

In 2017, the consolidation process of the Serbian banking sector intensified. Although the majority of the banking market still consisted of foreign-owned banks, the number of domestic banks went up from eight to nine. Direktna Banka took over Findomestic Bank and is in the process of acquiring Piraeus Bank, while AIK Bank acquired Alpha Bank, later selling most of its portfolio to Societe Generale Bank. Moreover, OTP Bank initiated the process of acquiring Vojvodjanska Banka, while Banca Intesa took over a part of Procredit Bank's portfolio. The trend of decline in the total number of employees and branches in the banking sector also continued.

The market share of banks in majority ownership of domestic entities (private entities and the Republic of Serbia) decreased a bit (from 24.7% to 24.2%), while their share in total banking sector capital edged down from 23.5% to 23.4%. Banks from Italy, Austria, Greece and France (9 banks) continued to account for the dominant share in total banking sector balance sheet assets – 61.0%, expanding by 0.7 pp from June 2017.

The Serbian banking sector still maintains an acceptable level of competition and low concentration of activities. The Herfindahl Hirschman index values indicate the absence of concentration in all observed categories. For a long time now, the highest values of the index were observed in deposits (chiefly household deposits) and income from fees and commissions, while the lowest figures were noted for total income and interest income, as well as gross loans (both total loans and household loans).

At the end of the third quarter of 2017, the total assets of the banking sector amounted around RSD 3.3 trillion (EUR 28 billion), which is a relative increase by 1.6% compared to the end of the previous year. The slower growth of total assets in 2017 compared to 2016 was a result of lower placements with the NBS and lower investment in securities.

On the other hand, total loans to customers recorded a growth of RSD 125 billion, or 7.1% against the end of the previous year despite significant NPL write-offs, reaching RSD 1.9 trillion (EUR 15.7 billion). The acceleration of credit activity in 2017 was triggered by the growth of economic activity and further stimulated by the monetary policy of the NBS, low interest rates in the Eurozone, stronger competition and decreased country risk premium.

In terms of balance sheet assets, Banca Intesa A.D. Beograd remains the leading bank in Serbia; its market share edged up slightly, by 0.1 pp from the previous quarter and by 0.3 pp from the same period last year. In addition to Banca Intesa A.D. Beograd, the following banks had market shares above 10% as at 30 September 2017: Komercijalna banka A.D. – Beograd and Unicredit Bank Srbija A.D. Beograd, with market shares of 11.4% and 10.9%, respectively. In terms of balance sheet assets, the six leading banks have an aggregate market share of around 60%.

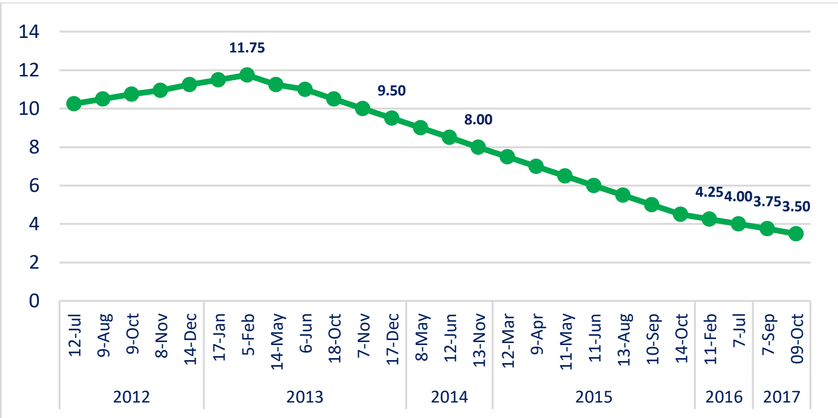


Chart 2: NBS Key Policy Rate; Source: NBS

Aiming to maintain inflation within the target band, the NBS lowered the key policy rate to a record low, which further contributed to the lowering of corporate and household borrowing costs in the domestic currency, which consequently increased dinar lending activity by 1.2% compared to the end of 2016. Local currency loans were mostly placed to the household sector, while there was also noticeable growth in corporate dinar loans, despite most NPLs that were written off being in the local currency. Euro-indexed and euro loans still make up the largest part of corporate loans and they recorded an increase compared to the previous year, while household loans in foreign currency were on a decline.

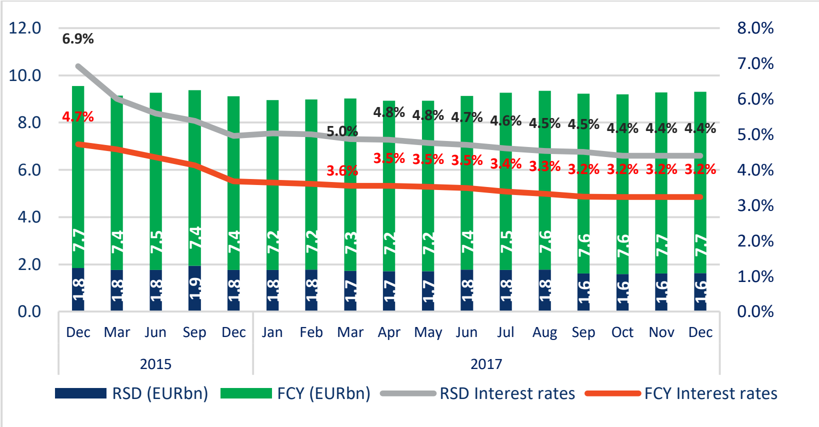


Chart 3: Loans to Corporate Sector – Currencies and Interest; Source: NBS Rates

Lending to the corporate sector has been recording a positive trend since mid-2017. Working capital loans accounted for the largest share in new production, 53.5%, accounting for 48% of total corporate loans. Investment loans had a 22.1% share in new loans, also making up 31.7% of total loans, which positively reflected on the maturity of the loan portfolio, which was dominated by loans with a maturity of more than two years. When it comes to industry structure, companies from the manufacturing industry and trade, as well as transport, were the biggest borrowers in 2017.

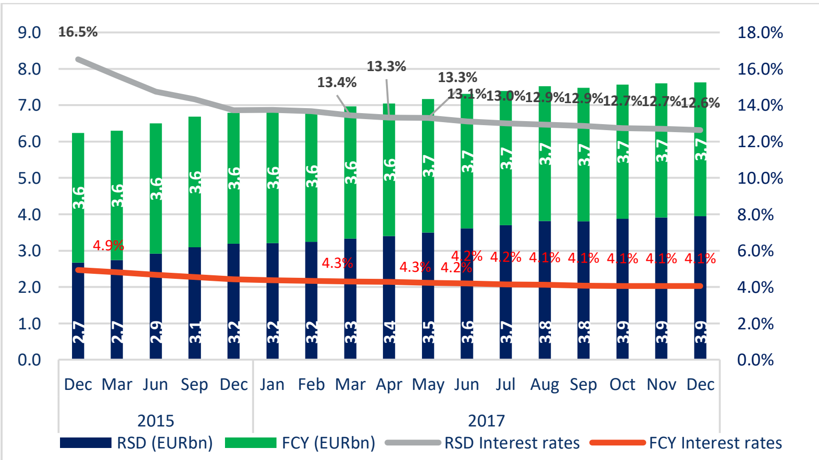


Chart 4: Loans to Household Sector – Currencies and Interest Rates; Source: NBS

Total household loans also rose in 2017, with the highest share of 40.1% held by mortgage loans, and followed by cash loans with 37.4%, while cash loans and refinancing lending had the largest share in new production. Favourable conditions in the real estate market, as well as all-time low interest rates on mortgage lending have helped push up demand for these loans, the growth of which mostly related to new borrowing, although there was also a rise in existing mortgage loan refinancing .

Successful implementation of the NPL Resolution Strategy, which was adopted in 2015, continued last year. By resolving this issue through increased collection activities restructuring, write-off and sale of NPLs to non-bank entities, the banks cleared a large portion of bad assets, opening up space for new potential lending. The reduction of NPLs intensified in the fourth quarter, due to the application of the Decision on the Accounting Write-off of Bank Balance-Sheet Assets. Since the beginning of the year the total amount of gross NPLs was reduced by RSD 94.4 billion to RSD 251.4 billion at the end of the third quarter. The share of these loans in total loans was reduced from 17% at the end of 2016 to 12.2% in September 2017, which represents the lowest value since 2009. At the end of the third quarter, corporate NPLs stood at RSD 188.4 billion after declining by RSD 73.7 billion (28%) since the start of the year, while NPLs in the household sector, including entrepreneurs, fell by RSD 20.7 billion (25%) to RSD 63 billion.

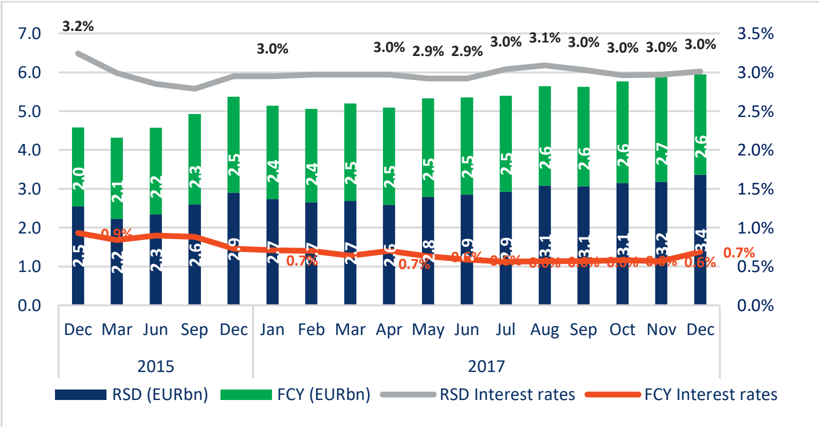


Chart 5: Deposits from Corporate Sector – Currencies and Interest Rates; Source: NBS

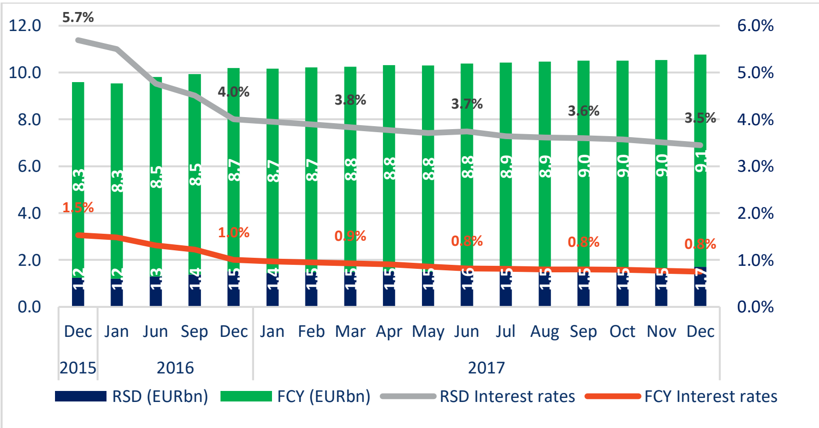


Chart 6: Deposits from Household Sector – Currencies and Interest Rates; Source: NBS

The main source of bank funding in Serbia in 2017 consisted of received deposits that include both household and corporate deposits, as well as deposits received from banks and other financial institutions. Their amount was slightly reduced in 2017, by 0.9%, mostly due to the dinar appreciation, considering the large amount of foreign currency deposits. During 2017, there was an increase in the use of funds from banks, other financial organisations and the NBS (by 11%). Growth was also recorded in corporate deposits (1.4%), while a slight decrease was posted in households and entrepreneurs (-0.5%). The majority of total deposits consisted of short-term deposits, at about 90%, of which most are sight deposits, while the currency structure is still dominated by foreign currency deposits, at 69%.

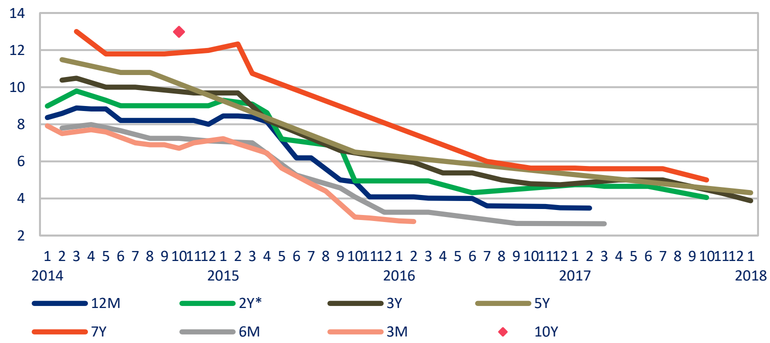


Chart 7: RS Government Securities - Interest Rates (in%); Source: NBS

The results of the Serbian banking sector at end-Q3 2017 indicate that banks' profitability has continued to improve. As at 30 September 2017 the banking sector's pre-tax net result was RSD 53.5 bn, up by 63.1%% compared to the same period last year. The improvement in bank profitability went hand in hand with the diverse structure of results as 25 banks operated with profits of RSD 54.7 bn, while only 5 banks reported a negative result in the total amount of RSD 1.2 bn. The growth of profitability in 2017 was primarily a result of a decrease in net credit losses. Even though lending activity of banks increased, net interest income declined by RSD 1.4 billion in the third quarter of 2017 compared to the third quarter of 2016. This was a result of monetary policy easing, i.e. the reduction of the key policy rate, and consequently lower interest rates in local currency, further underpinned by a drop in interest rates in the interbank market. In the same period, net fee and commission income increased by RSD 2.3 billion, which had a positive effect on net profit. The increase in banking sector's profitability at end-Q3 2017 was accompanied by a y-o-y improvement in profitability indicators, primarily the return on assets ratio and the return on equity ratio. ROA equalled 2.18% (rising by 0.77 pp y-o-y), and ROE 11.01% (rising by 4.12 pp y-o-y).

Following the process of aligning domestic regulations with the relevant EU legal acts, regulations in the field of banking supervision have been amended, starting from June 30, 2017. Namely, the NBS prescribed a reduction of the minimum capital adequacy ratio from 12% to 8%, which is additionally corrected for certain adjustments. At the end of the third quarter, the capital adequacy ratio of the banking sector was 22.5%, which is far above the prescribed minimum.

2 WHO we are

2.1 Establishment

The founder of Mirabank a.d. Beograd (hereinafter: the Bank), Duingraaf Financial Investments B.V., Hoogoorddreef 15, 1101BA Amsterdam, the Netherlands (hereinafter: the Founder), obtained the preliminary permit to incorporate the Bank with the Decision of the National Bank of Serbia No. IO NBS 32 dated August 18, 2014.

The National Bank of Serbia issued a Decision No. IO NBS 58 dated December 16, 2014, thus granting the operating license to the Bank.

Upon obtaining the approval from the National Bank of Serbia for the acts of the Founding Assembly of the Bank (the Decision on Appointment of the President and Members of the Board of Directors of the Bank, the Decision on Appointment of the President and Members of the Executive Board of the Bank, the Decision on the Adoption of the Articles of Association of the Bank, the Decision on the First Share Issue of the Bank, the Decision on the Adoption of the Strategy and Business Policy of the Bank), the Bank was registered with the Companies Registry based on the Decision of the Serbian Business Registers Agency BD 8779/2015 dated February 5, 2015.

The Founder of the Bank and the Bank are not members of the banking group. The initial capital of the Bank is EUR 15 million in RSD counter value; capital conversion was performed on April 6, 2015, upon opening of the Bank's account with the National Bank of Serbia, following which the Bank began conducting its operations through that account and payment transactions, and at the same time it initiated the reporting process to the National Bank of Serbia.

On May 11, 2016, with registration in the Central Securities Depository and Clearing House, the Bank's capital was increased through the II share issue in the amount of 1,840,500 ordinary shares with a nominal value of RSD 1,000 per share, after which the total share capital of the Bank (along with the initial issue in the amount of RSD 1,790,700 thousand) amounted to RSD 3,631,200 thousand. Pursuant to the Decision BD 39191/2016 of May 16, 2016, the Business Registers Agency completed registration of changes/increase in share capital.

The headquarter of the Bank is in Belgrade, 1 Španskih boraca Street in Novi Beograd, and its operations are conducted in 1 branch office in the territory of the Republic of Serbia at the same address. As at 31 December, 2017, the Bank had 42 employees (as at 31 December 2016 had 42 employees).

The Bank's Company registration number is 21080608. The Tax Identification Number assigned to the Bank is 108851504.

In 2017 the Bank did not acquire any Treasury Shares nor does it have any Treasury Stock (stock of its own shares).

In 2017 the Bank did not conduct any research and development activities.

2.2 Mission and Vision Statement

Our mission is to support economic growth of the countries we operate in by providing transparent and sustainable financial services.

.

Our vision is to become internationally recognized as an innovative bank which brings economic growth to the countries where we operate in and to our stakeholders.

