ANNUAL REPORT FOR THE YEAR 2016

March, 2017

CONTENTS

1. KEY PERFORMANCE INDICATORS OF THE BANK

PROFIT AND LOSS (In RSD thousand)	2016.	2015.	Index 16/15	2014.	2013.	2012.
Positions						
Profit / loss before tax	-8.377.636	-6.175.885	135,7	4.757.589	4.588.375	4.572.662
Net interest income	13.462.734	13.768.082	97,8	13.298.586	12.929.237	10.910.317
Net fee income	4.817.314	4.899.947	98,3	4.717.757	4.565.148	4.554.466
Operating costs	11.086.858	10.799.510	102,7	10.745.910	10.161.794	9.812.888
Net impairment losses on loans and provisions	14.907.539	13.008.526	114,6	2.725.389	3.220.075	1.444.299

1

BALANCE SHEET (in RSD thousand)	2016.	2015.	Index 16/15	2014.	2013.	2012.
Balance Sheet Assets	400.017.469	393.439.874	101,7	406.261.524	362.786.319	323.384.909
RETAIL						
Loans	75.522.465	70.784.957	106,7	69.039.387	61.848.487	55.917.000
Deposits	231.312.395	218.836.847	105,7	207.430.548	186.766.804	164.532.866
CORPORATE						
Loans	74.083.897	89.204.275	83,0	112.768.251	112.261.312	118.860.421
Deposits	78.300.568	55.503.896	141,1	57.437.462	42.131.535	40.526.379
Securities	136.366.773	129.607.464	105,2	95.654.325	57.001.465	41.347.719

2

RATIOS	2016.	2015.	Index 16/15	2014.	2013.	2012.
LOANS /DEPOSITS RATIO						
Gross loans/deposits	58,7%	67,4%		72,4%	77,8%	80,2%
Net loans /deposits	50,7%	57,2%		66,3%	72,0%	75,2%
CAPITAL (000 RSD)	55.424.302	62.838.046	88,2	69.546.804	64.962.218	59.866.560
Capital adequacy	26,97%	22,70%		17,70%	19,00%	21,90%
Number of employees	2.858	2.877	99,3	2.906	2.966	2.989
PROFITABILITY PARAMETERS						
ROA	-2,1%	-1,6%		1,25%	1,33%	1,51%
ROE-on total capital	-13,9%	-9,0%		7,05%	7,33%	9,44%
Net interest margin on total assets	3,3%	3,5%		3,5%	3,7%	3,6%
Cost / income ratio	60,7%	57,9%		59,6%	58,0%	63,5%
Assets per employee (000 EUR)	1.134	1.124	100,9	1.067	951	871

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1 The operating expenses include the costs of salaries, tangible and intangible operating costs
2 Position loans does not include other advances and receivables, position deposits does not include other liabilities and assets received through credit lines
3 At the request of the auditors in 2017, the correction was performed of balance sheet for the year 2015

The operations of the banking sector of the Republic of Serbia in 2016 was condition by: present macroeconomic operating conditions, reduced demand for loans, notable credit risk, necessity of resolving the NPLs, reduction in interest rates, high liquidity of the banking sector and also by regulations of the National Bank of Serbia rendered for the purpose of securing the stable and safe domestic banking sector.

In such circumstances the Bank's primary goal was to provide stability and security in business operations, and it maintained to keep the status of systemically important Bank, second position by balance sheet assets within the banking sector of the Republic of Serbia, while preserving high level of trust of its customers (both corporate and retail).

In 2016 the Bank conducted all necessary activities in line with the adopted Strategy and Revised Business Plan in order to: cover all risks in its operations, minimise potential risks, maintain security and safety of operations in the upcoming period and to provide further sustainable development of the Bank. Achievement of these strategic goals of the Bank in 2016 was necessary due to large number of Bank's clients, significant volume of collected domestic deposits and foreign currency savings, important position and strong reputation on domestic financial market, and/or due to systemic importance of the Bank on the banking market of the Republic of Serbia, on one hand, and realistic presentation of the regular financial statements with full application of IAS/IFRS and obligation of meeting all performance indicators as prescribed by the Law on Banks, on the other hand.

In order implement the above goals in 2016, certain organizational changes have been made that led to increase of operating efficiency, after the analysis of the current status, the rationalization has been carried out of the business network and number of the employees in the Bank, professional employees were hired for specific areas of work (risk management, digitalization of business process, human resources management, market research, introduction of new products, improvement of sale of the banking products, strategic planning, internal audit performance and security of the Bank); in addition the models and manners for motivating employees at all work levels in the Bank have been improved.

Maintaining security and safety in business operations, as priority objective of the Bank in 2016 has been accomplished. At the end of 2016, the Bank fulfils all capital requirements for all risks in its operations, both according to internal policies and procedures for managing and assessing the risks and also according to stipulated conditions of the National Bank of Serbia. Capital adequacy ratio, as the most significant indicator of security of Bank's business operations, and/or the indicator that represents a ratio between the Bank's capital and all risks, at the end of 2016, stands at 26,97% (prescribed minimum 12%). In addition to capital adequacy ratio the Bank has, in 2016, has, at all times, fulfilled all other parameters and frameworks as prescribed by the Law on Banks (Bank's investments, exposure to parties related to the Bank, the sum of large exposure, foreign exchange risk ratio, liquidity ratio).

Credit risk is the most prominent risk in business operations of the banks in the Republic of Serbia. Credit risk management in all banks, and particularly in domestic banking market, is quite a complex process. For the purpose of improving these processes in line with IAS/IFRS, by regulations of the National Bank of Serbia, by applying Basel III standards and through introduction of new standard IFRS 9 as of the next year, the Bank undertook all necessary measures in order to create conditions for quality credit risk management in 2016. The Bank's management has paid special attention to safe and secure credit risk management due to:

- Deterioration of financial position of the clients and increase in number of days in default of the corporate loan beneficiaries and growing trend in NPLs,
- Reduced market value of collaterals (immovable property mortgaged by the banks) compared to previous valuations (hair cut), and extended periods of possible sale, which decreases the present value of real estate (discount on present value),
- Reduced market values of acquired real estate (new estimates of acquired real estate),
- Diminished results in financial statements of banks' clients,
- Uncertainty of resolving the pre-packaged reorganisation plans.

In addition to coverage of credit risk, the Bank, in accordance with the requirements contained in IAS 36, performed the subsidiaries' capital evaluation (members of Komercijalna banka Group):

- Komercijalna banka AD Budva in the Republic of Montenegro and
- Komercijalna banka AD Banja Luka in BiH.

Following all the above activities aimed to provide security in business operations and to cover the risks, the reported loss of the Bank in 2016 after calculation of the tax effects, amounts to RSD 8.063,2 million and is mainly a consequence of recorded net expenses arising from impairment of financial assets and credit risk bearing off-balance sheet items amounting to RSD 14.907,5 million and net expenses originating from change in value of real estate (fixed assets, investment property and intangible assets) in the amount of RSD 600,3 million. Total net expenses relating to impairment provision of assets include:

-Loan impairment provision	RSD -11.669,1 million
-Impairment of equity investments in subsidiaries	RSD -2.869,0 million
Impairment of acquired assets	RSD - 427,1 million
-Income from collected written-off receivables	RSD 57,7 million
TOTAL	RSD 14.907,5 million

The lack of profitability in 2016 does not threaten nor will it threaten in any way the stability and the possibility of improving the Bank's profitability in the upcoming period:

- Capital adequacy is considerably above the prescribed level and stands at 26,97%.
- The coverage of NPL by impairment provision is 75,2%.
- More established reserves from profit than the required reserves as calculated in accordance with the regulations of the National Bank of Serbia (Decision on Classification of Bank Balance Sheet Assets and Off-balance Sheet Items), in the amount of RSD 10.171,5 million, which will be used to cover the loss from 2016, without reducing the share capital and without negative impact on capital adequacy ratio.
- The Bank meets all the parameters stipulated by the Law on Banks.

All the above, after the completed audit of the regular financial statements for the year 2016, was also confirmed by the external auditor of the Bank and the same issued an unqualified opinion, or that the financial statements provide a true and fair presentation of the financial position of the Bank in accordance with the International Financial Reporting Standards, Accounting Law and the regulations of the National Bank of Serbia. In the forthcoming period, according to the Strategy and Business Plan, the Bank remains focused on the following:

- Maintaining stability of its operations and Bank’s reputation.
- Raising the value of the Bank.
- Sustainable growth of operations and profitability.