2.3 Core Values

2.4 Major Strategic Objectives

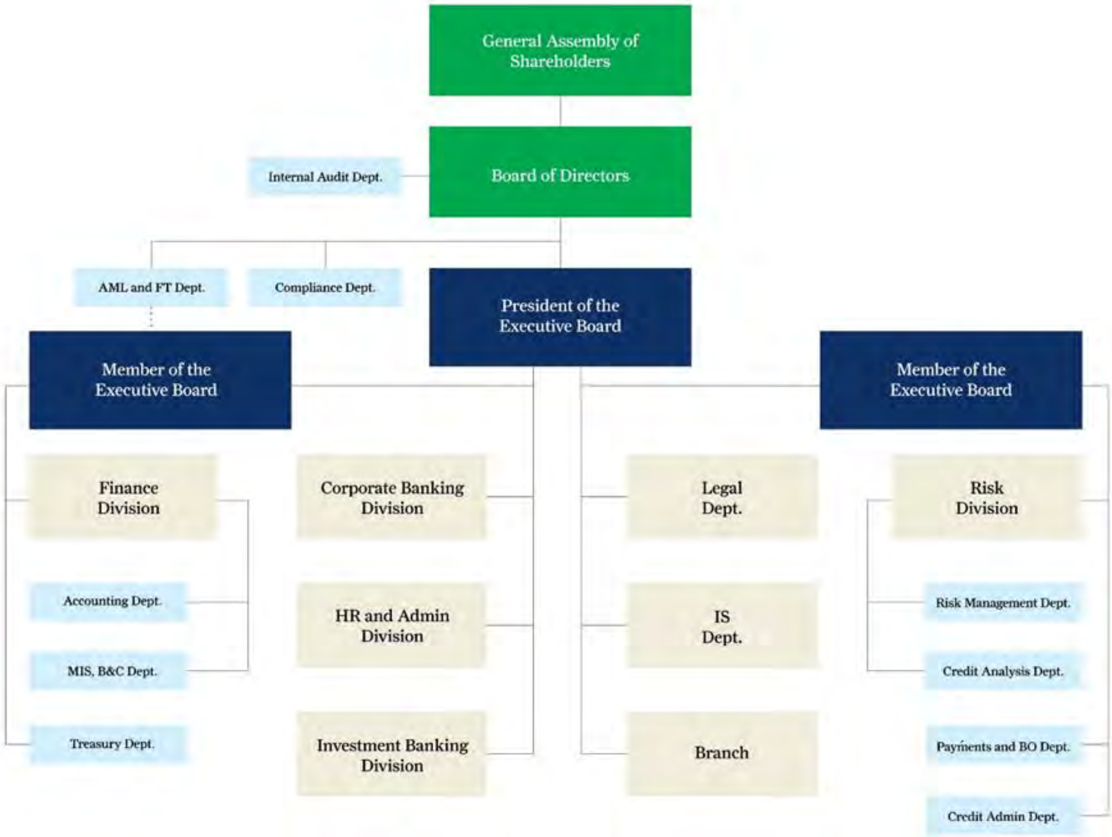
As an ultimate roadmap to the Vision, the Bank's Management has defined top Strategic goals for the next three years:	To be high-end professional corporate and investment bank providing tailor-made products and services to its clients
	To achieve excellence in customer service and execution time relying on flexibility and slim and efficient decision making process
	To implement and maintain strict risk controls to achieve development of healthy loan portfolio and it's balanced and stable growth
	To develop and steadily expand deposit funding base by being recognized as a trustworthy partner
	To maintain strong capital position through close monitoring of customers and human approach in risk management;
	To manage liquidity in the most appropriate and optimal manner, always taking the least possible risk and protecting customers' deposits and shareholder's capital;
	To control costs by implementing robust controls over expenditure and apply the concept of shared services in order to achieve "above the market average" efficiency rates.

2.5 The team

Board of Directors	Mr. Hamad Al Shamsi, Chairman
	Mr. Majed Odeh, Member
	Mr. Mahmood Mohamed Al Mahmood, Member
	Mr. Mustafa Kheriba, Member
	Mr. Vladimir Radić, Independent member
	Mr. Dejan Nikolić, Independent member

Executive Committee	Dr. Ilinca Rosetti, Chairperson
	Mr. Saša Mićević, Member
	Ms. Mirjana Garapić Zakanyi, Member

2.6 Organization



3 WHAT makes us different

3.1 Our Identity

The Bank is devoting significant efforts in creation of identity and increase of brand recognition of the Bank. The Bank intends in the future to continue with those activities, for the purpose of positioning, however, mainly through Below-The-Line communication and networking efforts since the nature of its business is related mainly to corporate clients where the best results are achieved on one-to-one relationship.

The Bank plans to have a marketing strategy that is based on targeted campaigns that will be directly addressed to target groups, namely: large and medium-sized businesses, their managers and owners, as well as a number of private individuals who want to avoid a massive banking approach.

3.2 Our Approach

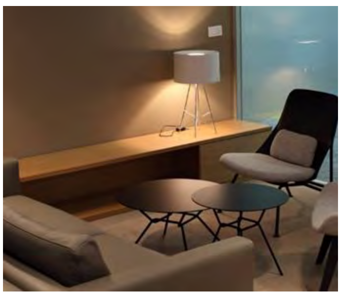
Our detailed, analytical and comprehensive approach and our firm belief in two-way communication provide us with the best understanding of your business ideas and targets. As each client is unique, we tailor our offers and services to your specific needs, taking all aspects carefully into account.

We take a methodical and meticulous approach to every client and situation, making us your first choice in personalized banking. Our detailed, analytic and comprehensive work and our firm belief in two-way communication provide us with the best understanding of their business ideas and targets. As each client is unique, we tailor our offers and services to their specific needs, taking all aspects carefully into account.

3.3 One-stop Shop

We believe that the time is the most precious thing in business and in professional and private life. Therefore we allocate special care to our customers trying to offer them complete service within our business premises with single visit.

3.4 Business Lounge



We believe that great business requires great partnerships, forged through mutual trust and understanding of each other's needs.

Every business relationship requires a space in which it will develop and grow. That is why our fully equipped banking centre includes a lounge – a pleasant space, available to our clients and their partners, for informal meetings, networking, exchange of ideas, or as a waiting room during regular bank business hours.

3.5 Partner advisors

In order to enable our clients a full advisory service along with the banking and financial services, Mirabank entered into strategic partnerships with PWC.

In the light of these partnerships, Mirabank plays the role of “one-stop-entry” for its clients and, in the frame of their relationship with Mirabank, enables them access to information and advice through its 1. Class partners.

Business advice, strategy & management consulting, tax issues, legal framework, deal structuring, financial planning, company set-up, joint ventures, M&A, privatizations, greenfield investments, etc.

3.6 Complementary services

The Bank’s approach is reflected through the organization of exclusive networking events, as Mirabank Business club at SQ9, then through an exclusive magazine that gets personally Bank’s target group and which is a part of the Bank’s communication with current and future clients (LUMEN).

Besides enabling our clients to have meetings in our branch, we offer them an exclusive space for networking on a weekly basis through the establishment of the Mirabank BUSINESS CLUB at Square Nine.

We complement our partnership with clients by giving them access to exclusive business intelligence and finely curated content that is not available elsewhere.

Mirabank’s unique approach is illustrated also in LUMEN – our magazine, dedicated to showcase the stories that matter and to provide deep insights that inspire and drive innovation.

3.7 Investments in Environmental Sustainability and Social Responsibility

In 2017. Bank participated in socially responsible activities (BELhospice donation scheme), thus confirming its dedication as a socially responsible company.

On the occasion of Savings Week 2017, Mirabank started promoting a unique message - "Through Savings We Donate". This is a pioneer concept within Serbia's banking market and is meant to support the activities of BELhospice, a local charitable organisation.

Within the framework of that campaign, which was promoting an attractive fixed nominal annual interest rate on EUR term deposits, Mirabank has, from its own funds, added 10% of the interest amount to be paid to the client and has donated that amount to BELhospice, a palliative care centre which cares for cancer patients during the terminal phase of their illness.

Mirabank has created a mechanism that will help those in need and will simultaneously satisfy the needs of those who have money to save. This unique service offers the market not only a good interest rate, but it also gives to those who wish to deposit funds the opportunity to participate in a humanitarian project. Anyone who would like to contribute to this mission and support a good cause can save with Mirabank and as a result, they will determine Mirabank's donation to BELhospice through the amount they choose to save.

The Bank did not participate in environment protection programs. However, Mirabank is committed to improving the environment in how the Bank approach its global business strategy, work with partners and support Bank's employees. The Bank is committed in supporting low-carbon and sustainable business activities, to develop solutions to climate change and other environmental challenges. We need to stress out that we are heavily involved in renewable energy projects through our investment banking business. Having in mind the culture of the shareholders, it is expected that the Bank will actively participate in such efforts in the future.

4 WHAT we offer

4.1 Executive banking

Executive banking is our exclusive banking solution for corporate clients. We are aware that your trust has to be earned every single day. We deeply believe we can achieve that by providing you with competent advice, keeping you appropriately informed and giving you the support you need and deserve. Your dedicated relationship manager is like a personal assistant you can turn to for help at any time. He or she will be delighted to communicate with you in a way that suits you and your workflow the best, and in as much detail as you desire.
Mirabank Executive banking is an exclusive solution for your business, consisting of a comprehensive set of products and services, tailored to your business needs, by your dedicated advisor, who is at your full disposal throughout our cooperation.

Accounts	Resident
	Non-resident
	Local & Foreign currency
Reporting	MT940 (end of day)
	MT942 (intra day)
Payables	Cash
	Outgoing Payments (Local)
	Outgoing Payments (International)
Receivables	Cash
	Bill of exchange collections
	Incoming Payments
	Incoming Payments (International)
Deposits	A vista
	Transactional
	Overnight
	Structured Deposits
Foreign Exchange	Foreign Exchange: Spot - Forward

Electronic Banking	Asseco
	Halcom
Documentary instruments	Issuance of Import / Export LCs, Shipping guarantees
	Confirmation/ advising of Exports LCs
	Discounting of Export LCs with deferred payment
	Documentary collections
Financial Guarantees	Bid Bonds
	Performance bonds
	Advance LG
	SBLCs
ST Financing	Straight Loan/Overdraft
	Roll Over/Revolving
MT - LT Financing	MT Investment Loan
	Mortgage Loan
Structured Finance	Acquisition Finance
	Restructuring
	Leveraged Finance
	Project Finance

4.2 Prime banking

Prime banking is the premium banking solution for private individuals.

As each client is unique, we tailor our offers and services to your specific needs, taking all aspects carefully into account. Clients value our personalised approach, reliability as a partner, and the unique experience we deliver.

- Products and services
    - Current accounts in local and foreign currencies,
    - Transactional and term deposits,
    - Savings accounts,
    - SMS balance control,
    - E-banking services,
    - Mobile services.

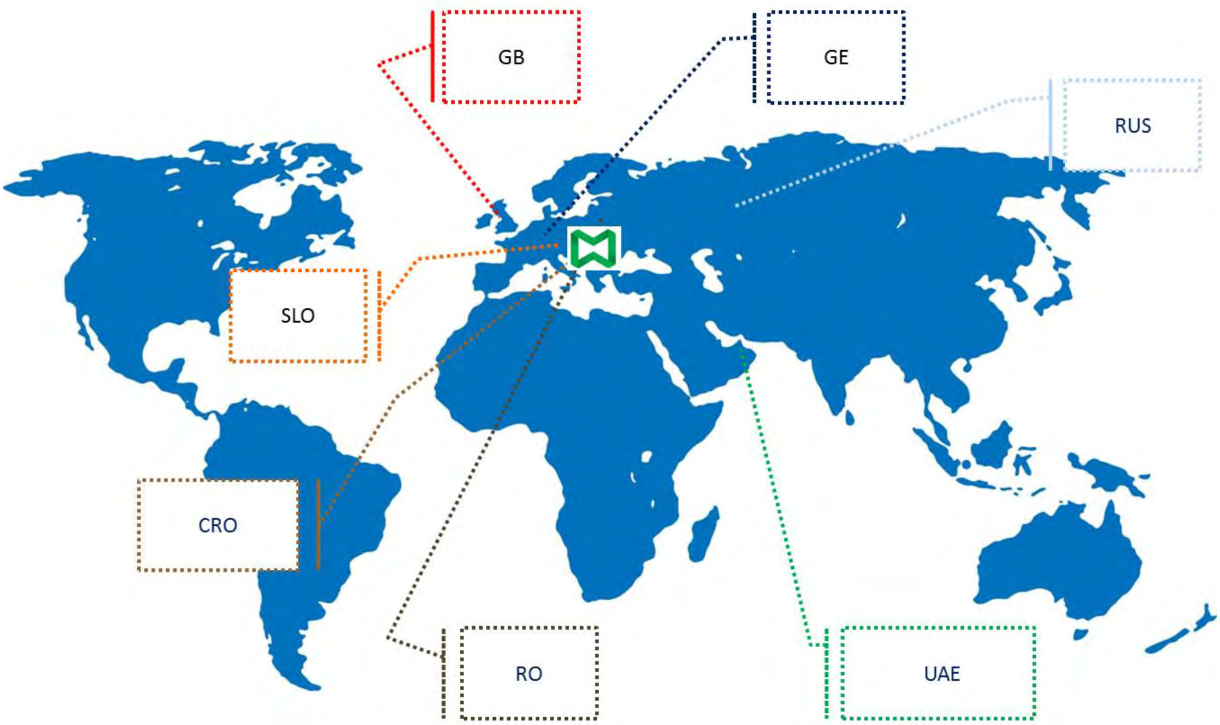
- Exclusive set of products
    - Personal advisor
    - No waiting services in our exclusive client lounge
    - Free national money transfer via e-banking and mobile banking
    - High interest rates on term deposits.

4.3 Investment banking

We offer Investment advisory services to our clients, including Transaction advisory and Capital structure advisory, as well as Valuation, Research, Assistance in selection of other professional advisers and enabling Stakeholder communication.

Transaction advisory	Capital structure advisory	Complementary services
Mergers and Acquisitions	Company and /or project business and financial analysis	Valuation
Privatizations	Risk analysis and stress testing	Research
Restructurings	Assessment of strategic options, structure of debt and equity financing	Assistance in selection of other professional advisers
Sourcing potential investors	Source and assist to negotiate new/adjusted financing	Stakeholder communication
Managing transaction process	Lead execution of financial restructuring plan	

We partner up with various “local” advisory firms around the world with whom we have established business relationships which enable us to present to them and indirectly to their pool of investors investment opportunities from wider Balkan region.



5 Our Business Focus 2018-2020

Mirabank is structured as a boutique bank extends its products and services mainly to corporates clients, medium-sized and large businesses. The Bank provide these clients with all banking services, focusing on financing and trade finance support and coupled with other services such as acceptance of deposits, processing of payments and other services.

Since 2016 the Bank expanded its business operations into the field of investment banking. Key focus in investment banking activities is to secure deal flow in financial advisory (M&A transactions and debt advisory) for buy-side and sell-side clients operating in different industries. Besides other international clients interested in investing in the region, primary customers in this business segment of the Bank are investors originating from UAE and Middle East as well as local companies aiming to attract funding for business growth.

The Bank also provides services to private individuals with limited scope. These are mainly transactional services and deposit products with the plan to extend the offer to advisory, private banking and wealth management services once the market conditions become appropriate and demand is created.

It will be achieved through making strong and personal relations with future clients and offering competitive products with tailor made service towards each individual client's needs and capabilities. Attention will be paid on the achievement of excellence in customer services, setting standards in corporate and investment banking business. Simultaneously, tailored financing products as well as financial advisory, through Executive banking package, will be offered to high potential SMEs which are considered to be the main driver of the economic development in economies in transition. Executive banking package is unique product on Serbia market and bank is a pioneer of combining commercial banking services together with advisory services through the partnership with PricewaterhouseCoopers Serbia and tier 1. Bank will continue to improve quality and diversity of services for corporate clients.

Bearing in mind the strategy of the Bank, the Bank does not plan to have a large number of clients, but plans to have a limited number of highly-potential clients who will get the service they have not experienced on the Serbian market. Given the number of planned employees, KPI are adopted in accordance with the annual budget of the Bank.

In next three years Bank will be also focused on more profitable projects with higher interest rates, e.g. project finance - real estate, agriculture/food and renewable energy.

6 Overview of financial aspect and results of operations

INCOME STATEMENT

For the period 1 January to 31 December

(In thousands of RSD)

	2017	**2016**
Interest income	191,021	133,519
Interest expenses	(74,402)	(34,065)
Net interest income	**116,619**	**99,454**
Fee and commission income	23,166	15,557
Fee and commission expenses	(4,056)	(2,791)
Net fee and commission income	**19,110**	**12,766**
Net (loss)/gain on financial assets held for trading	(118,897)	124,698
Net income/(expense) on foreign exchange rate differences and effects of foreign currency clause	131,793	(103,623)
Other operating income	4,220	6,811
Net expenses on impairment of financial assets and credit risk-weighted off-balance sheet items	(2,886)	(11,628)
Net operating income	**149,959**	**128,478**
Salaries, salary compensations and other personal expenses	(243,651)	(230,741)
Depreciation and amortisation expenses	(86,341)	(74,170)
Other expenses	(306,659)	(264,082)
LOSS BEFORE TAX	**(486,692)**	**(440,515)**
Deferred tax loss	1,319	(2,799)
LOSS AFTER TAX	**(485,373)**	**(443,314)**

BALANCE SHEET STATEMENT

As at December 31

(In thousands of RSD)

	31 December 2017	31 December 2016
ASSETS		
Cash and balances with the central bank	382,825	875,578
Financial assets at fair value through profit or loss held for trading	5,800	124,698
Financial assets available for sale	1,387,095	2,050,876
Loans and advances to banks and other financial institutions	1,706,061	1,734,431
Loans and advances to customers	2,200,643	2,509,710
Intangible assets	211,679	238,937
Property, plant and equipment	114,390	150,423
Other assets	14,234	13,233
Total assets	**6,022,727**	**7,697,886**
LIABILITIES		
Deposits and other liabilities to banks, other financial institutions and central bank	41,250	30,839
Deposits and other liabilities to customers	2,258,537	3,444,564
Subordinated liabilities	1,184,958	1,235,022
Provisions	5,971	4,841
Deferred tax liabilities	13,391	14,710
Other liabilities	49,910	35,173
Total liabilities	**3,554,017**	**4,765,149**
Equity		
Share capital	3,631,200	3,631,200
Accumulated loss	(1,189,845)	(704,472)
Reserves	27,355	6,009
Total equity	**2,468,710**	**2,932,737**
Total liabilities and equity	**6,022,727**	**7,697,886**

6.1 Net interest income

In thousands of RSD	1 January – 31 December 2017	1 January – 31 December 2016
a) Interest income		
Deposited excess liquidity with NBS	5,500	17,989
Interest income on loans to REPO transaction with NBS in RSD	287	2,036
Interest income from domestic banks based on a overnight deposit	1,015	867
Deposits in foreign currency with NBS	2,258	929
Securities of the Republic of Serbia in RSD	38,787	49,446
Mandatory reserves in RSD with NBS	5,218	2,441
Short-term loans to corporates	67,814	42,769
Long-term loans to corporates	70,024	17,042
Interest income from foreign banks	118	-
Total interest income	**191,021**	**133,519**
b) Interest expenses		
Foreign currency accounts with NBS	(2,961)	(1,124)
Subordinated liabilities of foreign legal entities, in foreign currency	(3,164)	(2,676)
Short-term deposits of legal entities in foreign currencies	(51,287)	(28,709)
Overnight of legal entities in RSD	(2,866)	(269)
Interest expense on overnight domestic banks deposits in RSD	(173)	-
Short-term special purpose deposits of legal entities in RSD	(12,750)	(565)
Interest expense on short-term bank deposits	(40)	-
Short-term deposits of insurance organizations in RSD	(452)	(718)
Interest expense on individual time deposits in foreign currency.	(709)	-
Other	-	(4)
Total interest expenses	**(74,402)**	**(34,065)**
Net interest income	**116,619**	**99,454**

6.2 Net fee and commission income

In thousands of RSD	1 January – 31 December 2017	1 January – 31 December 2016
a) Fee and commission income		
Fees and commissions on guarantees	11,541	3,518
Income from fees from non-residents	2,976	4,690
Fees from legal entities from domestic payment operations	5,562	3,893
Fees from legal entities by remittance	1,841	3,038
Card fees and commissions	229	-
Escrow account maintenance fees	280	-
Other	737	418
Total fee and commission income	**23,166**	**15,557**
b) Fee and commission expenses		
Fees and commissions to NBS	(1,692)	(1,272)
Fees and commissions to other banks	(2,153)	(1,412)
Card fees and commissions	(8)	-
Other	(203)	(107)
Total fee and commission expenses	**(4,056)**	**(2,791)**
Net fee and commission income	**19,110**	**12,766**

6.3 Net gains on financial assets held for trading

In 2017, derivatives were presented at fair value, based on which decrease was recorded in net loss on financial assets held for trading in the amount of RSD 118,897 thousand (in 2016 on this basis there was net gain of RSD 124,698 thousand)

Part of the income from the change in value of derivatives held for trading relating to increase in fair value, arising from exchange differences, compensates the amount of foreign exchange losses and the effects of foreign currency clause.

6.4 Net income/ (expense) on foreign exchange rate differences and effects of foreign currency clause

In thousands of RSD	**1 January – 31 December 2017**	**1 January – 31 December 2016**
Net income/ (expense) from foreign exchange rate differences		
from cash	(22,975)	(17,545)
from given loans and placements	(189,395)	67,426
from swap transaction	(124,146)	(841)
from buying/selling foreign currency	917	4,977
from other receivables	(18,085)	2,027
from impairment	3,793	116
from foreign currency	503,846	(152,546)
from received loans	49,996	(12,015)
from other liabilities	1,734	(183)
from state securities	(4,261)	-
from other position	393	(11)
from passive interest	(2,607)	(1,258)
Net income/(expense) from foreign exchange rate differences	**199,210**	**(109,853)**
Net income/(expense) from the effect of contractual foreign currency clause		
from loans and placements	(67,886)	6,386
from impairment value	407	-
from other line items	62	(156)
Net Income/(expense) from contractual foreign currency clause	**(67,417)**	**6,230**
TOTAL INCOME/(EXPENSE) FROM FOREIGN EXCHANGE DFFERENCES AND FOREIGN CONTRACTUAL CURRENCY CLAUSE	**131,793**	**(103,623)**

6.5 Other operating income

In thousands of RSD	**1 January – 31 December 2017**	**1 January – 31 December 2016**
Income from reversal of provision expenses	-	6.804
Revenues on the basis of damages	12	7
Income from services rendered to non-resident individuals	3,703	-
Income from supplier returns	130	-
Other income	375	-
Other operating income	**4,220**	**6,811**

6.6 Net expenses on impairment of financial assets and credit risk-weighted off-balance sheet items

a) Impairment losses

As at 31 December 2017 the Bank had expenses from impairment of financial assets and the credit risk off balance sheet items.

	1 January – 31 December 2017	**5 February – 31 December 2016**
Losses from impairment:		
- balance sheet items	(1,413)	(10,237)
- off-balance sheet items	(1,473)	(1,391)
	(2,886)	**(11,628)**

b) Special reserve for estimated losses

Based on categorization of placements determined in conformity with the regulations of the National Bank of Serbia as at 31 December 2016, the required reserve for estimated losses based on total exposure of the Bank to the credit risk is assessed:

	31 December 2017	**31 December 2016**
Required reserves from gains for estimated losses in balance-sheet assets and off-balance sheet items:		
- balance sheet items	16,410	92,280
- off-balance sheet items	3,259	24,753
	19,669	**117,033**

As at 31 December 2017, the required reserve for estimated losses which might arise from balance sheet assets and off-balance sheet items, calculated in accordance with the Decision of the National Bank of Serbia, ("Official Gazette of the Republic of Serbia", No. 94/2011, 57/2012, 123/2012, 43/2013, 113/2013, 135/2014, 25/2015, 38/2015, 61/2016, 69/2016, 91 / 2016, 101/2017 and 114/2017), amounts to RSD 19,669 thousand (31 December 2016 amounts to RSD 117,033 thousand).

6.7 Salaries, salary compensations and other personal expenses

In thousands of RSD	**1 January – 31 December 2017**	**5 February – 31 December 2016**
Cost of net earnings	(209,432)	(193,474)
Taxes and contributions on salaries	(25,068)	(22,951)
The cost of compensation for members of the BoD	(6,914)	(9,299)
Income/(expenses) from cancellation/(creation) provisions for annual leave and pension (IAS 19)	266	(558)
Other personal expenses	(2,503)	(4,459)
Salaries, salary compensations and other personal expenses	**(243,651)**	**(230,741)**

6.8 Depreciation and amortisation expenses

In thousands of RSD	**1 January – 31 December 2017**	**5 February – 31 December 2016**
The cost of depreciation of property, plant and equipment	(43,300)	(39,928)
Amortization of intangible assets	(43,041)	(34,242)
Depreciation expenses	**(86,341)**	**(74,170)**

6.9 Other expenses

In thousands of RSD	1 January – 31 December 2017	5 February – 31 December 2016
Facility expenses	(63,499)	(62,180)
ICT expenses	(87,448)	(68,342)
Professional services	(29,299)	(31,953)
Marketing	(49,180)	(46,205)
Insurance expenses	(10,071)	(5,438)
Deposit insurance agency	(3,196)	(1,632)
Retirements and impairment expenses	(12,209)	-
Other administrative expenses	(51,757)	(48,332)
Total other expenses	**(306,659)**	**(264,082)**

The Bank pays the rent to legal entities for its business premises under concluded lease agreements. The agreed lease periods are five years. The rent includes currency clause, and it is payable on monthly basis. Costs of business premises lease in 2017 amounted to the total of RSD 63,499 thousand (31 December 2016 amounted to RSD 62,180 thousand). In this category of costs, there are also the costs of maintenance of the premises (as defined in the Lease Agreement) as well as utility costs and all other expenses that are directly related to the use of the premises of the Bank.

6.10 Income Tax

a) Income tax components

	In thousands of RSD 31 December 2017	31 December 2016
Tax expenses for the period on the basis of deferred tax	1,319	(2,799)
	1,319	**(2,799)**

b) Deferred tax liabilities

Deferred tax liabilities relating to temporary differences between the carrying value of fixed assets and intangible assets and their tax base, due to the application of different rates of depreciation and revaluation of fixed assets. As at 31 December 2017, there were recorded deferred tax liabilities in the amount of RSD 13,391 thousand (31 December 2016 amounted of RSD 14,710 thousand).

c) Overview of tax loss carried forward from preceding periods

Year of loss	Amount of loss	Amount of used loss	Remaining losses carried forward	Year up to which loss can be carried forward
2015	317,942	-	317,942	2020
2016	485,393	-	485,393	2021
2017	536,116	-	536,116	2022
Total	**1,339,451**	**-**	**1,339,451**	

According to the Corporate Income Tax Law, since 27 March 2010, the time limit for tax loss carried forward is decreased from 10 to 5 years. The Bank did not recognize the carried forward tax losses as deferred tax assets as at 31 December 2017, due to uncertainty of income earning in the following years against which these losses could be used.

d) Deferred tax components

As at 31 December 2017, deferred taxes were calculated and corresponding bookings were entered. The deferred tax components are as follows:

	In thousands of RSD	
	31 December 2017	**31 December 2016**
Deferred tax liabilities	(13,748)	(15,103)
Deferred tax assets on provisions for retirement	357	393
	(13,391)	**(14,710)**

6.11 Cash and balances with the central bank

In thousands of RSD	**31 December 2017**	**31 December 2016**
Gyro account	50,431	292,250
Cash on hand in RSD	5,736	7,307
Deposited excess liquidity with NBS	180,000	89,000
Interest receivables from NBS	30	12
RSD cash	**236,197**	**388,569**
Cash on hand in foreign currency	30,154	13,371
Mandatory reserve in foreign currency with NBS	116,474	473,638
Foreign currency cash	**146,628**	**487,009**
Balance as at 31 December	**382,825**	**875,578**

The RSD mandatory reserve is the minimum RSD reserve allocated in compliance with the Decision of the National Bank of Serbia on Bank's Mandatory Reserve with the National Bank of Serbia ("Official Gazette of the Republic of Serbia", 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).

The RSD base for calculation of the mandatory reserve is comprised of the daily average of reservable RSD liabilities in preceding calendar month, excluding the currency clause-indexed RSD liabilities.

RSD liabilities are comprised of liabilities in respect of RSD deposits, credits and securities, and other RSD liabilities excluding RSD deposits received under transactions performed by the bank on behalf and for the account of third parties, that are not in excess of the amount of investment made from such deposits.

The National Bank of Serbia pays interest to banks on the amount of average daily balance of allocated RSD mandatory reserve in the accounting period not exceeding the amount of gross calculated RSD mandatory reserve, for all days of the accounting period – at the interest rate set by the decision on interest rates applied by the National Bank of Serbia in the implementation of monetary policy.

The Bank is obliged to maintain throughout an accounting period an average daily balance of allocated RSD mandatory reserve at the amount of calculated RSD mandatory reserve. The calculated RSD mandatory reserve for December 2017 was RSD 108,682 thousand (December 2016 was RSD 290,012 thousand and was compliant with the aforementioned Decision of the National Bank of Serbia. The interest rate on the amount of allocated RSD mandatory reserve during 2017, on annual level, amounted to 1.75%.

The required foreign currency reserve is the minimum reserve in foreign currency allocated in compliance with the Decision of the National Bank of Serbia on Bank's Mandatory Reserve with the National Bank of Serbia ("Official Gazette" of the Republic of Serbia nos. 3/2011, 31/2012, 57/2012, 78/2012, 87/2012,107/. 62/2013, 125/2014, 135/2014, 4/2015, 78/2015 and 102/2015) stipulating that banks shall calculate the foreign currency mandatory reserve at the rate of:

- 20% – on the foreign currency base portion comprised of liabilities maturing in less than two years, and/or 730 days and, exceptionally, at 100% rate for the foreign currency base portion comprised of currency clause-indexed RSD liabilities maturing in less than two years and/or 730 days,

- 13% – on the foreign currency base portion comprised of liabilities maturing in more than two years, and/or 730 days and, exceptionally, at 100% rate for the foreign currency base portion comprised of currency clause-indexed RSD liabilities maturing in more than two years and/or 730 days.

Foreign currency liabilities are the liabilities in respect of foreign currency deposits, credits and securities and other foreign currency liabilities, as well as deposits, credits and other foreign currency funds received from abroad under transactions performed by the bank on behalf and for the account of third parties.

The bank allocates the mandatory reserve calculated on the foreign currency base to the foreign currency account of the National Bank of Serbia. The bank is obliged to maintain throughout an accounting period the average daily balance of allocated foreign currency mandatory reserve at the amount of calculated foreign currency mandatory reserve. The National Bank of Serbia does not pay any interests on the amount of achieved average balance of allocated foreign currency reserve. The foreign currency base for calculation of the mandatory reserve is comprised of the daily average reservable balance of foreign currency liabilities in the preceding calendar month and the average daily reservable balance of currency clause-indexed RSD liabilities in the preceding calendar month.

The bank which achieved the average daily balance of allocated foreign currency mandatory reserve at the amount in excess of the calculated one – pays to the National Bank of Serbia the interest on the amount of difference between the achieved daily balance of allocated foreign currency mandatory reserve and calculated foreign currency mandatory reserve, for all days of the accounting period, at the interest rate set by the decision on interest rates applied by the National Bank of Serbia in the procedure of implementing the monetary policy. Daily average balance of allocated foreign currency mandatory reserve in the accounting period exceeds the calculated foreign currency mandatory reserve in the period.

As at 31 December 2017, the Bank's foreign currency mandatory reserve was compliant with the Decision of the National Bank of Serbia.

6.12 Financial assets at fair value through profit or loss held for trading

Financial assets at fair value through profit or loss held for trading include effects of fair value change of derivatives through the income statement:

6.13 Financial assets available for sale

The bank as at 31 December 2017 in its portfolio had government bonds and treasury bills amounting to RSD 1,387,095 thousand (in 2016 RSD 2,050,876 thousand).

In thousands of RSD	**31 December 2017**	**31 December 2016**
Bonds of Republic of Serbia	691,307	825,952
Treasury bills	695,788	1,224,924
Balance as at 31 December	**1,387,095**	**2,050,876**

6.14 Loans and advances from banks and other financial institutions

In thousands of RSD	31 December 2017	31 December 2016
Regular foreign currency accounts with foreign banks	867,914	474,005
Cash balances with the Central Securities Registry	4,839	4,939
Avista dedicated foreign currency deposits in foreign currency at NBS	473,838	502,758
Special purpose guarantee deposit in foreign currency VISA	10,025	11,714
OVERNIGHT investments with domestic banks in foreign currency	-	370,417
Short-term deposits with domestic banks in foreign currency	349,493	370,417
Accruals for interest calculated on the basis of RSD required reserves (NBS)	74	183
Allowance for impairment	(122)	(2)
Balance as at 31 December	**1,706,061**	**1,734,431**

Changes in allowance for impairment:

In thousands of RSD	31. 12.2017.	31. 12.2016.
Balance as at 31 December of previous year	**(2)**	**-**
Increase during the year	(120)	(2)
Balance as at 31 December	**(122)**	**(2)**

6.15 Loans and advances to customers

In thousands of RSD	**31 December 2017**	**31 December 2016**
Receivables from loans to customers	2,211,168	2,523,197
Receivables from interests and fees	7,141	3,281
Total	**2,218,309**	**2,526,478**
Deferred loan origination fee	(7,038)	(6,541)
Impairment provision for loans and advances to customers	(10,628)	(10,227)
Balance as at 31 December	**2,200,643**	**2,509,710**

Structure of loans and advances to customers

In thousands of RSD	**31.12.2017.**	**31.12.2016.**
Interests and fees	**7,141**	**3,281**
Short-term placements	**907,200**	**2,030,855**
In RSD and with currency clause	907,200	1,213,993
In foreign currency	-	816,862
Long-term placements	**1,303,968**	**492,342**
In RSD and with currency clause	711,604	492,342
In foreign currency	592,364	-
Gross placements to customers	**2,211,168**	**2,523,197**
Deferred loan origination fee		
Short-term placements	**(2,111)**	**(3,800)**
In RSD and with currency clause	(2,111)	(3,800)
In foreign currency	-	-
Long-term placements	**(4,927)**	**(2,741)**
In RSD and with currency clause	(4,927)	(2,741)
In foreign currency	-	-
Total deferred loan origination fee:	**(7,038)**	**(6,541)**
Allowance for impairment		
Interests and fees	(45)	(7)
Short-term placements	(7,833)	**(9,873)**
In RSD and with currency clause	(7,833)	(7,705)
In foreign currency	-	(2,168)
Long-term placements	(2,750)	**(347)**
In RSD and with currency clause	(2,297)	(347)
In foreign currency	(453)	-
Total allowance for impairment	**(10,628)**	**(10,227)**
Net investments to customers		
Interests and fees	**7,096**	**3,274**
Short-term placements	**897,256**	**2,017,182**
In RSD and with currency clause	897,256	1,202,488
In foreign currency	-	814,694
Long-term placements	**1,296,291**	**489,254**
In RSD and with currency clause	704,380	489,254
In foreign currency	591,911	-
Total net Loans and advances to customers:	**2,200,643**	**2,509,710**