Bank's financial objectives (as %)	*2016. realised*	*2017 plan*	*2018 plan*	*2019 plan*
Asset growth	*1,7*	*-5,8*	*1,3*	*2,2*
Gain /Loss before tax (RSD million)	*-8.378*	*4.530*	*5.891*	*7.081*
ROA	*-2,1*	*1,2*	*1,6*	*1,8*
ROE - total capital	*-13,9*	*7,9*	*9,9*	*11,4*
Interest margin (net interest income / total assets)	*3,3*	*3,3*	*3,3*	*3,3*
Breakeven margin	*5,3*	*2,1*	*1,8*	*1,5*
CIR	*60,7*	*58,9*	*57,5*	*56,4*
NPL	*19,4*	*16,8*	*15,9*	*14,2*

2. *MACROECONOMIC OPERATING CONDITIONS*

The last year 2016 was marked by uncertainty on international financial market, in terms of future measures of monetary policy of the leading central banks. Federal reserves (FED, USA) raised the key policy rate at the end of the year (0,50-0,75), European Central Bank (ECB) lowered the key policy rate (0,00) while the Swiss National Bank did not change the key policy rate in 2016 (from -1,25% to -0,25%). At the commodity market the uncertainty continued with regards to fluctuations in prices of crude oil. China is still the main driver of the global economic growth. Geopolitical tensions in the Middle East continue.
International Monetary Fund (IMF) revised the estimate of the world economy growth downwards to 3,1%[4] in 2016 (0,1 percentage point lower compared to April estimate), which resulted from the exit of the Great Britain from the European Union and weaker than expected growth of the US economy.

In the Republic of Serbia, the successful agricultural season, growth of industrial production, particularly growth of infrastructure projects in the construction industry prompted the overall growth of economic activity which, according to first estimates, will result in in GDP growth in 2016 of 2,8[5]%. Low inflationary pressures during the last year as a result of low oil prices and low prices of primary agricultural products, low inflation in the region caused domestic inflation to remain below the target. Data from the Labour Force Survey show a decrease in unemployment throughout 2016. Considerably faster growth of export of goods and services than the import contributed to a reduction of current account deficit when compared to previous years. Net inflow from foreign direct investments, thanks to development of business environment, shall in 2016 remain at approximately the same level as last year. The undertaken measures of fiscal consolidation and more efficient collection of taxes resulted in reduction of fiscal deficit compared to previous years. Country risk premium, measured by EMBI index continued to fall during 2016, to which a positive evaluation of IMF on successful completion of the fourth and fifth reviews of the precautionary ‘’stand by’’ arrangement adequately contributed.

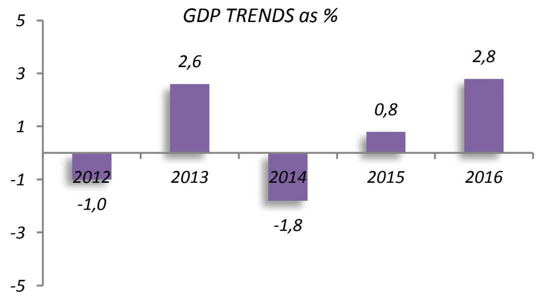
[4] Source: IMF, World Economic Outlook, October 2016
5 RS Ministry of Finance, Current macroeconomic trends, April 2017

At the end of the reported year a set of financial laws has been adopted in the Serbian Parliament, aimed at implementing financial consolidation, combating grey economy and supporting economic development. The following laws are adopted: Law Amending and Supplementing the Law on VAT, Law Amending and Supplementing the Law on Excise Tax, Law on Real Estate Appraisers, Law Amending and Supplementing the Law on Tax Procedure, Law on Regulating Public Debt of the Republic of Serbia in Respect of Citizens’ Unpaid Foreign Currency Savings.

GDP Trends

The undertaken economic policy measures led to growth of overall economic activity in 2016, measured by gross domestic product of 2,8%[6] compared to last year. The largest contributors to GDP growth were successful agricultural season (growth in physical volume of about 8,1%[7]), growth of infrastructure projects in construction industry (21,4[8]% more building permits than in the last year), growth in individual industrial sectors, growth in manufacturing industry and growth in services industries sector: tourism (13,0[9]%), transportation, retail trade (goods traffic increased by 7,5[10]%). Also, the positive impact came from low oil prices in the world market and stable inflow of foreign direct investments. Growth of employment, increase in salaries in private sector, higher available income of households due to lower lending costs and the announced increase in the minimum wage and pensions will contribute to GDP growth. Export is relatively high, and the growth of import will be slower than growth of export, which will provide a positive contribution of net export to GDP growth.

[6] Ditto
[7] Ditto
[8] Ministry of Finance of RS, Current macroeconomic trends, March 2017
[9] Ministry of Finance of RS, Current macroeconomic trends, February 2017
[10] Ditto



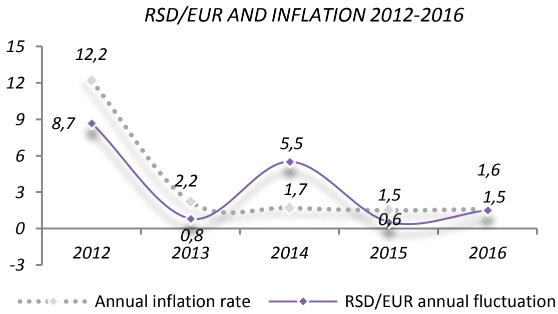
Employment /unemployment

A trend from 2015 continued in 2016, the labour market continues recovering. The growth of economic activity had a positive effect on labour market by increasing the number of formally employed persons since the start of the year. According to data obtained from the Labour Force Survey, which in addition to formal, also includes the informal part of the labour market, at the end of Q4 2016 a significant reduction of unemployment occurred. Unemployment rate at the end of fourth quarter of 2016 stood at 13,0[11]% and was reduced compared to the same period of 2015, when it stood at 17,7%. Growth of employment was recorded in agricultural and manufacturing industries, which are marked mainly by seasonal and temporary jobs. On the other hand, employment for indefinite period in government sector shows a downward tendency. Growth of employment is partially a result of increased informal employment, which reached a level of 20,9[12]%. Slight improvement in the labour market was also brought on by labour market reforms.

Source: Republic Statistical Office (average for the period)

Inflation

Y-o-Y inflation throughout 2016, as well, was constantly below the lower target corridor of NBS 4,0%±1,5pp. At the end of 2016 y-o-y inflation stands at 1,6%[13]. The inflation level in 2016 was impacted by the following factors: low price of oil derivatives and primary agricultural products, low demand and slow growth in regulated prices, low costs in food production and inflation in international environment. Considerably more favourable macroeconomic operating conditions for the upcoming period, reduced risk of investing in Serbia and achieved price stability caused NBS to adjust, at the end of 2016, its lowest inflation target to 3,0%±1,5pp for the year 2017.



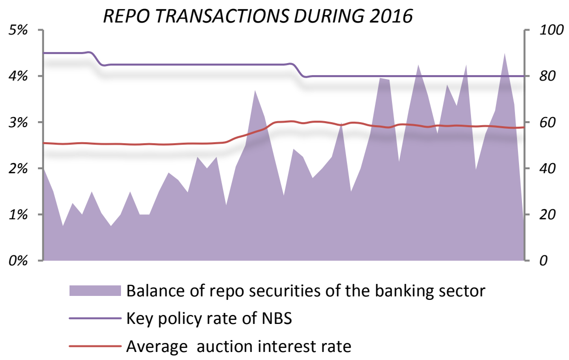
Repo rate

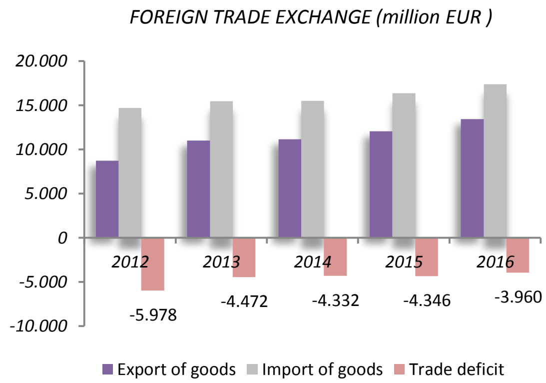
The implemented fiscal consolidation, structural reforms, decrease in foreign trade imbalance and economic growth strengthened the resilience of local economy to possible risks from the international environment. Overall macroeconomic trends enabled the National Bank of Serbia to retain the relaxed monetary policy in 2016 and to continue lowering the key policy rate from 4,5% from the beginning of the year to 4,0% at the year end. After lowering key policy rate and narrowing interest rate corridor of NBS relative to key policy rate to ±1,5pp, the spread between average repo rate and key policy rate has been reduced. By returning the instrument of reverse repo transactions, the NBS again enabled the banks to invest liquid assets in treasury bills, but by applying auctions and multiple interest rates. This resulted in separation and establishing of auction (lower) and reference (higher) interest rate. Average repo rate at the end of 2016 was 2,89%. The volume of repo transactions ranged from the initial RSD 40,0 billion to maximum volume of RSD 90,0 billion in December, only to reach RSD 15,2 billion at the end of the year.