Changes in allowance for impairment:

In thousands of RSD	31 December 2017	31 December 2016
Balance as at 31 December previous year	**(10,227)**	**-**
Increase during the year	(401)	(10,227)
Balance as at 31 December	**(10,628)**	**(10,227)**

Loans and advances to customers

In 2017, the Bank continued with credit activities by granting short-term and long-term loans to legal entities. In the mentioned period, the approved loans were: (a) short-term loans: in RSD with interest rate ranging from 4.00% to 12.00%, in foreign currency with interest rate of 2.00% and in RSD with a currency clause with interest rate ranging from 2.00% to 3.90%; and (b) long-term loans, such as: in RSD, with interest rate ranging from 5.80% to 6.64%, in foreign currency with interest rate from 2.329% and in RSD with currency clause in the range of 2.03% to 5.73% and in foreign currency at the interest rate of 2.35%

6.16 Intangible assets

Structure and changes in intangible assets during 2017 are presented in the table below:

In thousands of RSD	Software	Licenses	Intangible assets in progress	Total
Purchase value				
Balance as at 1 January 2016	**210,017**	**15,638**	**2,957**	**228,613**
Purchase during the year	-	-	55,354	55,354
Transfer from investments in progress	43,715	7,322	(51,037)	-
Balance as at 31 December 2016	**253,732**	**22,960**	**7,274**	**283,966**
Balance as at 1 January 2017	**253,732**	**22,960**	**7,274**	**283,966**
Purchase during the year	-	-	15,783	15,783
Transfer from investments in progress	19,977	-	(19,977)	-
Balance as at 31 December 2017	**273,709**	**22,960**	**3,080**	**299,749**
Impairment				
Balance as at 1 January 2016	**10,004**	**783**	**-**	**10,787**
Amortisation	30,918	3,324	-	34,242
Balance as at 31 December 2016	**40,922**	**4,107**	**-**	**45,029**
Balance as at 1 January 2017	**40,922**	**4,107**	**-**	**45,029**
Amortisation	38,212	4,829	-	43,041
Balance as at 31 December 2017	**79,134**	**8,936**	**-**	**88,070**
Net book value as at 31 December 2017	**194,575**	**14,024**	**3,080**	**211,679**
Net book value as at 31 December 2016	**212,810**	**18,853**	**7,274**	**238,937**

The Bank does not possess any intangible assets estimated to have an unlimited useful life as at 31 December 2017. Further to the estimate of the Bank's management, as at 31 December 2017 there are no indications that the value of intangible assets is impaired.

6.17 Property, plant and equipment

The structure and changes in property, plant and equipment during 2017 are shown in the table below:

In thousands of RSD	Equipment and other fixes assets	Investments in fixed assets of other legal entities	Fixed assets in progress	Total
Purchase value				
Balance as at 1 January 2016	**104.441**	**68.128**	**1.101**	**173.670**
Purchase during the year	-	-	26.981	26.981
Transfer from investments in progress	16.824	9.513	(26.337)	-
Balance as at 31 December 2016	**121.265**	**77.641**	**1.745**	**200.651**
Balance as at 1 January 2017	**121.265**	**77.641**	**1.745**	**200.651**
Purchase during the year	-	-	11.369	11.369
Impairment during the year	-	(7.189)	-	(7.189)
Transfer from investments in progress	9.937	128	(10.065)	-
Balance as at 31 December 2017	**131.202**	**70.580**	**3.049**	**204.831**
Impairment				
Balance as at 1 January 2016	**6.055**	**4.245**	**-**	**10.300**
Depreciation	24.771	15.157	-	39.928
Balance as at 31 December 2016	**30.826**	**19.402**	**-**	**50.228**
Balance as at 1 January 2017	**30.826**	**19.402**	**-**	**50.228**
Amortisation	27.012	16.288	-	43.300
Decrease	-	(3.087)	-	(3.087)
Balance as at 31 December 2017	**57.838**	**32.603**	**-**	**90.441**
Net book value as at 31 December 2017	**73.364**	**37.977**	**3.049**	**114.390**
Net book value as at 31 December 2016	**90.439**	**58.239**	**1.745**	**150.423**

The Bank does not possess any property, plants and equipment estimated to have an unlimited useful life. As at 31 December 2017, the Bank is in possession of the assets it avails with and has no encumbrance on property. Further to the estimate of the Bank's management, as at 31 December 2017 there are no indications that the value of fixed assets and investments in leased business premises is impaired. Part of the investment in leased office space has been written off, because the management of the Bank made the decision to rent a smaller area of office space in a relation to 2017. Investments in office space that will no longer be used, in the amount of RSD 7,189 thousand. The net book value of written-off investments was RSD 4,102 thousand.

6.18 Other assets

Other assets include:

In thousands of RSD	31 December 2017	31 December 2016
Receivables from advances paid for current assets	486	395
Receivables from advances paid for fixed assets	1,195	1,923
Prepaid costs	1,427	2,217
Petty inventory in use	616	2,823
Fees from legal entities and receivables from employees	448	147
Receivables in the calculation, fees refunded by the client	1,148	-
Deferred other costs	10,065	-
Other	104	6,250
Other assets	**15,489**	**13,755**
Impairment of other assets	(1,255)	(522)
Balance as at 31 December	**14,234**	**13,233**

Changes on Impairment:

In thousands of RSD	31 December 2017	31 December 2016
Balance as at 31 December of previous year	**(522)**	**(367)**
Increase during the year	(733)	(155)
Balance as at 31 December	**(1,255)**	**(522)**

6.19 Deposits and other liabilities to banks, other financial institutions and central bank

In thousands of RSD	31 December 2017	31 December 2016
Transaction deposits	173	110
Short-term deposits	40,000	30,001
Liabilities for fees and commissions to NBS	75	10
Liabilities for fees and commissions to other banks etc.	1,002	718
Balance as at 31 December	**41,250**	**30,839**

6.20 Deposits and other liabilities to customers

In thousands of RSD	31 December 2017	31 December 2016
Corporate and retail		
Transaction deposits in RSD	197,587	64,736
Short-term deposits in RSD	471,500	-
Long-term deposits on loans in RSD	1,282	24,347
Overnight	76,788	509
Transaction deposits in foreign currency	382,803	950,202
Long-term deposits on loans in foreign currency	12,937	11,217
Short-term deposits in foreign currency	1,109,224	2,363,869
Accrued interest	3,134	-
Other liabilities in foreign currency	3,282	29,684
Balance as at 31 December	**2,258,537**	**3,444,564**

Short-term deposit are term deposits denominated in RSD and foreign currency with maturity up to 12 mouths. These deposits have interest rates ranging from 1.30% - 2.2% per annum (on foreign currency deposits) or from 0.30 to 4.30% (on RSD deposits).

Long-term foreign currency deposits from individuals were collected at the interest rate from 1.40% to 1.50% annually.

Changes in deposits and other liabilities to banks, other financial organizations and the central bank and customers during the year are presented below:

	2017	2016
Initial state		
Deposits and other liabilities to banks, other financial institutions and central bank	30,839	82
Deposits and other liabilities to other customers	3,444,564	76,939
Initial state as at 1 January	**3,475,403**	**77,021**
Net (outflow)/inflow from deposits	(648,705)	3,215,506
Foreign exchange differences	(503,846)	152,546
Deferred interest and other non-cash transactions	(23,065)	30,330
Final state		
Deposits and other liabilities to banks, other financial institutions and central bank	41,250	30,839
Deposits and other liabilities to other customers	2,258,537	3,444,564
Final state as at 31 December	**2,299,787**	**3,475,403**

6.21 Subordinated liabilities

Loans received in foreign currency

The Bank has long-term subordinated liabilities to Aflaj INVESTMENT LLC. , with contract of six mouth income payment, with annual interest rate of 6M Euribor increased for 0.50%, which amounted to 0.23% as at 31 December 2017 (31 December 2016 it amounted to 0.35%).

The structure of received loans per creditors, with balance as at 31 December 2017, is presented in the following table:

Creditor name	Agreed amount	Currency	31 December 2017 in EUR	Interest rate p.a.	Maturity date	Balance as at 31 December 2017 in 000 RSD
AFLAJ INVESTMENT LLC, Abu Dhabi	5,000,000	EUR	5,000,000	6m euribor+0,5%	30.10.2025.	592,364
AFLAJ INVESTMENT LLC, Abu Dhabi	5,000,000	EUR	5,000,000	6m euribor+0,5%	02.11.2025.	592,364
Deferred liabilities for accrued interest						230
Total						1,184,958

Creditor name	Agreed amount	Currency	31 December 2016 in EUR	Interest rate p.a.	Maturity date	Balance as at 31 December 2016 in 000 RSD
AFLAJ INVESTMENT LLC, Abu Dhabi	5,000,000	EUR	5,000,000	6m euribor+0,5%	30.10.2025.	617,362
AFLAJ INVESTMENT LLC, Abu Dhabi	5,000,000	EUR	5,000,000	6m euribor+0,5%	02.11.2025.	617,362
Deferred liabilities for accrued interest						298
Total						**1,235,022**

6.22 Provisions

In thousands of RSD	**31 December 2017**	**31 December 2016**
Provisions for retirement benefits	2,378	2,620
Provisions for employees' annual leave	806	830
Provisions for losses on off-balance sheet assets	2,787	1,391
Total	**5,971**	**4,841**

Changes in total provisions:

	Provisions for retirement benefits, in accordance with IAS 19	**Provisions for employees' annual leave, in accordance with IAS 19**	**Provisions for losses on off-balance sheet assets IAS 39**
Balance as at 1 January 2016	**2,474**	**418**	**-**
Increase	146	412	1,391
Decrease	-	-	-
Balance as at 31 December 2016	**2,620**	**830**	**1,391**
Balance as at 1 January 2017	**2,620**	**830**	**1,391**
Increase	-	-	1,396
Decrease	(242)	(24)	-
Balance as at 31 December 2017	**2,378**	**806**	**2,787**

The trends in provisions for potential losses in retirement pays and other purposes are presented in the above table. Provisions for retirement pay to employees are formed based on actuarial valuation, with balance on the balance sheet date, and these are recognized in the amount of the present value of expected future payments.

In compliance with its Rules of Procedure, the Bank is obliged to pay out retirement pays at the amount of two average gross salaries in the Republic of Serbia in the month preceding the month of payment, as per latest published information of the republic statistical authority.

The value of expected outflows was assessed using the average monthly salary in the Republic of Serbia in December 2017 and 7% (in 2016 was 7%), discount rate which represents an adequate rate according to IAS 19 "Employee Benefits" in the absence of a developed market of high-quality corporate bonds, which is the return on 10-year treasury bonds of the Republic of Serbia. The provision is assessed based on the Bank's Rules of Procedure and an assumed average salary increase at the rate of 3% (in 2016 was 4%) p.a, which is equal to the target inflation rate projected by NBS.

6.23 Other liabilities

In thousands of RSD	31 December 2017	31 December 2016
Suppliers	4,554	3,951
Guarantee commissions	2,736	3,033
Fees (to use a billboard, to highlight a company)	64	-
Prepaid expenses for legal fees	31,424	26,465
Taxes and contributions	1,392	1,671
Other liabilities arising from suspended accounts of legal entities - non-residents	9,622	-
Other	118	53
Total	**49,910**	**35,173**

6.24 Equity and reserves

As at 31 December 2017, the subscribed paid-in share capital of the Bank amounted RSD 3,631,200 thousand, consisted of 3,631,200 ordinary shares with par value of RSD 1 thousand.

Shareholder Structure

Duingraaf Financial Investments B.V., Hoogoorddreef 15, 1101BA Amsterdam, the Netherlands, is 100% shareholder of the Bank as at 31 December 2016.

Shareholder name:	**31 December 2017**		**31 December 2016**	
	No. of shares	**% ownership**	**No. of shares**	**% ownership**
Duingraaf Financial Investments B.V., Amsterdam, The Netherlands	3,631,200	100%	3,631,200	100%

The share capital structure is presented in the table below:

In thousands of RSD	**31 December 2016**		**31 December 2015**	
	Amount in thousand RSD	**%**	**Amount in thousand RSD**	**%**
Ordinary shares	3,631,200	100.00	3,631,200	100.00
Balance as at 31 December	3,631,200	100.00	3,631,200	100.00

Provisions for estimated losses

The provisions for estimated credit risk losses contained in the Bank's credit portfolio are calculated in accordance with the Decision of the National Bank of Serbia on Classification of Bank Balance Sheet Assets and Off-Balance Sheet Items ("Official Gazette of RS" no. 94/2011, 57/2012, 123/2012, 43/2013, 113/2013, 135/2014, 25/2015, 38/2015, 61/2016, 69/2016, 91/2016, 101/2017 and 114/2017).

As at 31 December 2017, a special reserve for estimated losses that may arise on the basis of assets and off-balance sheet items, calculated in accordance with the Decision of the National Bank of Serbia, amounts to RSD 19,669 thousand (on 31 December 2016, it amounted to RSD 117,033 thousand).

The Bank's regulatory capital includes only the negative effects of the fair value changes of financial assets available-for-sale in the amount of RSD 468 thousand.

Positive effects of revaluation reserves on the basis of changes in the fair value of financial assets available for sale in the amount of RSD 20,879 thousand, the Bank does not include in its regulatory capital.

Capital adequacy and Bank's business indicators stipulated under the Law on Banks

The Bank is obliged to harmonize the scope and structure of its business and risk-weighted placements with business indicators stipulated under the Law on Banks and relevant decisions of the National Bank of Serbia made pursuant to the named Law.

The achieved business indicators of the Bank as at 31 December 2017 were as follows:

1. Capital adequacy indicators

In thousands of RSD	**31 December 2017**	**31 December 2016**
Core capital	2,209,823	2,570,105
Supplementary capital	1,184,727	1,240,719
Deductibles from capital	-	-
Capital	**3,394,550**	**3,810,824**
Assets weighted with credit risk multiplied by reciprocal value of the adequacy of capital	4,472,244	3,350,751
Exposure to foreign currency risk multiplied by the reciprocal value of the capital adequacy	-	-
Exposure to operational risk	308,656	96,933
Total risk assets	282	-
Capital adequacy indicator	**4,781,182**	**3,447,684**
Assets weighted with credit risk multiplied by reciprocal value of the adequacy of capital	**71.00%**	**110.53%**

1. Business indicators	**Prescribed**	**Realized in 2017**	**Realized in 2016**
1. Capital (expressed in EUR)	Minimum EUR 10 million	28,652,593	30,863,797
2. Capital adequacy	Minimum 8% u 2017. 12% u 2016.	71.00%	110.53%
1. The indicator of the basic capital adequacy	Minimum 4,5%	46.22%	n/a
2. Equity capital adequacy indicator	Minimum 6%	46.22%	n/a
3. Bank's investments in non-financial sector and in non-current asset	Maximum 60%	3.37%	3.95%
4. Sum of large exposures	Maximum 400%	77.73%	44.80%
5. Average monthly liquidity indicators (December)	Minimum 1	3.19	13.61
6. Foreign currency risk ratio	Maximum 20%	0.18%	0.28%
7. Exposure of the Bank to a single entity or a group of related entities	Maximum 25%	18.20%	21.05%

6.25 Off-balance sheet items

In thousands of RSD	31 December 2017	31 December 2016
Guarantees, securities, secured property and commitments	**2,034,772**	**2,540,998**
Payment guarantees:	**325,655**	**286,700**
In RSD	309,382	286,700
In foreign currency	16,273	-
Performance guarantees:	**871,799**	**193,877**
In RSD	69,362	66,998
In foreign currency	802,437	126,879
Other forms of guarantee:	**2,400**	**2,400**
In RSD	2,400	2,400
In foreign currency	-	-
Revocable and irrevocable commitments for unwithdrawn loans and placements in RSD:	**834,918**	**2,058,021**
revocable	654,901	1,547,604
irrevocable	180,017	510,417
Derivatives	**1,863,712**	**2,392,205**
Other off-balance sheet items	**343,795**	**185,347**
Other irrevocable commitments under guarantees	338,139	185,208
Checks, bills, policies, authorities and others	42	44
Other	5,614	95
Total off-balance sheet items	**4,242,279**	**5,118,550**

6.26 Related party relationships

The following table presents the total balance sheet exposure and exposure to related parties, as well as income and expenses from related parties which influence the Bank's business operations:

In thousands of RSD

BALANCE SHEET	**31 December 2017**	**31 December 2016**
Liabilities		
Subordinated loan	1,184,728	1,234,723

PROFIT AND LOSS ACCOUNT	**2017**	**2016**
Interest expenses from subordinated loans	(3,164)	(2,676)

Gross and net income of the President and members of the Board of Directors and the Executive Board in 2017 and 2016 were as follows:

In thousands of RSD	2017	2016
Gross income	**66,123**	**66,001**
Executive board	59,209	58,979
Board of directors	6,914	7,022
Net income	**55,380**	**55,362**
Executive board	51,010	50,924
Board of directors	4,370	4,438

Remuneration of the Executive Board in 2017 relates to the payment of three members for the full-year, (in 2016 relates to the payment of two members: one member for eleven months and one for five months) and remuneration of two members of the Board of the directors for the whole year (same in 2016). The above benefits relate to short-term employee benefits.