[11] RSO, Labour Force Survey, Q4 2016

[12] Ditto

13 RSO

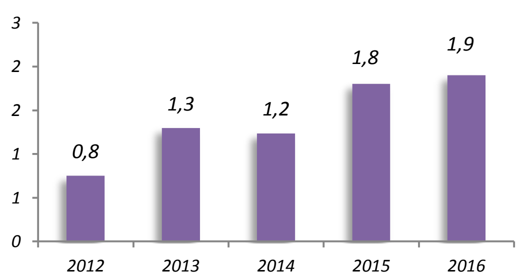




Foreign Direct Investments

At the end of December 2016 Foreign Direct Investments reached the amount of EUR 1,9 billion[14]. The biggest investment was realised in the metal industry sector (still mill Hesteel doo Smederevo), while a significant inflow of investments was also realised in real estate, construction industry, financial services, trade, telecommunications and air traffic sectors.

FOREIGN DIRECT INVESTMENTS (billion EUR)



The volume of foreign direct investments of EUR 1,9 billion was more than enough to cover the current account deficit, which, for 2016, is estimated at 4,0[15]% of GDP.

Foreign Trade Exchange

Total foreign trade exchange of the Republic of Serbia, in twelve months of 2016, was EUR 30,8 billion[16]. This volume represents an increase of 8,4% compared to the same period last year. The export of goods, in twelve months of 2016, reached the value of EUR 13,4 billion. The import of goods, in the same period, amounted to EUR 17,4 billion, or realised trade deficit amounted to EUR 4,0 billion.

Broken down by export companies, the company Fiat automobili Srbija d.o.o., Kragujevac (FAS), is the leading exporter in 2016, as well. By the end of 2016 volume of exports by FAS amounted to EUR 1.068 million[17]; it is followed by Hesteel Serbia d.o.o., Smederevo (former Steel Mill Smederevo), Tigar tyres d.o.o., Pirot and NIS a.d., Novi Sad.

Analysing the structure of foreign trade exchange by regions and countries, the EU countries account for about 2/3 of foreign trade exchange. The import from EU countries accounts for 63,1% of total import, while the export to EU countries account for 66,1% of total export[18]. In 2016, as well as in 2015, the main foreign trade partners from EU are Italy and Germany, with 27,6% of total export and 23,2% of total import from these countries.

Exchange rate EUR/RSD

At the end of 2016 the exchange rate EUR/RSD (123,47) is by 1,52% higher than the exchange rate applicable at the end of 2015. During 2016 EUR/RSD exchange rate ranged between RSD 121,5 and RSD 123,9 for one EUR. Dinar exchange rate fluctuations against foreign currencies were impacted by: significantly more favourable macroeconomic indicators, positive evaluations of IMF with regard to implementation of signed arrangement, improved country credit rating by the foreign agency Fitch, increased trust of foreign investors and consequently by growth of investments in dinar securities of the Republic of Serbia.

Dinar depreciation in 2016 had a positive impact on the competitiveness of the domestic economy. The National Bank of Serbia (NBS) intervened in the interbank foreign exchange market in both directions, through the purchase, thus preventing

14 RS Ministry of Finance, Basic macroeconomic indicators, May 2017

15 Ditto

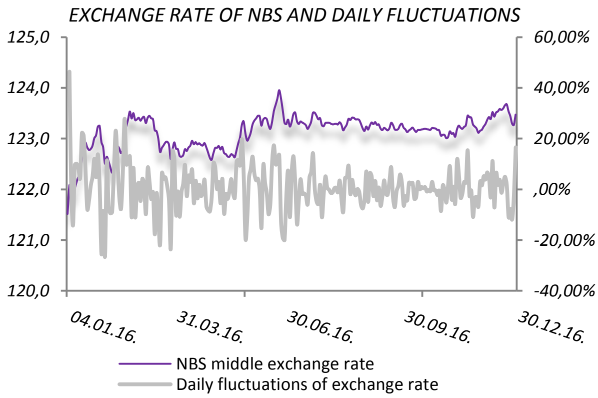
16 RS Ministry of Finance, Current macroeconomic trends, February 2017

17 RS Ministry of Finance, Current macroeconomic trends, February 2017

18 Ditto,

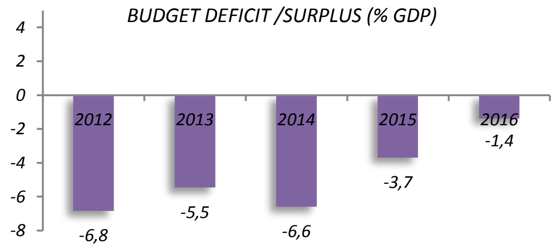
the appreciation of dinar, but it was also selling the foreign currencies, therefore preventing excessive fluctuations of the local currency. During 2016 the volume of purchase by NBS amounted to EUR 820 million, whereas the volume of sale amounted to EUR 980 million.

Foreign currency reserves of NBS at the end of the year amounted to EUR 10,2 billion[19] and were reduced relative to the end of 2015 by 1,67%.



Budget deficit/surplus

At the overall government level, over the period January-December 2016, a deficit is recorded in the amount of RSD 57,1 billion[20], or 1,4% of GDP, which is a better result compared to a planned deficit defined by the IMF Programme (RSD 163,5 billion or 3,9% of GDP).

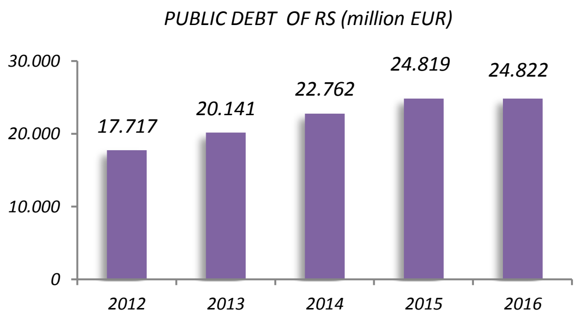


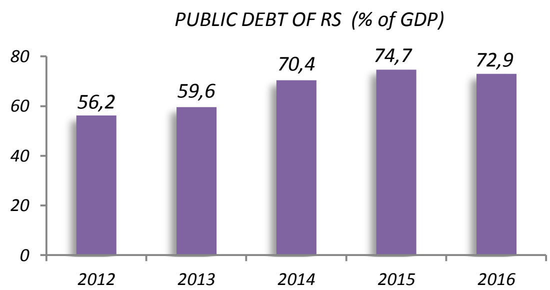
Source: Ministry of Finance of RS (consolidated fiscal result)

In the same period the budget surplus of the Republic was recorded amounting to RSD 5,0 billion. Reduction in deficit at the overall government level came as a result of increase in fiscal revenues, particularly one-off non-tax revenue and lower expenditures. Biggest growth was recorded in excise taxes and VAT due to more efficient collection of public revenues and growth of final consumption. Better revenues were also realized from corporate income tax, along with revenues from contributions and personal income tax. Larger non-tax revenue was also recorded. On the expenditure side, the expenditures for employees, for pensions and subsidies are reduced with concurrent increase in capital expenditures, which should have a positive impact on economic growth.

Public debt

Public debt of the Republic of Serbia at the end of December 2016 amounted to EUR 24,8[21] billion, or 72,9% of GDP. According to available data, in comparison to the end of 2015, the public debt has been increased by EUR 3,2 million. The biggest threat for reduction of share of public debt in GDP came from developments in international environment, and primarily in dollar exchange rate fluctuations (about 33% of the debt is in dollars) and also in changes of interest rates.