6.27 Commitments to lease

The Bank rents office space through operational leasing.

Future payments under operating leases where the Bank emerges as the lessee are shown in the following table:

In thousands of RSD	31 December 2017	31 December 2016
Operating leasing payments		
One year period	43,686	63,094
Period from 1 to 5 years	66,265	160,897
Period over 5 years	-	-
Total	**109,951**	**223,991**

6.28 Litigation

On 31 December 2017, there are no court litigations that the Bank leads against third parties.

On 31 December 2017, there are two court litigations against the Bank. Based on evidence so far produced in the proceedings, it is estimated that litigation will be settled in the Bank's favor, with an estimate of 70% success. For these reasons, and in accordance with applicable accounting standards, the Bank has not allocated any funds for the needs of the provision.

In addition to the aforementioned two litigations, a misdemeanor procedure with a possible negative outcome is charged against the Bank in the amount of 100,000 RSD.

6.29 Reconciliation of receivables and payables

In accordance with Article 18 of the Accounting Law ("Official Gazette of the Republic of Serbia", No. 62/2013), the Bank performed reconciliation of receivables and payables with its debtors and creditors. The Bank sent clients confirmation requests or statements of outstanding items, in order to reconcile outstanding receivables / payables as at 31 December 2017.

The total reconciled amount refers to:

- Receivables in the amount of RSD 2,351,833 thousand, which is 33.14% of receivables,
- Liabilities in the amount of RSD 430,394 thousand, which is 16.70% of liabilities.

The total amount of unconfirmed receivables is RSD 3,906,398 thousand, and unconfirmed liabilities in the amount of 1,447,516 thousand RSD.

The reason they outstanding balances remain unconfirmed in the total amount of 1,447,516 thousand RSD is that clients did not confirm balances on their current accounts at the Bank, as well as deposits, and customer receivables in the total amount of RSD 1,081,100 thousand, that clients do not keep in their off-balance sheet records their obligations on the basis of the credit limits, which Bank has approved.

7 Risk Management

7.1. Risk Profile and Risk Appetite

Risk profile and risk appetite of the Bank are clearly defined and documented throughout the risk management process, taking into consideration the major risks the Bank is willing and capable to take in order to meet its business goals. Bank stipulates its risk appetite in Risk Management Strategy, predominantly in the Chapter no7 of the Strategy.

The risk management system of the Bank has the goal to identify the main types of risk and adjust the Bank's business profile and Bank's plans to its risk appetite. Bank aims to optimize the decisions it takes by balancing the risks assumed with the expected gains from the business opportunities. Simultaneously, Bank is committed to establishing a strong and independent control function and structure ready to respond to the challenges in the organization and the environment, as to ensure that the growth of the business is adequately supported by efficient risk management infrastructure.

In its business operation, the Bank actively takes over and manages the risks, while relying on the following principles:

- The level of risks need to be within the limits defined by the Bank's risk appetite
- Taken risks has to be approved within the risk management system
- The award should compensate the taken risk
- Continuous risk monitoring
- Promoting awareness about the risk and strengthening of the risk management culture shall help the strengthening of the Bank's resistance.

Risk Management Strategy has determined Bank risk appetite through compliance with two key/main indicators:

- Capital adequacy ratio
- Internal capital adequacy ratio.

Risk management process ensures that all other limits defined in the Bank - those being limits from different risk management segments and determined in the other Bank internal acts such as limits on liquidity risk as defined in the Bank Liquidity risk management policy or concentration risk limits as defined in the Procedure on concentration risk management, limits on counterparty risk and other, are integrated into two main limits as presented above. Therefore, risk appetite of the Bank is defined as

- Maintenance of Capital Adequacy Ratio at all times above 15%,
- Maintenance of Internal Capital Adequacy Ratio at all times above 13.5%.

If it is deemed as necessary to introduce additional indicators and their limits for the purpose of determining Bank risk appetite, Bank will adjust Risk Management Strategy the Chapter 7 that regulates this aspect.

7.2. NPLs & Collection

In its Risk Management Strategy the Bank has determined its long-term objectives concerning the level of distressed assets. The Bank's distressed assets are its non-performing exposures as defined by the Credit Risk Management Policy, which is in compliance with the NBS Decision on the Classification of Bank Balance Sheet Assets and Off-Balance Sheet Items. The Bank has determined the basic principles of Distressed Asset Management, and the highest acceptable level of distressed assets.

For the strategy planning period, NPLs are planned at a relatively low level (lower than the average for Serbia's banking sector) and for the following years (planning period: 2018 to 2021). This represents one of the aims and most important principles of Distressed Asset Management.

The Bank uses wide spectar of credit risk management techniques to keep the NPL level in line with the defined levels, such as well defined credit process, robust credit analysis, approval of exposures to clients in relation to their credit capacity, strict monitoring of credit exposures post disbursement, early detection of deteriorating clients, well structured collection process, requirements with regard to credit protection instruments and other.

For the purpose of effective Distressed Assets Management, Bank has designated a position within its organization structure specialized in this area and has introduced set of internal acts that govern Bank activities and rules within this segment. Bank's Recovery Plan plays an important role in risk mitigation related to distressed asset management for all the risks arising from adverse developments of bank performance or external factors affecting the banking business.

7.3. Financial risk review

In compliance with the nature of its business activity, the Bank established an adequate risk management system, which pertains to the management of types of risks, and especially so for the most important risks that may arise during operation.

Risk Management Objectives and Principles

The Bank established the risk management process through:

- A specified risk management strategy;
- Clearly defined risk management policies and procedures that include risk identification, measuring, monitoring, reporting and control;
- Adequately established organizational structure that clearly defines the roles and responsibilities of individuals involved in undertaking of risks, risk management and supervision of risk management adequacy;
- Independence of the organizational units tasked with risk management from those tasked with other business activities;
- Effective information system intended for use by the management, which provides information flow from the operational level to top management, as well as the reporting system for any deviations identified;
- Continuous independent supervision of the risk management system.

Responsibilities

The Board of Directors, Supervisory Board, Executive Board, Asset and Liability Committee are responsible for establishing of the system and for the supervision of the risk management system in compliance with the regulations of the National Bank of Serbia, policy and principles of the Bank and risk management best practices.

With the aim to set up a consolidated risk management system and to provide for the functional and organizational independence of the risk management function from the regular business activities, in addition to the legally prescribed management bodies, individual Boards and Committees of the Bank are responsible for risk management, in compliance with the Rules on their operations.

Bodies of the Bank continuously monitor the changes in legal regulations as well, they analyze the impact of such changes to the risk levels on the level of the Bank and undertake measures to bring the operations and procedures with newly adopted regulations within the controlled risk.

In addition to the above, the introduction of new products, activities, lines of business and systems is followed by required analyses with the aim to determine their impact on the risk portfolio of the Bank.

Bodies of the Bank responsible for risk management jointly establish the risk management principles and methodology, based on the following:

- Regulations and decisions passed by the legislative authorities, and principally by the National Bank of Serbia;

- Appetite for risk-taking, adopted as an internal act of the Bank (part of the Strategy for Risk Management) by the Board;
- Needs of the good business practice, with the aim to adequately identify, measure and estimate the risks, as well as to manage the risks to which the Bank is exposed.

Risk Measurement and Reporting

Organizational units responsible for monitoring of individual risk types and other expert services continuously monitor the indicators of individual categories of risks within their specific competencies and perform measuring, control and reporting to the competent Boards/Committees of the Bank, in compliance with the risk management system established by means of the most important internal acts regulating risk management.

Overview of Risk Types

In compliance with the Risk Management Strategy, the Bank has classified the potential operating risks in the following categories:

- **A.** **Credit risk** and risks related to credit risk (concentration risk, country risk, FX credit risk, residual risk)
- **B.** **Liquidity risk**,
- **C.** **Market risk**, interest risk in banking book, foreign exchange risk,
- **D.** **Capital management.**

In addition to the above listed risks, the following risks may arise as well:
- Strategic risk,
- Reputational risk,
- Compliance risk,
- Operational risk,
- Other risks that are difficult to quantify.

7.3.A Credit risk

Credit risk is the risk of negative effects on the financial result and capital of the Bank caused by borrower's default on its obligations to the Bank.

The basic goal of credit risk management within the Bank is to reduce the possibility of occurrence of negative effects on the financial result and capital of the Bank due to the failure of the debtors to meet their obligations towards the Bank. In order to control the acceptance of the credit risk and adequate management of such risks, the Bank has established an adequate credit process which includes the approval of placements and credit risk management, which are regulated by Bank's procedures.

The credit risk management process includes:
- identification,
- evaluation and measuring,
- monitoring and
- reporting about the credit risk.

Credit Risk Management

The Bank manages the credit risk from individual borrowers, portfolio risk, transaction risk, i.e., it manages the collaterals separately, through the management of:

- Default risk – the risk of defaulting by the borrower;
- Risk from the changes in asset value – the risk of losses in the value of assets;
- FX credit risk – the risk of defaulting by the borrower due to a significant rise in the foreign exchange rate;

- Concentration risk that originates from the exposure to entities from the high exposures group, as well as the concentration risk that originates from the concentration of exposure to individual risk factors pertaining to: the economic sector, geographical area, product type and loan hedging activities and the similar.

Credit risk is adequately managed through risk identification, measuring, control, monitoring and reporting.

With the aim to achieve an effective credit risk management framework, the Bank has defined the basic components as follows:

- Establishing and supervision of the system by the Board of Directors and senior management,
- Clear allocation of competencies and responsibilities in the management process,
- Adequate implementation of management system and relevant policies and procedures.

The credit risk management process includes the following:

- Risk identification in compliance with the adopted procedures,
- Risk measuring and assessment by using the prescribed methodologies,
- Risk monitoring and control in accordance with the established procedures, as well as the application of relevant risk mitigation techniques, by using the loan hedging instruments,
- Reporting on exposure to credit risk.

Supervision by the Board of Directors and Senior Management

The Board of Directors of the Bank approved the credit risk management strategy and policies. The Board of Directors adopts the risk profile of the Bank and supervises the implementation of the process of adequate credit risk management, to ensure that the total credit risk exposure of the Bank is maintained on a safe level and matched to available capital both under the regular conditions and in crisis and any disturbances in the market.

Credit risk management of the Bank is based on the implementation of the following basic principles:

- Conservative approach to credit risk management,
- Management through defined control levels,
- Credit policy cycles in conjecture with segmentation of clients, products, economic sectors, geographic locations, currencies and maturity dates,
- Focus on the target market in compliance with the strategy,
- Diversification of credit exposure, and
- Risk pricing.

The Executive Board of the Bank, as well as other bodies are responsible for the development and establishing of credit policies and credit administration procedures within the relevant organizational units of the Bank, as a part of the general credit risk management system and for the adequate implementation and permanent supervision of such system.

Prior to the approval of any investment, competent decision-making levels perform assessments of the risk profile of the client/transaction, and following that, the continuous monitoring of the value of receivables and collaterals' values and adequacy is performed.

Limit Setting

The Bank actively participates in the management of its exposure to credit risks by means of defining and setting the exposure limits for individual borrowers and for the group of related borrowers, such that using various factors of risk concentration credit limits are revised from time to time.

Credit Risk Supervision and Control

Supervision of credit risk pertains to continuous supervision of individual loans, including the off-balance sheet exposure to borrowers and supervision of the entire portfolio of the Bank.
The system established for the credit risk supervision includes the following:

- The time dimension of the supervision in accordance with the nature of the credit risk (from daily to quarterly),
- Different supervisory procedures on predefined decision making levels,
- Continuous independent internal control of the lending process,
- Separate credit risk management on the level of clients and on the portfolio level, as well as on the level of transactions,
- Collateral management, and
- Management of risk investments.

The Bank conducts this activity with the aid of a system that ensures daily supervision of the quality of credit portfolio and implements corrective measures if and when the creditworthiness of a client deteriorates.

This system is created to ensure reliable monitoring of placements' servicing in accordance with the specified deadlines, adequacy of impairments, maintenance of the total risk profile within the limits set by the management and compliance with the regulatory limits by the Bank. Credit monitoring system is created to provide support to the senior management in the supervision of the quality of the entire credit portfolio and its trends.

Credit Risk Identification

The credit risk identification is the basic step in the credit risk management aiming to detect credit risk in a timely manner.

The identification of exposure to a specific risk starts at the moment of submitting of the loan application. The analysis of individual placements includes the analysis of the qualitative and quantitative indicators of the client, as well as the identification of other client's risk factors.

The approval process consist of the defined steps which may differ depending on the type of the client, the characteristics, type and the purpose of placement, the security instruments and include following steps:

- The preparation of the proposals for credit placement;
- The collection and verification of the credit documents;
- Credit analysis;
- Risk assessment;
- Placement approval;
- Control of the accompanying documents and other conditions;
- Disbursement of the funds.

Credit Risk Assessment and Measurement

The Bank has defined the mechanism of independent, continuous assessment of credit risk management process. The result of such assessment is documented in an adequate manner, and is a part of the reporting system to the Board of Directors and senior management.

Management of Non-Performing Loans

The Bank has a defined and established system that enables prior identification of non-performing loans where there is a number of acceptable options for corrective measures. As soon as a loan is designated as non-performing, the course of the management of such loan changes and it is included in the implementation of special corrective procedures.

With the aim to reduce the risk of defaulting by the clients, the Bank may undertake the following measures to regulate the receivables:

- Rescheduling and restructuring,
- Activation of collaterals,
- Sales and assignment of receivables,
- Settlements,
- Initiation of court procedures and other measures.

In case that the measures undertaken should fail to produce adequate results, the proposal for permanent write-off of outstanding receivable will be made in the collection procedure on the specified decision-making levels.

The assessment of the credit risk is being performed during the review of the requirements for a specific placement, the requests for the change of conditions, terms of use and repayment of certain loan, as well as during the regular annual report about the business operations of the client. The assessment of the credit risk is based on the analysis of financial situation of the debtor, the timeliness of debtor's settlement of the obligations towards the Bank, qualitative data collected about the client and the quality of collateral instruments.

The process of measuring the credit risk is based on regulatory approach according with the classification of the debtor's receivables, as well as the assessment of the provisions for losses per off-balance positions, in line with the regulations of the National Bank of Serbia.

Restructuring

Restructuring of loans relates to any change in contractual terms concluded between the Bank and the client in changing the repayment schedule of the exposure in order to respond to any potential increase in current or future delays for such placement. The decision to restructure the credit exposure is always based on the client's liability toward the Bank. The Bank does not have any restructured loans as at balance sheet date.

Credit Risk Mitigation

In order to mitigate the credit risk, during the approval of the placement, security instruments are requested. The type of the requested security instrument depends on the evaluated credit risk of each client. The security conditions that follow each placement depend on the creditworthiness of the debtor, the type and the degree of exposure to the credit risk, the maturity and the amount of placement.

Credit Risk Monitoring

After the approval of the placement, the clients are being monitored through regular and extraordinary monitoring aiming to ensure timely identification of the warning signs.

In order to prevent any increase in the credit risk, monitoring process is established to identify clients for which it is necessary to take measures to prevent their migration from the status of non-problematic clients to the status of clients under intensive monitoring or of problematic clients.

The status of the client is defined based on the combination of the basic indicators (number of days of delay, account freezing, etc.), financial indicators and the professional opinion of the employees involved in the risk management process.

By monitoring the portfolio at the level of the individual placements and at the level of the entire credit portfolio, the Bank performs a comparison against the previous periods, identifies the tendencies and causes of changes in the level of exposure to the credit risk.

The Bank is required to maintain the level of reserves at an adequate level to be able to absorb expected and unexpected credit losses related to the credit portfolio.

Assessment of impairment of balance sheet financial assets

Impairment of placements (provisioning) is determined based on the assessment indicating the cash flows that will not be realized, and in principle it is the difference between the carrying amount less the determined uncollectible percentage and the recoverable amount – expected cash flows discounted by using the effective interest rate.

Recoverable amount is the present value of the expected future cash flows (inflows), discounted by using the effective interest rate.

The most important factors taken into account in impairment assessment of a financial asset or a group of financial assets include objective evidence that can include: significant difficulties of the client, non-compliance with the agreed conditions, high probability of bankruptcy or some other change in the organizational and financial status of the client, deteriorating of an active market for the financial asset.

Financial assets subject to impairment assessment are classified in two separate groups: the receivables that are assessed for impairment: (a) individually – for receivables where there is objective evidence of impairment and according to the amount of material receivables and (b) collectively – for receivables that are not assessed individually.

Individual Assessment

Individual assessment is performed for individually significant receivables where there is objective evidence that the receivables will not be collected by the Bank in the originally agreed amount or within the originally agreed deadlines, or for the receivables where there is objective evidence of impairment.

When assessing impairment the possibility of implementation of the customer's business plan is taken into account, its ability to improve performance in the event of financial difficulties, the value at which collateral may realize and timing of realization of collateral, the availability of financial support customers, the ability to charge overdue receivables, as well as the timing of the expected cash flows.

When it is estimated that collection from ordinary activities of the client is not possible, during the individual assessment expected income from the realization of collateral is taken into account.

Assessment of impairment of balance sheet assets on individual basis includes determining the existence of objective evidence of impairment, assessment of the present value of future cash flows and the calculation of the amount of that impairment for each individual claim against the debtor that is included in this assessment.