Foreign debt

According to data provided by NBS, at the end of December 2016, the total public debt, of public and private sector, amounted to EUR 26,6[22] billion and compared to December 2015 it has been increased by EUR 357,6 million. Foreign debt accounts for 77,9% of GDP. Foreign debt of private sector, over the reporting period, was reduced by EUR 26,5 million, whereas the public sector debt

[19] NBS, Basic macroeconomic indicators, April 2017
20 RS Ministry of Finance, release for November 2016

[21] RS Ministry of Finance, Current macroeconomic developments, February 2017
[22] NBS, RS external debt by debtors, March 2017

was increased by EUR 384,2 million. The external solvency indicator that is calculated as the ratio between the amount of foreign debt and the value of export of goods and services is slightly improved at the end of 2016 and equals 153,6[23]%, (beginning of the year 167,8%).

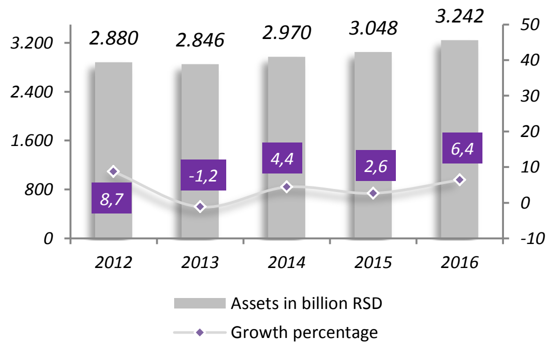
3. *BANKING SECTOR OF THE REPUBLIC OF SERBIA AND FINANCIAL POSITION OF THE BANK*

3.1. Banking sector

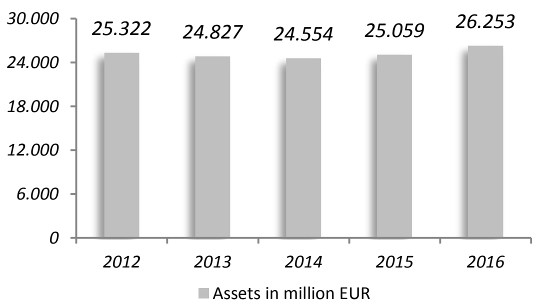
The Banking sector of the Republic of Serbia, at the end of 2016, comprises in total 30 banks with 23.847 employees, total assets of RSD 3.241,5 billion and total capital of RSD 632,5 billion. The ten largest banks by assets account for 77,4% in total assets of the sector.

In the first twelve months of 2016 the balance sheet assets of the banking sector increased by 6,4% compared to the end of last year, total capital is increased by 1,9%, while the number of employees decreased by 1,7%.

TRENDS IN THE BANKING SECTOR

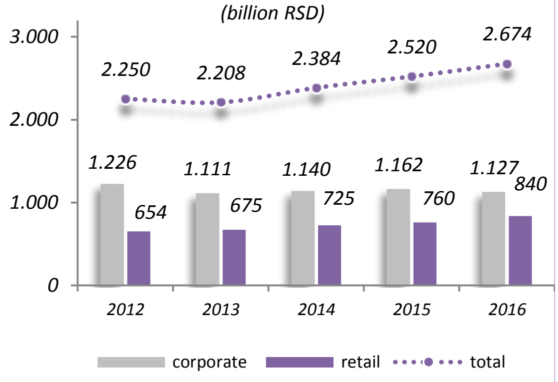


TRENDS IN BANKING SECTOR



During 2016 the trend of reduction in interest rates continued, which led to growth of total loans being realised, whereby retail loans recorded a higher growth, while corporate loans increased to a lesser extent. The banking sector has significantly high liquidity surplus, taking into consideration the basic liquidity ratios. The liquidity surplus of the sector is invested mainly in government securities and reverse repo transactions of NBS. At the end of December 2016 the balance of bank investments under repo transactions amounted about RSD 15,2 billion. As for government securities, total value of portfolio, at the end of December, amounted about RSD 678,5 billion. Share of securities stood at 20,9% of banking sector assets, and the cash and funds with the Central Bank 14,9%.

CREDIT ACTIVITY OF THE SECTOR (billion RSD)



Share of gross NPL (loans defaulting over 90 days) in total gross loans, at the end of Q4 2016 reaches the level of 17,0%, whereas at the end of December 2015 it stood at 21,6%. Analysed by sectors, most of gross NPL relate to companies. At the end of December 2016 coverage of gross NPL by calculated reserve for estimated losses on balance sheet receivables stands at 118,9%. Impairment provisioning of total loans cover 72,9% of gross NPL[24]. Gross retail NPL at the end of the third quarter amount to RSD 87,5 billion and are slightly reduced compared to Q2 2016.

Retail foreign currency savings showed a growing tendency and in December 2016 it reached the amount of EUR 8,7[25] billion, which is an increase compared to the end of 2015 (4,0%).

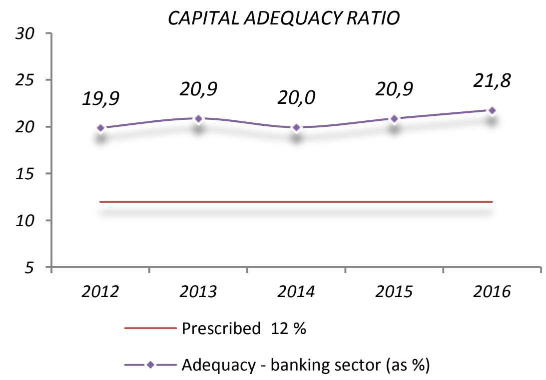
Capital adequacy, as of December 31th, 2016 stands at 21,8%, which means that the banking sector is adequately capitalised. Achieved capital adequacy is well above the prescribed regulatory minimum of 12,0%. At the end of December 2016, the total capital of the banking sector amounts to RSD 632,5 billion, which is an increase compared

23 NBS, RS external debt by debtors, March 2017

24 NBS, macroprudential indicators

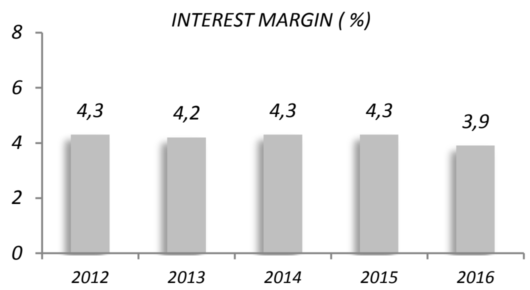
25 NBS

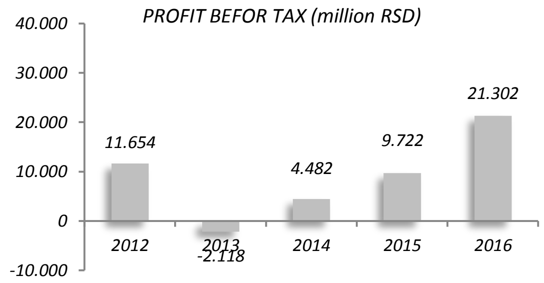
to the end of 2015 in the amount of RSD 12,0 billion.



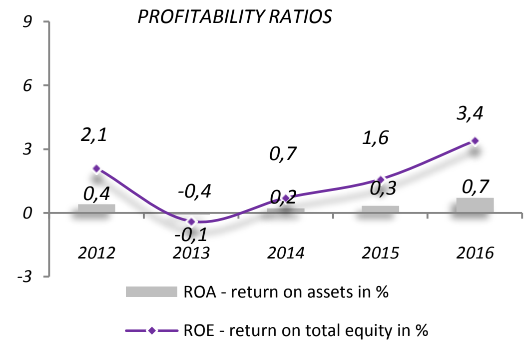
In 2016 there is also a tendency of reduction of credit indebtedness of the banking sector abroad. By the end of December of 2016, a reduction was recorded of total indebtedness of the banks towards foreign entities by 11,3% compared to the end of 2015.