Objective evidence of impairment of balance sheet assets on an individual basis, exist:

- if the debtor's financial condition indicates significant problems in his business activities;
- if there is information of default, frequent delays in payment of interest and / or principal, or the non-fulfilment of other contractual provisions;
- if the bank, due to financial difficulties of the debtor, significantly changes repayment terms in relation to those originally agreed;
- if it becomes certain that bankruptcy proceedings will be initiated against the debtor or other type of financial reorganization.

The selection of the collateral (collateral) is closely connected with the assessment of credit risk, which depends on the financial status of the debtor, the amount of credit exposure, maturity, purpose of the loan and the ways in which the loan is repaid.

Collective Assessment

The Bank has developed a methodology for group impairment, given the current regulatory act of the National Bank of Serbia (and the accompanying guidelines and other documents), International Accounting Standards, the characteristics of the Bank and other relevant factors.

The evaluation group basis, inter alia, takes into account the internal rating of the loan portfolio in the following 8 categories: A1, A2, B1, B2, V1, V2, G1, D. Category A1 represents the highest quality category, while D represent the worst category in the loan portfolio of the Bank .

The Bank performs assessment of impairment of balance sheet assets and probable losses arising from off-balance sheet items on an aggregate basis for all receivables in which impairment or losses cannot be directly linked to the receivable, but which based on experience can be estimated as present in the loan portfolio.

The Bank performs the specified assessment on a group basis:

- For claims for which assessment on individual basis determines no objective evidence of impairment of balance sheet assets or probable losses on off-balance sheet items, or if based on individual assessment no amount of impairment of balance sheet assets and probable losses arising from off-balance sheet items is identified;
- For claims that belong to the group of small claims.

Notwithstanding the above rule, the Bank's assessment of impairment of balance sheet assets and probable loss on off-balance sheet items for claims that belong to the group of small claims, in accordance with the methodology, may be carried out on an individual basis.

In the implementation of such collective assessment, the Bank grouped receivables based on similar credit risk characteristics that reflect the debtor's ability to meet its obligations in accordance with contractual terms.

Assessment of impairment of balance sheet assets at group level is a joint estimation of future cash flows of individual groups of receivables on the basis of data on losses from previous periods for receivables, with credit risk characteristics similar to those in the group.

The assessment of probable loss on off-balance sheet items on a group basis is a joint assessment of the recoverability of future cash outflows for off-balance sheet liabilities for group off-balance sheet items with similar characteristics.

Assessment of Provisioning for Off-Balance Sheet Items

Assessment of provisioning for off-balance sheet items (guarantees, avals, letters of credit, etc.) is performed in compliance with the adopted criteria, individually and on collective basis.

Evidence based on which the Bank performs individual impairment assessments of the items of off-balance sheet assets are payments from the Bank accounts for obligations undertaken for guarantees, avals and letters of credit and other off-balance sheet items that can potentially be activated at the expense of the Bank.

Assessment of provisioning for off-balance sheet items on individual basis is performed in the same manner as for the receivables in the balance sheet assets, by using the same software application, bearing in mind that the majority such cases involve an intervention from the part of the Bank, i.e., the transfer of an off-balance sheet item in the balance sheet.

For off-balance sheet items for the reporting date of 31 December 2017, the entire amount of the provision for losses on off-balance sheet items is based on group assessment, bearing in mind that no objective evidence of impairment had been established.

7.3.A.i. Analysis of loan portfolio quality

The table below shows the structure of credit portfolio of the Bank, at levels of quality.

Maximum credit exposure

	Loans and advances to customers		**Loans and advances to banks and other financial institutions**		**Other assets**		**Off-balance sheet items**	
In thousands of RSD	**2017**	**2016**	**2017**	**2016**	**2017**	**2016**	**2017**	**2016**
Gross exposure:	**2,211,271**	**2,519,937**	**1,706,183**	**1,734,433**	**3,276**	**2,465**	**2,034,772**	**2,540,998**
Category A1	-	82,641	1,078,269	1,734,433	160	176	139,797	73,736
Category A2	619,439	962,144	-	-	989	1,482	99,678	62,560
Category B1	383,059	211,538	627,914	-	694	155	599,296	1,307,665
Category B2	1,073,693	656,902	-	-	11	594	1,154,423	485,413
Category V1	115,286	500,248	-	-	2	11	40,012	611,624
Category V2	19,794	92,172	-	-	6	7	-	-
Category G1	-	14,292	-	-	-	37	-	-
Category D	-	-	-	-	1,414	3	1,566	-
Not exposed to credit risk	-	-	-	-	11,598	10,776	2,207,507	2,577,552
Allowance for impairment of balance sheet assets	(10,628)	(10,227)	(122)	(2)	(640)	(8)	-	-
Provisions for losses on off-balance sheet items	-	-	-	-	-	-	(2,787)	(1,391)
Net exposure	**2,200,643**	**2,509,710**	**1,706,061**	**1,734,431**	**14,234**	**13,233**	**4,239,492**	**5,117,159**

The table below shows the structure of credit portfolio of the Bank, by days of delay.

As at 31 December 2017

In thousands of RSD	**Not in delay**	**Less than 30 days**	**31-60 days**	**61-90 days**	**More than 90 days**	**Total gross**
Balance sheet items						
Loans and advances to customers	2,177,975	13,503	19,793	-	-	**2,211,271**
Loans and advances to banks and other financial institutions	1,706,183	-	-	-	-	**1,706,183**
Other assets	2,812	328	-	-	136	**3,276**
Total	**3,886,970**	**13,831**	**19,793**	**-**	**136**	**3,920,730**

As at 31 December 2016

In thousands of RSD	**Not in delay**	**Less than 30 days**	**31-60 days**	**61-90 days**	**More than 90 days**	**Total gross**
Balance sheet items						
Loans and advances to customers	2,449,781	70,156	-	-	-	**2,519,937**
Loans and advances to banks and other financial institutions	1,734,433	-	-	-	-	**1,734,433**
Other assets	2,412	36	-	-	17	**2,465**
Total	**4,186,626**	**70,192**	**-**	**-**	**17**	**4,256,835**

The table below shows the amount of impairment of the credit portfolio of the Bank, including the matured and undue part of the loan portfolio.

As at 31 December	**Loans and advances to customers**		**Loans and advances to banks and other financial institutions**		**Other assets**		**Off – balance sheet items**	
In thousands of RSD	**2017**	**2016**	**2017**	**2016**	**2017**	**2016**	**2017**	**2016**
Maximum exposure to credit risk								
Gross exposure	**2,211,271**	**2,519,937**	**1,706,183**	**1,734,433**	**3,276**	**2,465**	**2,034,772**	**2,540,998**
Thereof:								
Matured	33,761	8,361	-	32	-	131	-	-
The corresponding impairment	(5,089)	(64)	-	-	-	(7)	-	-
Undue	2,177,510	2,511,576	1,706,183	1,734,401	3,276	2,334	2,034,772	2,540,998
The corresponding impairment	(5,539)	(10,163)	(122)	(2)	(639)	(1)	-	-
Total impairment	**(10,628)**	**(10,227)**	**(122)**	**(2)**	**(640)**	**(8)**	**-**	**-**
Provisions for losses on off-balance sheet items	**-**	**-**	**-**	**-**	**-**	**-**	**(2,787)**	**(1,391)**
Net exposure	**2,200,643**	**2,509,710**	**1,706,061**	**1,734,431**	**2,636**	**2,457**	**2,031,985**	**2,539,607**

The table below shows the analysis of credit risk exposure arising from transactions with derivatives:

7.3.A.ii. Derivatives

In thousands of RSD	**Nominal value**	**Fair value**
31 December 2017		
Receivables arising from derivatives	602,108	607,908
Derivative liabilities arising from derivatives	(592,364)	(592,364)
31 December 2016		
Receivables arising from derivatives	2,338,430	2,463,128
Derivative liabilities arising from derivatives	(2,200,276)	(2,200,276)

The fair value of financial assets through profit or loss held for trading (financial derivatives) is calculated using a model that discounts cash flows to their present value using market interest rates and exchange rates, and is classified into a level 2 for measuring fair value.

7.3.A.iii. Collateral and other credit enhancements

Collateralization of credit exposures serves as an important risk mitigation factor and enhances the incentives for borrowers to repay their financial obligations.

Collateral provides additional security and the Bank generally requests that corporate borrowers provide it.

The collateral has to be permitted by law and deemed appropriate by the Credit Committee. The collateral serves as a guarantee that the Bank, as the creditor, can recover the credit exposure and as a means of motivating the borrower to repay the credit exposure.

The Bank makes agreement with the client in which the client agrees to register certain collateral with the Bank in order to cover various credit facilities that the client intends to utilize during the term of validity of the agreement.

The lending decision is primarily based on assessment of the business and the creditworthiness of the borrower and his/her ability to repay the requested credit exposure, as well as on other factors related to credit risk. Nevertheless, the Bank aims to secure its claims against the clients it finances with high-quality collateral.
The Bank will require that the financed asset will serve as collateral for the credit exposure.

The choice of the collateral is closely related to the credit risk assessment, which depends on the financial status of the borrower, the credit exposure amount, the maturity, the purpose of the credit exposure and the manner in which it is to be repaid.

Collateral *In thousands of RSD*	**Market value as at 31 December 2017**	**Market value as at 31 December 2016**
Land	82,102	125,942
Residential buildings	86,568	46,673
Office building	494,940	160,181
Deposits	14,133	24,347
Equipment	491,664	25,558
Supplies	278,923	369,063
Receivables	210,819	265,815
Pledge on shares	10	71
Corporative guarantee	21,325	185,208
Total:	**1,680,484**	**1,202,858**
Loans and advances from customers	2,211,271	2,519,937
Coverage of collateral	76.0%	47.7%

Collateral Management

The Collateral Management Policy regulates in greater detail the methods and procedures for collateral management with the aim to minimize the credit risk for the Bank. The purpose of this Policy is to describe the characteristics of the collaterals accepted by the Bank, as well as to specify the necessary activities within the regular monitoring of collateral acceptance. This document describes the allocation of responsibilities among individual organizational units of the Bank, aimed at efficient performance of the collateral management process.

Collaterals are presented in the financial statements at their fair (as last assessed) value, which is at the same time the subject of continuous monitoring process and periodical assessments. Collateral classification (table under point 5.A. iii. Collateral and other security) in the overview is performed based on the criteria specified in the Decision on the Classification of Balance Sheet Assets and Off-Balance Sheet Items.

7.3.A. iiii. Concentrations of Credit Risk

Exposure to risks per regions, industrial sectors and types of clients is presented in the Tables below, to present the exposure to concentration risk. Depending on the general economic trends and the trends observable in individual industrial sectors, the Bank performs diversification of investments in industrial sectors that are resistant to the influence of the negative economic trends.

At 31 December	**Loans and advances to banks and other financial institutions.**		**Loans and advances to customers**		**Other assets**		**Off-balance sheet items**	
In thousands of RSD	**2017**	**2016**	**2017**	**2016**	**2017**	**2016**	**2017**	**2016**
Maximum exposure to credit risk								
Concentration by sector								
Corporate:								
Agriculture, forestry and fishing	-	-	123,201	157,151	-	15	668,805	-
Mining, manufacturing, water supply	-	-	296,430	363,759	32	77	243,931	607,877
Electricity supply	-	-	-	-	-	-	142,521	-
Construction	-	-	334,177	358,809	5	10	730,715	52,826
Wholesale and retail trade and other	-	-	1,268,291	1,575,892	297	533	142,371	1,597,963
Transportation and storage	-	-	109,315	64,326	989	1,637	83,464	220,594
Real estate	-	-	79,855	-	39	7	1,567	61,736
Other	-	-	2	-	1,438	176	-	2
Financial institutions	1,706,183	1,734,433	-	-	476	-	21,398	-
Total	**1,706,183**	**1,734,433**	**2,211,271**	**2,519,937**	**3,276**	**2,465**	**2,034,772**	**2,540,998**
Concentration by location								
Serbia	1,706,183	1,248,714	2,211,271	2,519,937	3,276	2,458	2,034,772	2,540,998
Europe	-	474,005	-	-	-	7	-	-
The rest of the world	-	11,714	-	-	-	-	-	-
Total	**1,706,183**	**1,231,491**	**2,211,271**	**2,519,937**	**3,276**	**2,465**	**2,034,772**	**2,540,998**

The maximum exposure to a single entity or group of related entities, as at 31 December 2017 amounted to: 18.20% of regulatory capital, which is in line with the NBS the prescribed regulatory value.

7.3.B. Liquidity risk
i. Exposure to liquidity risk

Liquidity risk is the potential for the occurrence of certain unfavorable events with adverse effects on the financial result and equity of the Bank, as the inability of the Bank to meet its liabilities due at the time of their maturity, due to the inadequate structure of its sources, i.e. because its placements are not marketable.

Liquidity ratio is a ratio between the sum of Bank's liquid first- and second-degree receivables, on the one hand, and the sum of the Bank's sight liabilities or liabilities without determined maturity and the Bank's liabilities with maturity within one month from the date of liquidity ratio calculation, on the other hand.

Narrow liquidity ratio is the ratio between the sum of Bank's liquid first-degree receivables, on the one hand, and the sum of the Bank's sight liabilities or liabilities without determined maturity and the Bank's liabilities with maturity within one month from the date of liquidity ratio calculation, on the other hand.

The bank's first-degree liquid receivables shall include cash and receivables where the agreed maturity falls within one month from the date of calculation of liquidity ratio, as follows:

- vault cash, gyro-account balances, gold and other precious metals;
- funds in the accounts with banks with available credit rating of the chosen credit rating agency equivalent to credit quality 3 or better, determined in accordance with the decision on capital adequacy of banks (investment rank);
- deposits with the National Bank of Serbia;
- checks and other monetary receivables in the process of execution;
- irrevocable credit facilities approved to the bank;
- shares and debt securities quoted on the stock exchange.

Liquid first-degree receivables of the bank shall also include 90% of the fair value of securities denominated in RSD with no foreign currency clause, issued by the Republic of Serbia with minimum maturity of three months or 90 days, which the bank has classified as securities that are traded or securities available for sale.

As at 31 December 2017 the Bank had investments in securities denominated in RSD and issued by the Republic of Serbia in the amount of RSD 1,387,095 thousand.

Bank's second-degree liquid receivables shall include other bank receivables falling due within one month from the date of calculation of liquidity ratio.

Receivables classified into G and D categories according to the decision on classification of balance-sheet assets and off-balance sheet items shall not be included in the calculation of the bank's liquidity ratio.

Bank's sight liabilities or liabilities without agreed maturity shall constitute a part of its liabilities as follows:

- 40% of sight deposits of banks;
- 20% of sight deposits of other depositors;
- 10% of savings deposits;
- 5% of guarantees and other sureties;
- 20% of unfunded committed irrevocable credit lines.

Other Banks liabilities falling due within one month from the date of calculation of liquidity ratio shall be considered bank liabilities with agreed maturity.

The Bank expresses the level of liquidity through the liquidity ratio and narrow liquidity ratio.

The Bank shall maintain its liquidity level in a way that:

Liquidity ratio:

– equals at least 1.0 when calculated as an average of liquidity ratios for all business days in a month,
– is not lower than 0.9 for more than three consecutive business days,
– equals at least 0.8 when calculated for a single business day.

Also, the Bank shall maintain the level of liquidity with the narrow liquidity ratio as follows:

Narrow liquidity ratio:

– equals at least 0.7 when calculated as an average of liquidity ratios for all business days in a month,
– is not lower than 0.6 for more than three consecutive business days,
– equals at least 0.5 when calculated for a single business day.

Liquidity coverage ratio

The liquidity ratio (LCR) is the ratio of the bank's liquidity layer to the liquidity of the bank and the net outflow of its liquid assets that would occur after the next 30 days from the date of calculating this indicator under the assumed stress conditions.

The Management Board shall establish a system of liquidity risk management and supervises that system in accordance with an acceptable risk profile. Above leadership is responsible for the implementation appropriate policies and procedures in line with the strategic direction and a penchant for risk defined by the Board.

Liquidity risk management in the Bank is defined by Policy and Procedure for liquidity. ALCO committee is responsible for managing of liquidity risk. The Bank uses the following tools for measuring and managing liquidity risk:

- liquidity report with the standard analysis of the liquidity gap,
- liquidity ratios movements
- narrow liquidity ratio movements
- ratio loans/deposits
- Liquidity plan
- Liquid assets coverage ratio.

The Asset and Liability Committee (ALCO) has special competencies in the liquidity risk management process, and specifically it:

- Manages liquidity risk;
- Monitors and analyses liquidity ratios;
- Analyses the assumptions of the stress tests and perform their adoption;
- Defines liquidity ratios (internal limits and triggers for reporting);
- Gives proposals to Executive Board in the short and long-term investments and bank borrowings;
- Analyses the movement of the Bank's liquidity, including liquidity gap analysis and decision-making in order to reduce liquidity risk;
- Approved for no separate liquidity gap analysis to be carried out for the currency in which the Bank has more than 5% of liabilities;
- Decides on the establishment and the amount of liquidity reserves;
- Analyses other parameters that may have an effect on the liquidity of the Bank and make decisions in order to reduce liquidity risk.

The Liquidity Risk Management Strategy, includes the monitoring of liquidity risk in compliance with the following principles:

- Adjusting the structure of assets and liabilities according to their maturity and currencies,
- Diversification of financing sources as per their maturity and currencies,
- Ensuring access to interbank market of currencies and capital,
- Establishing of adequate liquidity provisions' levels.