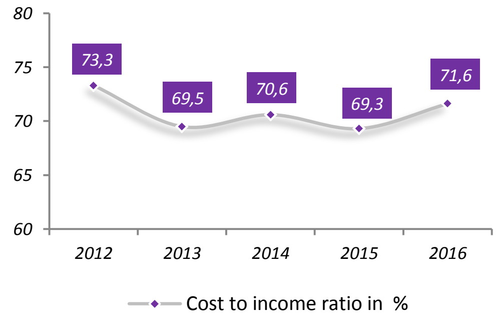
In the first twelve months of 2016 the banks recorded a growth of profitability. At the end of 2016 a positive net financial result was achieved, before tax, amounting to RSD 21,3 billion. Over the reporting period 19 banks operated with positive result with total overall result of RSD 41,4 billion, while 11 banks operated with a total loss of RSD 20,1 billion. One of the main drivers of growth of net profit is also a lower amount of net credit losses. The costs of net impairment provisioning recorded a reduction compared to the same period last year (December 2016 – RSD 40,6 billion, December 2015 – RSD 59,6 billion).





Note: the result at the end of 2012 includes the loss of Razvojna banka Vojvodine of EUR 128 million, and the result at the end of 2013 includes the loss of Univerzal banka of EUR 13million.

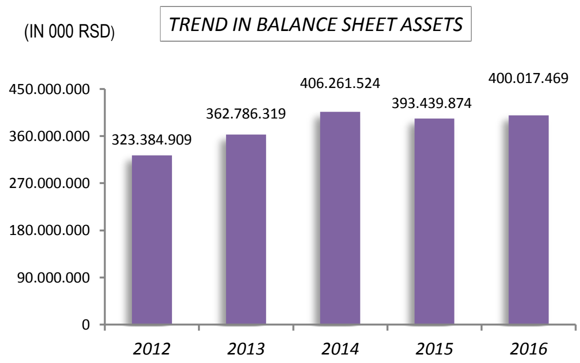


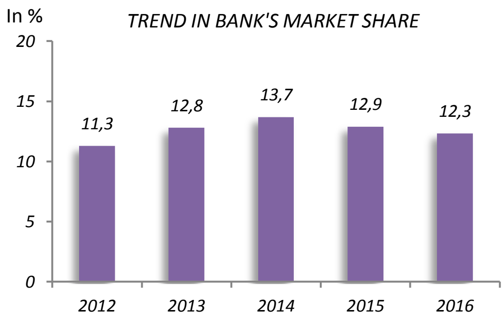


Cost-to-Income ratio continues the upward trend, after an increase in 2014 and reaches the value of 71,6%.

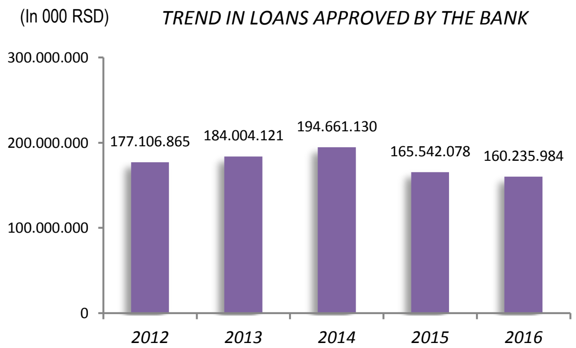
3.2. Financial position of the Bank versus sector

As of 31 December 2016, the Bank with the balance sheet assets amounting to RSD 400.017,5 million accounted for 12,3% of the Serbian banking market and ranked second by this parameter. Market share at the end of 2015 amounted to 12,9%.



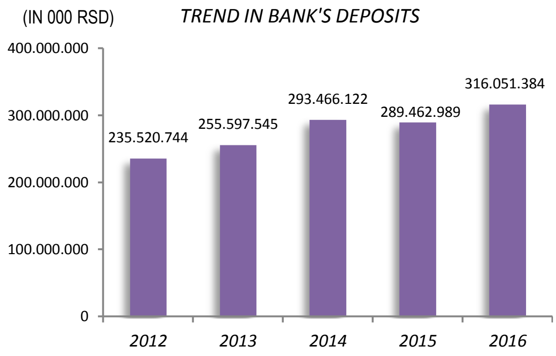


Loans approved to customers and Bank's receivables as of 31 December 2016 amount to RSD 191.012,8 million, which accounts for 9,8% of market share. The result achieved is the same compared to the result at the end of 2015 when the Bank had 9,8% of share in the banking sector (RSD 179.586,6 million).



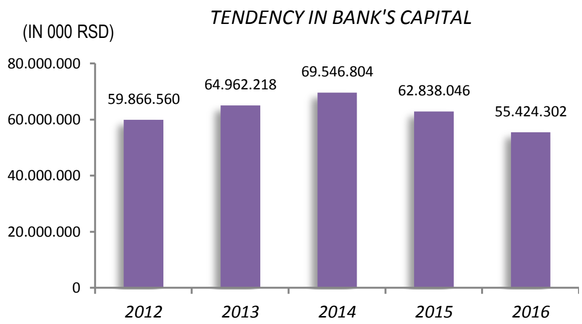
** Chart shows the loans without any other investments and receivables*

The position deposits from customers and other liabilities are slightly changed in the period from the end of 2015 to 31 December 2016. Share of deposits and other liabilities of the Bank in total deposits of the banking sector stood at 13,7% at the end of 2015 (RSD 317.165,2 million), while on the end of 2016 it equalled 13,1% of total deposits of the banking sector (RSD 330.456,3 million).



** Chart shows deposits without other liabilities and credit lines*

In terms of the position total capital the Bank reduced a share in the banking sector from 10,1% (RSD 62.838,0 million at the end of 2015) to 8,8% of the banking market as of 31 December 2016 (RSD 55.424,3 million).



4. *BANK'S BODIES AND ORGANIZATIONAL STRUCTURE*

4.1. Bank's Board of Directors

Bank's Board of Directors has been established in compliance with the Law on Banks and Shareholders Agreement – Republic of Serbia and the group of international financial institutions (EBRD, IFC, DEG, SwedFund); it comprises nine members, including the Chairperson, three of whom are the persons independent of the Bank. The members of the Bank's Board of Directors are appointed by the General Meeting of Bank's Shareholders for a term of four years.

Competences of the Bank's Board of Directors are defined by the Article 73 of the Law on Banks and by the Article 27 of the Bank's Articles of Association. The members of the Bank's Board of Directors as of 31 December 2016 are as follows:

FIRST NAME AND FAMILY NAME	SHAREHOLDER / MEMBER INDEPENDENT OF THE BANK	POSITION
Vladimir Krulj, PhD	*Republic of Serbia*	*Chairperson*
Mirjana Ćojbašić	*Republic of Serbia*	*Member*
Ljilja Jovanović	*Republic of Serbia*	*Member*
Andreas Klingen	*EBRD*	*Member*
Philippe Delpal	*EBRD*	*Member*
Khosrow Zamani	*IFC*	*Member*
Olivera Matić Brbora	*Member independent of the Bank*	*Member*
Mila Korugić Milošević	*Member independent of the Bank*	*Member*
Mats Kjaer	*Member independent of the Bank*	*Member*

4.2. Bank's Executive Board

The Executive Board consists of the President of the Executive Board, Deputy President of the Executive Board and at least three members.
The term of office of the members of the Bank's Executive Board, including the President and the Deputy President is four years starting from the date of appointment.

Competences of the Executive Board are defined by the Article 76 of the Law on Banks and by the Article 31 of the Bank's Articles of Association.
The members of the Bank's Executive Board as of 31 December 2016 are as follows:

FIRST NAME AND FAMILY NAME	POSITION
Alexander Picker, PhD	*President*
Slađana Jelić	*Deputy President*
Dragiša Stanojević	*Member*
Dejan Tešić, PhD	*Member*