Liquidity risk management, as a part of the Bank management, includes the systems for identification, measuring, supervision and control of Bank exposure to liquidity risk. The Bank performs timely identification and quantification of primary sources of liquidity risk for the Bank on transaction level and on the levels of credit and deposit portfolios, under the regular conditions for operation, as well as under conditions of higher risk and market disturbances, as well as on the occasion of approval of new business processes, products and activities.

Liquidity ratio	**2017**	**2016**
At 31 December	3.84	12.15
Average for the period (December)	3.21	13.61
Maximum for the period (December)	3.84	16.69
Minimum for the period (December)	2.95	11.51
Narrow liquidity ratio		
At 31 December	2.90	9.59
Average for the period (December)	2.25	10.97
Maximum for the period (December)	2.90	13.09
Minimum for the period (December)	1.99	9.32

The Bank devotes particular attention to the liquidity measures defined by Basel III regulations, which the National Bank of Serbia prescribed as mandatory in 2017. The Liquidity Coverage Ratio (LCR) is monitored on a monthly basis as a ratio of the Bank's liquidity buffer and net outflow of liquidity over a period of 30 calendar days.

Liquidity Coverage Ratio	
On the 31st. December 2017	898%
On the 30th. September 2017	585%
On the 30th. June 2017	293%

ii. Maturity analysis for financial assets and financial liabilities

The tables below set out the remaining maturities of the Bank's financial liabilities and financial assets.

31 December 2017 In thousands of RSD	Amount	Gross amount	Less than 1 month	1–3 months	3 months –1 year	1–5 years	More than 5 years
Assets							
Cash and balances with the central bank	382,825	382,825	382,825	-	-	-	-
Financial assets at fair value through profit or loss held for trading	5,800	5,800	3,480	2,320	-	-	-
Financial assets available for sale	1,387,095	1,387,095	-	-	150,465	1,236,630	-
Loans and advances to banks and other financial institutions	1,706,061	1,706,183	1,706,183	-	-	-	-
Loans and advances to customers	2,200,643	2,211,271	149,598	189,386	849,478	1,022,809	-
	5,682,424	**5,693,174**	**2,242,086**	**191,706**	**999,943**	**2,259,439**	**-**
Liabilities							
Deposits and liabilities to banks, other fin. inst. and central bank	41,250	41,250	41,250	-	-	-	-
Deposits and other liabilities to customers	2,258,537	2,258,537	1,024,109	820,114	293,094	121,220	-
Subordinated liabilities	1,184,958	1,184,958	-	-	-	-	1,184,958
	3,484,745	**3,484,745**	**1,065,359**	**820,114**	**293,094**	**121,220**	**1,184,958**
Liquidity gap	**2,197,679**	**2,208,429**	**1,176,727**	**(628,408)**	**706,849**	**2,138,219**	**(1,184,958)**

31 December 2016 In thousands of RSD	Amount	Gross amount	Less than 1 month	1–3 months	3 months –1 year	1–5 years	More than 5 years
Assets							
Cash and balances with the central bank	875,578	875,578	875,578	-	-	-	-
Financial assets at fair value through profit or loss held for trading	124,698	124,698	-	-	124,698	-	-
Financial assets available for sale	2,050,876	2,050,876	-	-	1,263,738	787,138	-
Loans and advances to banks and other financial institutions	1,734,431	1,734,433	1,734,433	-	-	-	-
Loans and advances to customers	2,509,710	2,519,937	53,837	319,387	1,756,608	315,876	74,229
	7,295,293	**7,305,522**	**2,663,848**	**319,387**	**3,145,044**	**1,103,014**	**74,229**
Liabilities							
Deposits and liabilities to banks, other fin. inst. and central bank	30,839	30,839	30,839	-	-	-	-
Deposits and other liabilities to customers	3,444,564	3,444,564	1,043,948	-	2,388,270	-	12,346
Subordinated liabilities	1,235,022	1,235,022	-	-	299	-	1,234,723
	4,710,425	**4,710,425**	**1,074,787**	**-**	**2,388,569**	**-**	**1,247,069**
Liquidity gap	**2,584,868**	**2,595,097**	**1,589,061**	**319,387**	**756,475**	**1,103,014**	**(1,172,840)**

iii. Liquidity reserves

To use Risk liquidity management, the Bank formed liquidity reserves. The bank holds liquidity reserves in the form of cash, equivalents cash and/or placing the National Bank of Serbia.

In thousands of RSD	**31 December 2017**	**31 December 2016**
National bank of Serbia	820,847	1,357,842
Other banks	1,156,382	1,219,778
Liquidity reserves	**1,977,229**	**2,577,620**

7.3.C. Market risk

Market risks – the possibility of occurrence of negative effects on financial result and the capital of the Bank due to changes in the value of balance sheet items and off-balance items of the Bank resulting from the movement of prices on the market.

Include the interest rate risk, foreign exchange risk, price risk of debt and equity securities and commodity risk. The Bank has exposure to interest rate risk and foreign exchange risk.

Interest rate risk is the Bank's exposure risk to the adverse change of interest rates.

The foreign exchange risk is the possibility of occurrence of negative effects on financial result and the capital of the bank due to changes in the foreign exchange rate.

ALCO Committee is responsible for managing market risks.

Interest Rate Risk

Interest rate risk is the risk of negative effects on the financial result and equity of the Bank due to the variations in interest rates. The interest rate risk occurs in cases where there are discrepancies between the items that are subject to interest rate adjustments over a certain period.

The Bank controls the interest rate risk by monitoring the ratio of interest-bearing assets and liabilities for which interest is paid and their share in the total assets, i.e. liabilities, through the management of:

- Repricing risk,
- Risk of economic value of capital,
- Basis risk,
- Optionality, and
- Yield curve risk.

Revenue Forecasts - The Bank manages the interest risk by analyzing the maturity matching of revenues and expenditure.

Economic Value Forecasts - Net present value of capital is the present value of future cash flows. In economic value forecasts, the potential for long-term impact of the interest rates on the capital of the Bank is taken into account.

The interest rate risk occurs due to (1) the different timings of interest rate change and cash flow; (2) changes in the correlation rate between different yield curves that impact the activities of the Bank; (3) changes in the correlation rate in maturity classes, and (4) options related to interest embedded in the products of the Bank.

The risk from the change of interest rates is measured and monitored by analyzing the risk of exposure to the changes in interest rates, which shows the structure and the level of interest-sensitive assets and interest-sensitive liabilities in different maturity intervals.

ii. Exposure to interest rate risk – Non-trading portfolios

The following is a summary of the Bank's interest rate gap position of financial assets and financial liabilities of the Bank, from the interest rate perspective, relating on non-trading portfolios (interest rate gap position):

31 December 2017 ***In thousands of RSD***	**Carrying amount**	**Less than 1 month**	**1-3 month**	**3–12 months**	**1–5 years**	**More than 5 years**	**Non-interest bearing**
Cash and balances with the central bank	382,825	230,387	-	-	-	-	152,438
Financial assets at fair value through profit or loss held for trading	5,800	3,480	2,320	-	-	-	-
Financial assets available for sale	1,387,095	150,465	-	-	1,236,630	-	-
Loans and advances to banks and financial institutions	1,706,061	1,559,433	-	-	-	-	146,628
Loans and advances to customers	2,200,643	140,724	183,774	1,768,530	100,151	-	7,464
	5,682,424	**2,084,489**	**186,094**	**1,768,530**	**1,336,781**	**-**	**306,530**
Deposits and other liabilities to banks, other fin. inst. and central bank	41,250	-	-	-	-	-	41,250
Deposits and other liabilities to customers	2,258,537	1,003,389	462,105	651,102	119,348	-	22,593
Subordinated liabilities	1,184,958	-	-	1,139,572	-	45,386	-
	3,484,745	**1,003,389**	**462,105**	**1,790,674**	**119,348**	**45,386**	**63,843**
Interest rate risk gap	**2,197,679**	**1,081,100**	**(276,011)**	**(22,144)**	**1,217,433**	**(45,386)**	**242,687**

31 December 2016 ***In thousands of RSD***	**Carrying amount**	**Less than 1 month**	**1-3 month**	**3–12 months**	**1–5 years**	**More than 5 years**	**Non-interest bearing**
Cash and balances with the central bank	875,578	381,079	-	-	-	-	494,499
Financial assets at fair value through profit or loss held for trading	124,698	-	-	124,698	-	-	-
Financial assets available for sale	2,050,876	300,439	-	-	1,750,437	-	-
Loans and advances to banks and financial institutions	1,734,431	1,729,495	-	-	-	-	4,936
Loans and advances to customers	2,509,710	385,056	306,835	1,693,792	-	123,050	977
	7,295,293	**2,796,069**	**306,835**	**1,818,490**	**1,750,437**	**123,050**	**500,412**
Deposits and other liabilities to banks, other fin. inst. and central bank	30,839	-	-	-	-	-	30,839
Deposits and other liabilities to customers	3,444,564	1,040,657	-	2,349,143	-	12,347	42,417
Subordinated liabilities	1,235,022	-	-	1,234,724	-	-	298
	4,710,425	**1,040,657**	**-**	**3,583,867**	**-**	**12,347**	**73,554**
Interest rate risk gap	**2,584,868**	**1,755,412**	**306,835**	**(1,765,377)**	**1,750,437**	**110,703**	**426,858**

The Bank is exposed to the changes in levels of market interest rates that impact its financial position and cash flows. As the result of these changes, the interest rate margin can increase or decrease.

Interest rates are based on market interest rates and the Bank performs adjustments of interest rates. The interest rate risk management activity is aimed at achieving optimum net income from interest, maintenance of market interest rate on a consistent level, in compliance with the business strategy of the Bank.

ALCO manages the liquidity gaps of assets and liabilities based on: the macroeconomic analyses and forecasts; forecasts of conditions for achieving liquidity, as well as based on the analysis and forecasts of the market trends in interest rates.

Interest rate risk is the adverse change in the price of active interest rates compared against the level of passive interest rates, as well as the potential for the reduction of the optimum difference between the average active and passive interest rates.

ii. Exposure to interest rate risk -Non-trading portfolio

The table below shows the impact of the effect of potential changes interest rate on income of the Bank as at 31 December 2017.

The effects of potential changes in interest rates are related to interest bearing assets and liabilities in the balance sheet.

Risk calculation illustrates the effect of the interest rate on interest-sensitive assets and passive. The scenario includes a 50BP parallel rise and fall and 100BP parallel growth and falling interest rates.

	Effect on interest earning (cumulatively over a period of 1 year)					
In thousands of RSD	Interest increase of 50 b.p.			Interest decrease of 50 b.p.		
	Total	Foreign currencies	RSD	Total	Foreign currencies	RSD
31 December 2017	5,016	4,632	384	(5,016)	(4,632)	(384)

	Effect on interest earning (cumulatively over a period of 1 year)					
	Interest increase of 100 b.p.			Interest decrease of 100 b.p.		
	Total	Foreign currencies	RSD	Total	Foreign currencies	RSD
31 December 2017	10,032	9,264	768	(10,032)	(9,264)	(768)

	Effect on economic value of equity in thousands of RSD					
	Interest increase of 50 b.p.			Interest decrease of 50 b.p.		
	Total	Foreign currencies	RSD	Total	Foreign currencies	RSD
31 December 2017	(7,016)	3,147	(10,163)	7,016	(3,147)	10,163

	Effect on economic value of equity					
	Increasing of 100BP Interest increase			Decreasing of 100BP Interest decrease		
	Total	Foreign currencies	RSD	Total	Foreign currencies	RSD
31 December 2017	(14,031)	6,294	(20,325)	14,031	(6,294)	20,325

The table below shows the impact of the effect of potential changes in interest rate on income of the Bank as at 31 December 2016.

In thousands of RSD	Effect on interest earning (cumulatively over a period of 1 year)					
	Interest increase of 50 b.p.			Interest decrease of 50 b.p.		
	Total	Foreign currencies	RSD	Total	Foreign currencies	RSD
31 December 2016	4,501	(2,775)	7,276	(4,501)	2,775	(7,276)

	Effect on interest earning (cumulatively over a period of 1 year)					
	Interest increase of 100 b.p.			Interest decrease of 100 b.p.		
	Total	Foreign currencies	RSD	Total	Foreign currencies	RSD
31 December 2016	9,003	(5,549)	14,552	(9,003)	5,549	(14,552)

	Effect on economic value of equity in thousands of RSD					
	Interest increase of 100 b.p.			Interest decrease of 100 b.p.		
	Total	Foreign currencies	RSD	Total	Foreign currencies	RSD
31 December 2016	(10,988)	90	(11,078)	10,988	(90)	11,078

	Effect on economic value of equity					
	Increasing of 100BP Interest increase			Decreasing of 100BP Interest decrease		
	Total	Foreign currencies	RSD	Total	Foreign currencies	RSD
31 December 2016	(21,975)	180	(22,155)	21,975	(180)	22,155

iii. Exposure to currency risks

Foreign currency risk is the risk from the negative effects of adverse changes in foreign exchange rates to the financial result and equity of the Bank. It pertains to the impact of the inauspicious trends in foreign exchange rates on the value of open foreign currency position.

Foreign Currency Position:

31 December 2017 ***In thousands of RSD***	**EUR**	**USD**	**RSD**	**Total**
Cash and balances with the central bank	144,856	1,772	236,197	**382,825**
Financial assets at fair value through profit or loss held for trading	-	-	5,800	**5,800**
Financial assets available for sale	-	-	1,387,095	**1,387,095**
Loans and advances to banks and financial institutions	1,634,485	-	71,576	**1,706,061**
Loans and advances to customers	1,500,069	-	700,574	**2,200,643**
Intangible assets	-	-	211,679	**211,679**
Property, plant and equipment	-	-	114,390	**114,390**
Other assets	-	10,021	4,213	**14,234**
Total assets	3,279,410	11,793	2,731,524	6,022,727
Deposits and other liabilities to banks, other financial institutions and central bank	-	-	41,250	**41,250**
Deposits and other liabilities to customers	1,452,099	17,742	788,696	**2,258,537**
Subordinated liabilities	1,184,958	-	-	**1,184,958**
Provisions	-	-	5,971	**5,971**
Deferred tax liabilities	-	-	13,391	**13,391**
Other liabilities	49,910	-	-	**49,910**
Equity	-	-	2,468,710	**2,468,710**
Total liabilities and equity	2,686,967	17,742	3,318,018	**6,022,727**
Foreign currency swap	(592,364)	-	592,364	**-**
Net foreign currency position 31 December 2017	**79**	**(5,949)**	**5,870**	**-**

31 December 2016 ***In thousands of RSD***	**EUR**	**USD**	**RSD**	**Total**
Cash and balances with the central bank	481,502	5,507	388,569	**875,578**
Financial assets at fair value through profit or loss held for trading	-	-	124,698	**124,698**
Financial assets available for sale	-	-	2,050,876	**2,050,876**
Loans and advances to banks and financial institutions	1,233,531	500,718	182	**1,734,431**
Loans and advances to customers	2,217,725	-	291,985	**2,509,710**
Intangible assets	14,292	-	224,645	**238,937**
Property, plant and equipment	-	-	150,423	**150,423**
Other assets	-	147	13,086	**13,233**
Total assets	3,947,050	506,372	3,244,464	**7,697,886**
Deposits and other liabilities to banks, other financial institutions and central bank	-	-	30,839	**30,839**
Deposits and other liabilities to customers	518,463	2,848,785	77,316	**3,444,564**
Subordinated liabilities	1,235,021	-	1	**1,235,022**
Provisions	-	-	4,841	**4,841**
Deferred tax liabilities	-	-	14,710	**14,710**
Other liabilities	-	-	35,173	**35,173**
Equity	-	-	2,932,737	**2,932,737**
Total liabilities and equity	1,753,484	2,848,785	3,095,617	**7,697,886**
Foreign currency swap	2,200,276	(2,338,430)	138,154	**-**
Net foreign currency position 31 December 2016	**(6,710)**	**(3,983)**	**10,693**	**-**

With the aim to protect against the foreign exchange risk, the Bank monitors the foreign exchange rates' trends in the financial market on the daily basis, implements the policy of low exposure to the foreign exchange risk. The Asset Management Division monitors the trends in the foreign exchange market on the daily basis and manages the foreign exchange position of the Bank in its entirety and per individual significant currencies.

Asset and Liability Committee proposes measures to the Executive Board of the Bank for adjustments of FX assets and liabilities to provide for favorable foreign exchange position on each currency segment. An independent market risk department performs independent analysis of the foreign exchange management process through monitoring of the compliance with the established system of limits.

Foreign exchange risk management is supplemented with the monitoring of:

- Impact of increase/decrease of FX items of assets/liabilities to the open position and foreign exchange risk indicator, and
- Sensitivity of income statement of the Bank to different scenarios of variations in foreign exchange rates. Sensitivity of income statement is the effect of assumptions regarding the changes in foreign exchange rates to net income from fluctuations in foreign exchange rates.

iii. Exposure to currency risks

In thousands of RSD	**2017 EUR**	**2017 USD**
Exposure to foreign currency risk:		
USD	-	(5,949)
EUR	79	-

The effect of increasing the rate of 10% on net income

In thousands of RSD	**EUR**	**USD**
Exposure to foreign currency risk:		
USD	-	(595)
EUR	8	-

The effect of decreasing the rate of 10% on net income

In thousands of RSD	**EUR**	**USD**
Exposure to foreign currency risk:		
USD	-	595
EUR	(8)	-

The effect of growth rate of 10% of the economic value of capital: 0.19%
The effect of reducing rate of 10% of the economic value of capital: (0.16%).