4.3. Committee for Supervision of Bank's Operations (Audit Committee)

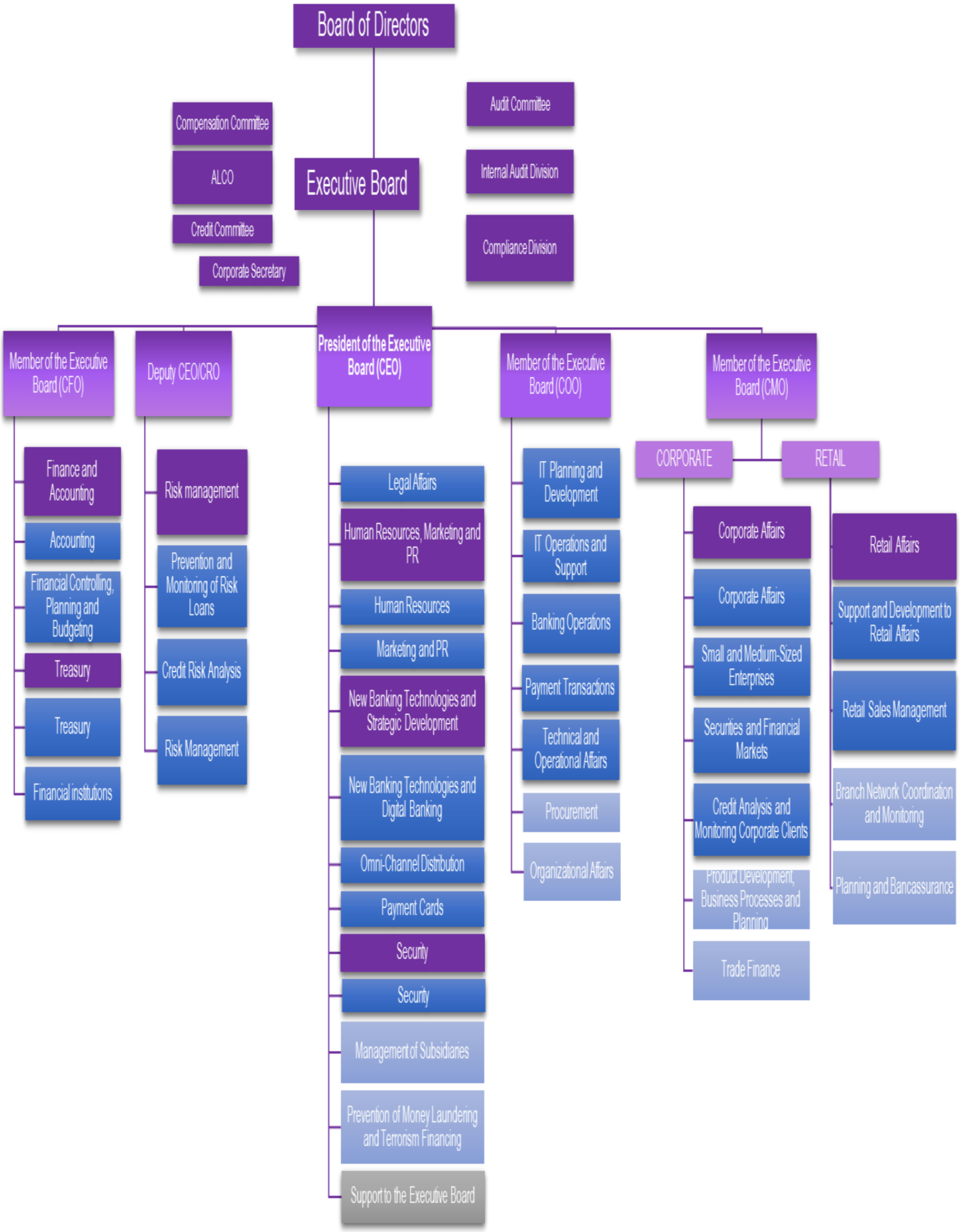
The Committee for Supervision of Bank's Operations consists of three members, two of whom are the members of the Bank's Board of Directors who have appropriate experience in the field of finance. One member of the Committee for Supervision of Operations is the person independent of the Bank. The members of the Committee are appointed for a term of four years.

The duties of the Committee for Supervision of Operations are defined by Article 80 of the Law on Banks and by Article 34 of the Bank's Articles of Association.

The members of the Committee for Supervision of Operations as of 31 December 2016 are as follows:

FIRST NAME AND FAMILY NAME	POSITION
Mats Kjaer	*Chairperson*
Andreas Klingen	*Member*
Milena Kovačević	*Member*

4.4. Organisation Chart



4.5. Regional distribution of Bank's branches

In 2016, as well, the Bank performed its operations through a network of branches and sub-branches whose number was changing and adapting to market requirements.

At the end of 2016 (October) the Bank's management commenced the process of reorganisation of the business network of branches and sub-branches, by closing down Смедерево Branch and by opening two business centres, Business centre Beograd 1 and Business Centre Beograd 2 within Beograd Branch. The intention of the management is to replace the existing network of 24 branches and over 200 sub-branches with more efficient and more rational business network, which will cover both the existing and the new target groups.

At the end of 2016 the business network of the Bank included 23 branches, 2 business centres (Beograd 1 and Beograd 2 within Beograd Branch) and 205 sub-branches, which enabled the Bank to fully cover the territory of the Republic of Serbia. During 2016, four sub-branches and one branch were shut down, and two new Business centres were established

BRANCHES

Beograd- Svetogorska 42-44
Niš –Episkopska 32
Kruševac-Trg Fontana 1
Kraljevo-Trg S. Ratnika bb
Novi Pazar -Njegoševa 1
Novi Sad-Novosadskog sajma 2
Užice-Petra Ćelovića 4
Zrenjanin-Trg Slobode 5
Čačak-Gradsko šetalište 10-14
Vranje -K. Stefana Prvovenčanog 58
Valjevo -Gradski Trg bb
Subotica-Korzo 10
Šabac-Gospodar Jevremova 2
Kragujevac-Save Kovačevića 1
Požarevac- Moše Pijade 2
Jagodina- Knjeginje Milice 10
Loznica- Gimnazijska 1
S. Mitrovica- Kralja Petra I 5-7
Zaječar-Nikole Pašića 25
Kikinda -Braće Tatić 7
Sombor-Staparski put 14
Vršac-Trg Sv. Teodora vršačkog 2
K. Mitrovica -Kneza Miloša 27

5. BANK'S BRANCH NETWORK AND SUBSIDIARIES

The Bank performs its business operations through a network of branches and sub-branches whose number is changing and adapting to market requirements. During 2016, the business operations were conducted in the Bank's Head Office in Belgrade, 23 branches and 205 sub-branches and through two new Business centres, Beograd 1 and Beograd 2 that were established at the end of the year.

The Bank also has three subsidiaries, which together form Komercijalna banka a.d., Beograd Group, as follows:

1. Komercijalna banka a.d., Budva in the Republic of Montenegro (100% ownership),
2. Komercijalna banka a.d., Banja Luka in Bosnia and Herzegovina (99,998% ownership) and
3. KomBank INVEST a.d., Beograd, the Investment Fund Management Company (IFMC) (100% ownership).

Komercijalna banka ad Banja Luka
-157 employees,
-18 organisational units and the head office
(8 branches and 10 agencies)

Komercijalna banka ad Budva
-133 employees,
-13 organisational units
(3 branches and 10 sub-branches)

KomBank Invest ad Beograd
-4 employees

5.1. Major Transactions with Related Parties

Total exposure to parties related to the Bank, as at 31 December 2016 amounted to РСД 532,1 million, which in terms of regulatory capital of RSD 46.230,7 million accounted for 1,2% (as prescribed by the Law on Banks the maximum value of total loans and advances to all parties related to the Bank may equal 20% of capital).

The major part of the exposure to parties related to the Bank, as at 31 December 2016, amounting to RSD 525,5 million, or 1,1% of the regulatory capital of the Bank, refers to loans and advances to retail customers who are the parties related to the Bank.

Pursuant to the Article 37 of the Law on Banks and with respect to entities related to the Bank, the Bank did not approve loans to such entities under the conditions that are more favourable than the conditions under which the loans were approved to other entities that are not related to the Bank, and/or are not the employees of the Bank.

6. FINANCIAL POSITION AND OPERATING RESULTS OF KOMERCIJLANA BANKA IN 2016

6.1. Introduction

The Bank's operations in 2016 were crucially influenced by the commencement of the privatisation process and accordingly the continuation of final correction of the loan portfolio. Still high amount of loan impairment provision exerted effect on negative financial result, but also on an increase in coverage of NPL above 75%. The afore-stated should, in the forthcoming period, contribute to better NPL portfolio management. Negative result recorded in 2016 had no impact on safety, stability and liquidity of the Bank. Realised net interest and fee income in 2016 is slightly lower compared to the end of 2015. The policy of Bank's management to allocate considerable portion of realised profit to reserves, in the previous period, now provides the possibility to cover the entire loss without reducing the share capital.

Balance Sheet Total

At the end of 2016, the Balance Sheet Total (net assets) reached the amount of RSD 400.017,5 million (EUR 3,2 billion) and represents an increase of 1,7% compared to last year. Focus remains on sustainable operations, through balancing between profitability and portfolio quality, further optimisation of asset structure and quality, finding new sources of funding and faster employment of funds.

Sources

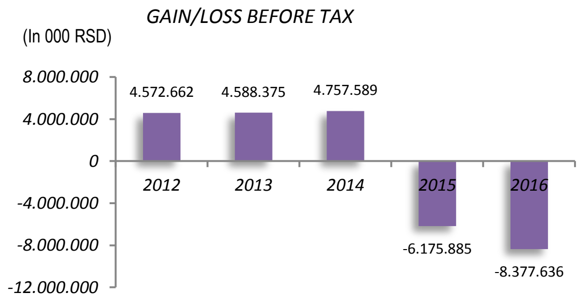
In the course of 2016, as well, the growth of retail foreign currency savings continued, amounting to approximately EUR 20,8 million, and corporate deposits recorded a growth compared to the end of 2015 by RSD 22.796,7 million. Deposits of banks and other financial organisations are reduced during 2016 by RSD 8.683,8 million.
Throughout 2016, the Bank returned to foreign creditors EUR 136 million, and it drew down EUR 34 million in credit lines. Balance of Bank's liabilities under the received credit lines at the end of 2016 amounts to RSD 12.984,1 million and the same is reduced compared to the end of 2015 by RSD 12.149,9 million.
Subordinated liabilities at the end of the reported year amount to RSD 6.178,4 million.

Loans and Advances

At the end of the reported period the Bank recorded a drop in corporate loans (in the amount of RSD 15.120,4 million, or 17,0%), mainly as a result of reduced demand by quality clients, early repayments, as well as significant loan impairment. At the same time a growth is recorded in retail loans (growth of RSD 4.737,5 million) among which predominant are cash loans and loans for refinancing. Large part of its liquid assets the Bank invested in dinar and foreign currency securities. At the end of 2016, RSD 136.123,8 million were invested in securities available for sale, which is an increase of RSD 7.367,4 million compared to the same period of 2015 (increase of 5,7%).

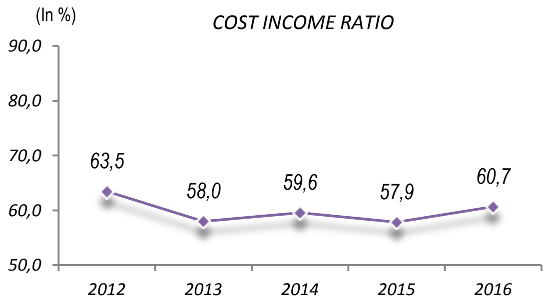
Profitability

The result in 2016, same as in 2015, was decisively impacted by the expenses of loan impairment and credit risk-bearing off-balance sheet items (RSD 14.907,5 million).

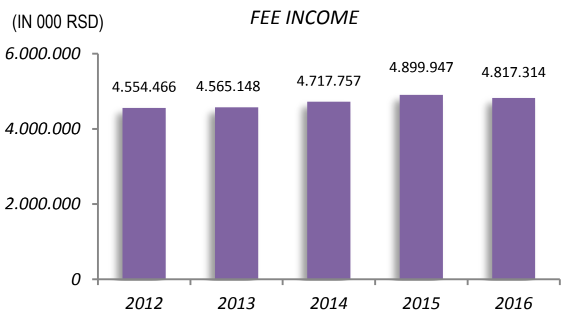


At the end of 2016 the Bank recorded a decline in net interest income and net fee income, accompanied with the growth of CIR, while, on the other side, it recorded one-off increase in loan impairment provision, which ultimately resulted in loss before tax amounting to RSD 8.377,6 million.

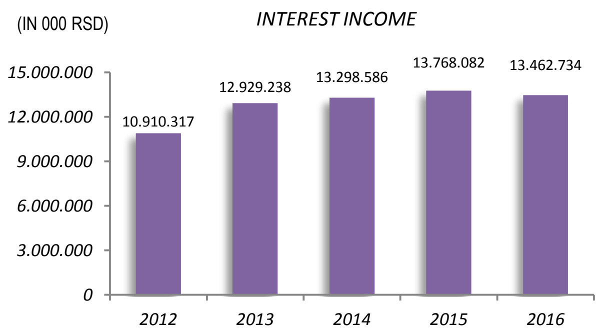
The Bank’s loss is lower than the amount of allocated reserves from profit for estimated losses which is higher than the total required reserves calculated by the regulations of the National Bank of Serbia. At the end of 2016 the Bank formed more reserves than required in the amount of RSD 10.171,5 million.

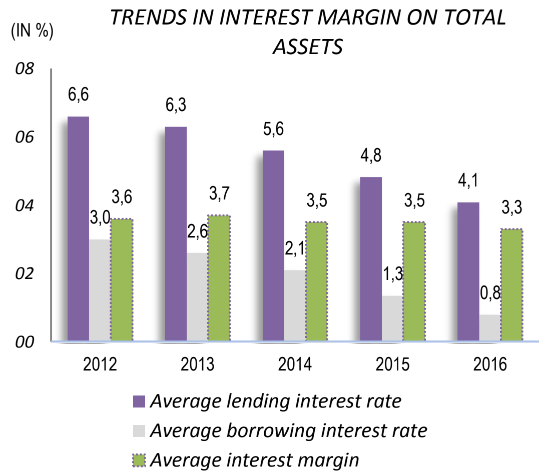


Cost Income Ratio is within the planned value for 2016 (revision).

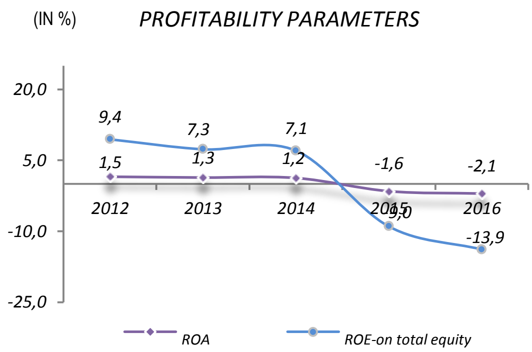


In the course of 2016 the interest income recorded a decline of 2,2% compared to the end of 2015, and concurrently the fee income recorded a decline of 1,7%.





By further optimisation of the price and the structure of sources of funds the interest margin has been achieved in line with the plan (3,3%), despite the constant decline in both lending and borrowing interest rates during 2016, as well.

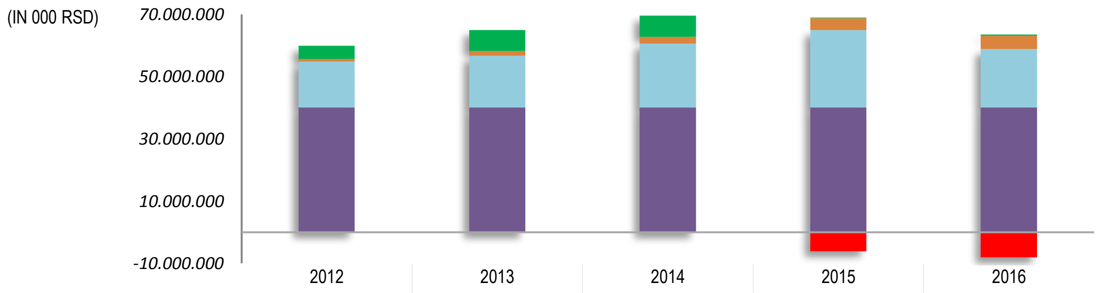


Bank's Capital

Changes in capital over the period from 2012 to 2016:

ITEM	2016	2015	2014	2013	2012
BANK'S CAPITAL (IN 000 RSD)					
Share capital	40.034.550	40.034.550	40.034.550	40.034.550	40.034.550
Reserves from profit	18.791.828	24.935.440	20.635.440	16.635.440	14.785.440
Revaluation reserves	4.311.409	3.749.864	2.120.959	1.604.257	860.758
Retained earnings	349.698	179.550	6.755.855	6.687.971	4.185.812
Loss	8.063.183	6.061.358	-	-	-
TOTAL CAPITAL	55.424.302	62.838.046	69.546.804	64.962.218	59.866.560