In thousands of RSD	**2016 EUR**	**2016 USD**
Exposure to foreign currency risk:		
USD	-	(3,983)
EUR	(6,710)	-

The effect of increasing the rate of 10% on net income

In thousands of RSD	**2016 EUR**	**2016 USD**
Exposure to foreign currency risk:		
USD	-	(398)
EUR	(671)	-

The effect of decreasing the rate of 10% on net income

	2016	2016
In thousands of RSD	**EUR**	**USD**
Exposure to foreign currency risk:		
USD	-	398
EUR	671	-

The effect of growth rate of 10% of the economic value of capital: 0.05%.
The effect of reducing the rate of 10% of the economic value of capital: (0.05%).

iv. Other market risks

Other market risks include the price risk on debt securities, price risk on equity securities and – the commodity risk, in compliance with the Decision regulating the Bank's capital adequacy.

During 2017, given the nature of its operations and the fact that it had no items in the trading book, the Bank was not exposed to any other market risks.

Once it introduces products exposed to this kind of risk, the Bank shall previously provide the prerequisites for such products (HR-technical equipment, written procedures for daily monitoring of trading book items, procedures for measuring of capital requirements for these risks, and item valuation methods in financial instruments included in calculation and subject to prior approval of the National Bank of Serbia, etc.) subject to consent of the Bank's competent boards.

Operational risk

The operational risk is the risk of negative effects on the Bank's financial result and capital due to failures in employees' performance, inadequate internal procedures and processes, inadequacy of information and other systems management in the Bank, and any other unforeseeable external events.

In the operational risk management, the Bank implements quantitative and qualitative measures based on collection of data on losses arising from operational risk, per categories defined according to sources of losses, and based on adopted internal acts.

The role of the operational risk management is to identify, estimate, control and mitigate the possibilities for the arising and impact of operational risks and losses. The Bank cannot eliminate all operational risks, but it may use the process of operational losses recording and analysis to identify flaws in its processes, products and procedures, and to improve them in order to reduce the frequency and negative effects of operational losses on Bank's operations and profitability. The Bank manages the operational risk so as to minimize the effects of adverse and unsuccessful internal processes, people and systems, or external events, on the Bank's financial result.

Database of on the basis of which the loss occurred or could have occurred, according to the prescribed limit, as a consequence of operational risk per categories defined according to sources of losses, shall be filled by entering the data based on identified risks per types of operations, by persons in charge of operational risk management.

Bank's exposure to operational risks shall be particularly attentively treated when introducing new products, activities, lines of business or systems, when required analyses are to be made by organisational units which participate in introduction of new products, activities, lines of business or system, and the Risk Management Department which is directly in charge of operational risk management.

For the assessment of exposure the Bank uses internal methods developed in line with best practice in the area of operational risk management.

Bank's investment risks

The Bank's investment risks include the risks of investing in capital of other legal entities and fixed assets. In compliance with the regulations of the National Bank of Serbia, the amount of Bank's investments and the amount of regulatory capital are monitored, to ensure that the Bank's investment in any non-financial sector entity does not exceed 10% Bank's capital, and that the Bank's total investments in non-financial sector entities and in Bank's fixed assets do not exceed 60% Bank's capital. The exposure to the risk of Bank's investments in other legal entities and fixed assets is monitored by way of informing the organizational unit or body of the Bank in charge of fixed assets procurement and investments in legal entities of the current status of exposure and amount of capital, in order to act timely in accordance with the set limits.

In 2017, the Bank took care of compliance of investment risks and conducted appropriate activities to ensure the compliance of investments with the indicators stipulated by the National Bank of Serbia. Additional monitoring of the Bank's investment risks indicators is performed in risk management division, finance division and compliance control functions, reported to the Bank's management bodies. The Bank has no items under investment property.

Exposure risk

The Bank's exposure risks (which also represent part of the concentration risk) include the risks of Bank's exposure to a single entity or to a group of related entities, as well as the risks of Bank's exposure to an entity related to the Bank. Monitoring of the Bank's exposure to the risk of exposure to a single entity or a group of related entities, and to entities related to the Bank, is performed at the moment of a request initiation, at the moment of financing, and after completed financing. Monitoring of Bank's exposure to this risk is a mandatory part of procedures in the investment approval phase, meaning that the board which approves of the investment avails with information concerning the total level of Bank's exposure to a client or to a group of related entities against the Bank's total capital.

In accordance with regulations and Bank's internal acts, the competent board issues approval on Bank's exposure to the exposure risk per individual clients or per groups of related entities and entities related to the Bank. Additional monitoring of the Bank's exposure indicators is performed in risk management division and finance division, with reporting to the Bank's management bodies.

Country risk

The risk related to the country of origin of the entity to which the Bank is exposed implies negative effects which might influence its financial result and capital, due to Bank's inability to collect debts from such entity for reasons resulting from political, economic or social conditions in such entity's country of origin.

The Bank's placements are mostly to customers from the Republic of Serbia, while being exposed to the country risk mostly concerning the part of funds held at times on accounts with foreign banks. The Bank's policy of country risk management is to continuously monitor the exposure to the country risk against adopted limits, defined according to the country rating as determined by competent institutions (OECD), with regular reporting of existing exposures to the management bodies.

D. Capital management

i. Regulatory capital

In thousands of RSD	31 December 2017	31 December 2016
Ordinary share capital	3,631,200	3,631,200
Loss up to the amount of equity	(1,189,845)	(704,472)
Intangible assets	(211,679)	(238,937)
Required reserve for estimated losses on balance sheet assets and off-balance sheet items	(19,669)	(117,033)
Unrealized losses on securities available for sale	(185)	(653)
Total share capital	**2,209,822**	**2,570,105**
Subordinated liabilities	1,184,728	1,234,723
Part of revaluation reserves of the Bank	-	5,996
Total additional capital	**1,184,728**	**1,240,719**
Total regulatory capital	**3,394,550**	**3,810,824**

The bank continuously manages the capital in order to:

- ensure compliance with capital requirements defined by the National Bank of Serbia (NBS),
- maintain an adequate level of capital for continuous operation by the “going concern” principle,
- maintain the capital base which enables coverage of risks it is exposed to while ensuring further business development.

Capital adequacy, as well as the use of the Bank’s capital is monitored on monthly basis by the Bank management. The Bank manages its capital structure and may make adjustments in the light of changes in economic conditions and risk characteristics inherent in its activities.

The National Bank of Serbia has defined the following limits for capital:

- Minimum monetary amount of capital of EUR 10 million; and
- Capital adequacy ratio not lower than 8%.

In accordance with the Decision on Capital Adequacy of Banks, ("Official Gazette of the Republic of Serbia", No. 103/2016) the methodology of capital adequacy calculation has been determined.

The Bank is required to calculate the following indicators:

- The Core Capital Adequacy ratio, which represents the percentage ratio of core capital and the risky assets of the bank;
- The Supplementary Capital Adequacy ratio, which represents the percentage ratio of supplementary capital and the risky assets of the bank;
- The Capital Adequacy ratio, which represents the percentage ratio of all capital and the risky assets of the bank;

The Bank must maintain the capital adequacy ratios at levels not lower than:

- 4,50 %, for the core capital adequacy ratio;
- 6,00 %, for the supplementary adequacy ratio;
- 8,00 %, for the capital adequacy ratio.

The Bank's Capital is the sum of core capital and supplementary capital minus deduction items from the capital defined in this Decision.

Risk assets represent the sum of total credit risk weighted assets and capital requirements for market risks and capital requirements for operational risk determined in the manner prescribed by the aforementioned decision, multiplied by the reciprocal value of the capital adequacy indicator. The Bank uses a standardized approach to calculate credit risk weighted assets. The Bank's credit risk weighted assets represent the sum of the balance sheet items and off-balance sheet items multiplied by the corresponding credit risk weightings.

The value of the balance sheet assets position for the purpose of calculating credit risk weighted assets is equal to the gross value of those positions minus the allowance for impairment and the required reserve for estimated losses. The value of off-balance sheet items for the purpose of calculating assets weighted by credit risk is equal to the gross value of these items minus provisions for losses on off-balance sheet assets and for the required reserve for estimated losses, multiplied by the corresponding conversion factors.

In conformity with the Decision on the Bank's Capital Adequacy, the Bank must, besides the minimum amount of EUR 10 million equity, maintain capital at any time and at the level required to cover all risks to which it is exposed or may be exposed in its business, at the least in the sum of the following capital requirements:

- Capital requirement for credit risk and the counterparty risk for all Bank's business activities and the capital requirement for settlement / delivery risk for trading book activities;
- Capital requirement for the price risk of trading book activities;
- Capital requirement for the foreign exchange risk and for the commodity risk of all business activities of the Bank; and
- Capital requirement for the operational risk of all business activities of the Bank.

The Bank’s total capital consists of the core capital and supplementary capital and deductible items.

Core Capital consists of Common Equity tier 1 and additional tier 1 equity.

The Core Capital of the Bank consists of the following elements, reduced by the elements of the deductible items:

- shares and other equity instruments that meet the requirements of item 8. of the Decision;
- corresponding issuance premiums along with basic equity instruments, i.e. the value paid above the nominal value of these instruments;
- bank retained profit;
- revaluation reserves and other unrealized gains;
- profit reserves and other reserves of the bank, except reserves for general banking risks;
- reserves for general banking risks.

Deductions from the Core Capital are:

- Current year and previous year losses, as well as unrealized losses;
- Intangible assets, including goodwill, reduced by the amount of deferred tax liabilities that would cease to exist in case of impairment or cessation of recognition of intangible investments in accordance with the IFRS / IAS;
- Deferred tax assets that are dependent on the future profitability of the bank, in accordance with the regulations;
- Negative value received by calculations in accordance with item 134. This decision is for banks that have received approval for the implementation of IRB access;
- Pension fund assets with defined benefits in the balance sheet of the bank;
- Direct, indirect and synthetic investments in the Bank's own core capital instruments, including instruments that the bank is or may be required to repurchase under a contractual obligation;
- Direct, indirect and synthetic investments in core capital instruments of individuals in the financial sector that have mutual investments in the bank, which were performed to present a larger amount of the bank's capital;

- The applicable amount of direct, indirect and synthetic investments of the bank in the core capital instruments of individuals in the financial sector in which the bank does not have a significant investment, in accordance with items 19 and 20 of the Decision;
- The applicable amount of direct, indirect and synthetic investments of the bank in core capital instruments of an individual in the financial sector in which the bank has significant investments, in accordance with item 19 of the Decision;
- The value for which the deductible items from the supplementary capital of the bank exceed the value of the supplementary capital of the bank;
- The amount of exposure that meets the requirements of risk weighting of 1.250%, for which the bank decides to deduct from the Core Capital instead of applying that weight;
- The amount of tax relating to the elements of the Core Capital that can be predicted at the time of the capital calculation, unless the bank has previously corrected the amount of the elements of the Core Capital in the amount in which these taxes reduce the amount by which the elements of the Core Capital can be used to cover the risk; or losses;
- Amount of required reserves for estimated losses on balance sheet assets and off-balance sheet items of the bank.

The Bank's Capital in its entirety consists of Core Capital of the bank and deductions from the supplementary capital.

The Capital adequacy decision determines the protective layers of capital as follows:

- protective layer for the preservation of capital;
- countercyclical protective layer of capital;
- protective layer of capital for a globally systemically important bank;
- protective layer of capital for a systemically important bank;
- protective layer of capital for structural system risk.

As of 31 December 2017, the Bank established protective layers for the preservation of capital and for structural systemic risk. The protective layer for the preservation of capital was determined in the amount of 2.5% of the Bank's risky assets, while the protective layer for structural system risk was determined at the level of 3% of the total foreign exchange and foreign exchange indexed placements approved in accordance to the economy and population in the Republic of Serbia.

The Bank classifies the exposures from the banking book, exposures from the trading book for which it is obliged to calculate the capital requirements of counterparty risks, and other exposures from the trading book, provided that the conditions specified in the a/m Decision are fulfilled, into one of the following categories, and thereby estimates the risk of:

1) Exposure to countries and central banks;
2) Exposure to territorial autonomies and local self-government units;;
3) Exposure to public administrative bodies;
4) Exposure to international development banks;
5) Exposure to international organizations;
6) Exposure to banks;
7) Exposure to corporates;
8) Exposure to natural persons;
9) Exposure secured by mortgage on real estate property
10) Exposure to defaults;
11) High-risk exposures;
12) Exposure based on covered bonds;
13) Exposure to securities;
14) Exposure to banks and companies with short-term credit rating;
15) Exposure from investments in open-end investment funds;
16) Exposure to equity investments;
17) Other exposures.

The Bank has established and continuously developed the process of internal capital adequacy assessment.

7.4. Fair values of financial instruments

A. Valuation models (assessments)

The Bank measures fair values using the following fair value hierarchy, which reflects the significance of the inputs used in making the measurements.

Level 1: Inputs that are quoted market prices (unadjusted) in active markets for identical instruments.

Level 2: Inputs other than quoted prices included within Level 1 that are observable either directly (i.e. as prices) or indirectly (i.e. derived from prices). This category includes instruments valued using: quoted market prices in active markets for similar instruments; quoted prices for identical or similar instruments in markets that are considered less than active; or other valuation techniques in which all significant inputs are directly or indirectly observable from market data.

Level 3: Inputs that are unobservable. This category includes all instruments for which the valuation technique includes inputs not based on observable data and the unobservable inputs have a significant effect on the instrument's valuation. This category includes instruments that are valued based on quoted prices for similar instruments for which significant unobservable adjustments or assumptions are required to reflect differences between the instruments.

Fair value of financial assets and liabilities

The Bank's business policy is to disclose information on the fair value of assets and liabilities when there is official market information and when the fair value significantly differs from the book value.

The market price, provided that there is an active market, is the best proof of a financial instrument's fair value. However, market prices are not available for a number of Bank's financial assets and liabilities. Therefore, when market prices of financial instruments are unavailable, the fair value of assets and liabilities is estimated using the present value or other valuation techniques based on currently prevailing market conditions.

In the Republic of Serbia, the market experience is insufficient, the same as the stability and liquidity in purchase and sale of debts and other financial assets and liabilities, since the official market information is not available at all times. Consequently, the fair value is impossible to be reliably determined in the absence of an active market.

The following methods and assumptions were used for the estimate of the fair value of Bank's financial instruments as at 31 December 2017:

- The fair values of cash and cash equivalents, short-term deposits, other loans and advances and other assets, transaction deposits, trade payables and other short-term liabilities, match their respective book values primarily due to short-term maturity of such financial instruments.
- Loans and advances from banks and other financial organizations tend to have short-term maturities and carry an interest rate that reflects current market conditions. Consequently, the Bank considers that the value of listed financial instruments approximates their market value.
- The fair value of loans and investments to customers and deposits and other liabilities to customers is calculated by discounting cash flows using market interest rates of comparable maturities and currency structure. The fair value of financial assets through profit or loss held for trading (financial derivatives) is calculated using a model that discounts cash flows to their present value using market interest rates and exchange rates, and is classified into level 2 for measuring fair value.
- Bonds of the Republic of Serbia are measured using available prices on the secondary market and are classified in Level 2 of the fair value measurement.

In the opinion of the Bank's management, the amounts in the enclosed financial statements reflect the value which is, under the circumstances, the most credible and useful for the reporting purposes.

E. Financial instruments not measured at fair value

The following table sets out the fair values of financial instruments:

31 December 2017 *In thousands of RSD*	Level 1	Level 2	Level 3	Total fair values	Total carrying amount (gross)
Assets					
Cash and balances with the central bank	-	382,825	-	382,825	382,825
Loans and advances to banks and other financial institutions	-	-	1,706,061	1,706,061	1,706,061
Loans and advances to customers	-	-	2,128,898	2,128,898	2,200,643
Financial assets at fair value through profit or loss held for trading	-	5,800	-	5,800	5,800
Financial assets available for sale	-	1,387,095	-	1,387,095	1,387,095
Liabilities					
Deposits and other liabilities to banks, other financial institutions and central bank	-	-	41,250	41,250	41,250
Deposits and other liabilities to customers	-	-	2,181,306	2,181,306	2,258,537
Subordinated liabilities	-	-	1,152,818	1,152,818	1,184,958

31 December 2016 *In thousands of RSD*	Level 1	Level 2	Level 3	Total fair values	Total carrying amount (gross)
Assets					
Cash and balances with the central bank	-	875,577	-	875,577	875,578
Loans and advances to banks and other financial institutions	-	-	1,734,433	1,734,433	1,734,431
Loans and advances to customers	-	-	2,471,665	2,471,665	2,509,710
Financial assets at fair value through profit or loss held for trading	-	124,698	-	124,698	124,698
Financial assets available for sale	-	2,050,876	-	2,050,876	2,050,876
Liabilities					
Deposits and other liabilities to banks, other financial institutions and central bank	-	-	30,839	30,839	30,839
Deposits and other liabilities to customers	-	-	3,430,863	3,430,863	3,444,564
Subordinated liabilities	-	-	1,188,237	1,188,237	1,235,022

8 Subsequent events

There were no significant events after the end of the reporting period that could require adjustments to or disclosures in notes to the accompanying financial statements of the Bank for 2017.

Belgrade, April 10, 2018

Dragana Bojin	Ilinca Rosetti
Head of Accounting Department	President of the Executive Board
	Saša Mićević
	Member of the Executive Board