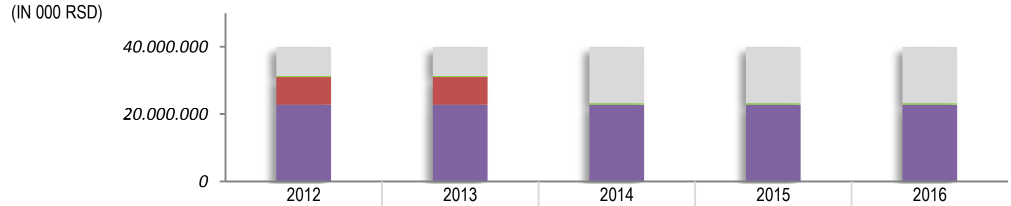
BANK'S TOTAL CAPITAL OVER THE PERIOD 2012-2016



	2012	2013	2014	2015	2016
LOSS				-6.061.358	-8.063.183
RETAINED EARNINGS	4.185.812	6.687.971	6.755.855	179.550	349.698
REVALUATION RESERVES	860.758	1.604.257	2.120.959	3.749.864	4.311.409
RESERVES FROM PROFIT	14.785.440	16.635.440	20.635.440	24.935.440	18.791.828
SHARE CAPITAL	40.034.550	40.034.550	40.034.550	40.034.550	40.034.550
MOVEMENT OF CAPITAL in %	35%	9%	7%	-10%	-12%
TOTAL CAPITAL	59.866.560	64.962.218	69.546.804	62.838.046	55.424.302

Total capital of the Bank at the end of 2016 amounts to RSD 55.424,3 million and is reduced by 11,8% compared to the end of 2015. Over the period from 2010 to 2016 the Bank's total capital was increased by 35,0%. The share capital, in the same period, is increased by 40,7%, or by RSD 11.572,0 million. Until present the Bank increased the share capital based on two issues of convertible preferred shares (2010 in the amount of RSD 11.400 million and in 2012 RSD 11.572 million). In the last ten years, the Bank has allocated the major part of realised profit to reserves for estimated losses in order to maintain safety and security in business operations and capital adequacy, and/or for the purpose of protecting the share capital from potential losses, but also for increase of the core capital. The Bank has during the last five years from the profit and revaluation, increase the total reserves in the amount of RSD 7,457.0 million. At the end of 2016, the reserves from profit are reduced compared to 2015 by RSD 6.143,6 million, since the Bank used the part thereof to cover the loss from 2015.

BANK'S SHARE CAPITAL IN THE PERIOD 2012-2016



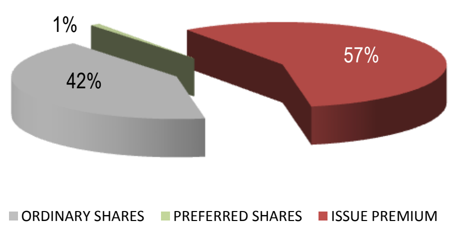
	2012	2013	2014	2015	2016
ORDINARY SHARES	8.709.310	8.709.310	16.817.956	16.817.956	16.817.956
PREFERRED SHARES	373.510	373.510	373.510	373.510	373.510
CONVERTIBLE PREFERRED SHARES	8.108.646	8.108.646			
ISSUE PREMIUM	22.843.084	22.843.084	22.843.084	22.843.084	22.843.084
GROWTH RATES	41%	0%	0%	0%	0%
TOTAL SHARE CAPITAL	40.034.550	40.034.550	40.034.550	40.034.550	40.034.550

The ordinary (regular) shares of the Bank have been traded at the Standard listing of Belgrade Stock Exchange since 2010. During 2014 a conversion was carried out of convertible preferred shares into ordinary shares and since then there have been no changes in the structure of the share capital. As of 31 December 2016 the Bank has 16.817.956 ordinary shares (regular) and 373.510 preferred shares of individual nominal value of RSD 1.000. At the end of 2016 the Bank's ordinary shares are held by 1.199 shareholders, and preferred shares by 616 shareholders.

The Bank's Shareholders as of 31 December 2016 are as follows:

SHAREHOLDERS	Ordinary shares	% STAKE	Preferred shares	% STAKE	TOTAL SHARES	% STAKE IN SHARE CAPITAL
Republic of Serbia	7.020.346	41,7	-	0,00	7.020.346	40,8
EBRD	4.109.440	24,4	-	0,00	4.109.440	23,9
IFC	1.706.810	10,2	-	0,00	1.706.810	9,9
DEG	772.850	4,6	-	0,00	772.850	4,5
SWEDFUND	386.420	2,3	-	0,00	386.420	2,3
OTHERS	2.822.090	16,8	373.510	100,00	3.195.600	18,6
TOTAL	16.817.956	100,0	373.510	100,0	17.191.466	100,0

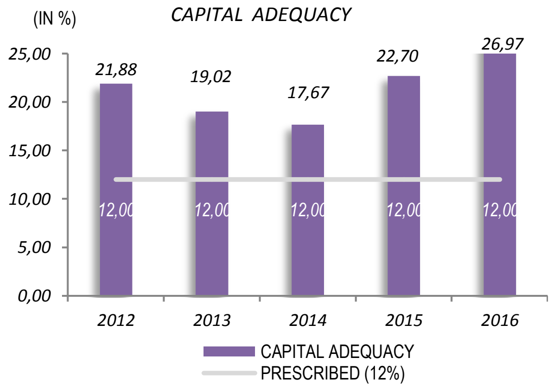
STRUCTURE OF SHARE CAPITAL AS OF 31.12.2016



Capital adequacy

Bank's capital adequacy ratio at the end of 2016, with still considerably high impairments and provisions, stands at 27,0%, which is the best evidence that the Bank managed to maintain the adequate capitalisation. Over the reported time period, and also in the course of 2015, the Bank met all the parameters of operations prescribed by the Law on Banks and discharged all liabilities, which is a reliable indicator of sound, stable and safe business operations.

CAPITAL ADEQUACY

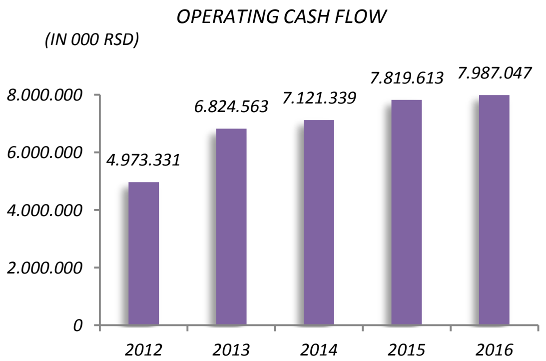


Performance indicators

No.	ITEM	STATUTORY	2016.	2015.	2014.	2013.	2012.
1.	CAPITAL ADEQUACY RATIO	min 12%	26,97%	22,70%	17,67%	19,02%	21,88%
2.	RATIO OF INVESTMETN INTO ENTITIES OUTSIDE THE FINANCIAL SECTOR AND INTO FIXED ASSETS	max 60%	17,47%	23,13%	27,60%	24,67%	18,38%
3.	LARGE EXPOSURE RATIO	max 400%	38,48%	79,76%	160,59%	97,78%	107,37%
4.	FX RISK RATIO	max 20%	2,96%	10,60%	2,90%	2,12%	0,82%
5.	LIQUIDITY RATIO	min 0,8	2,86	2,73	2,84	3,45	2,18

Operating cash flow

At the end of 2016 operating cash flow was RSD 167.4 million higher year-over-year (increase of 2.1%). At the end of 2016 there was an increase in fee receipts of RSD 343.3 million or 5.8%, while interest receipts recorded a decrease in the same period of RSD 1,225.5 million or 6.5%, primarily due to a decrease in lending rates. On the side of cash outflow from the business activities, realized interest payments were lower by RSD 1,617.6 million or 27.3%, primarily due to a decrease in average interest rate on fixed-term deposits.



Description of changes in the company's business policies

During 2016 the Bank did not make amendments to the document Business Policy. The Bank's business policy was adopted at the General Meeting of the Bank's Shareholders on 26.01.2012.

The business policy specifies the key operating principles and the tasks the Bank performs with the aim of achieving business results and priorities specified in the applicable Strategy and Business Plan, based on:

- the Bank’s position in the financial market and customers’ trust,
- projections of key parameters of macroeconomic policy and
- the Bank’s development targets.

The Bank's business policy has been brought into compliance with the Risk Management Strategy and Capital Management Strategy, as well as with the policies for managing individual risks.

The Bank operates independently, on market principles, with the implementation of the principle of liquidity, profitability and safety, while obeying the law, other regulations and the general banking principles in achieving its targets in a socially responsible manner, in accordance with the basic values and business ethics.

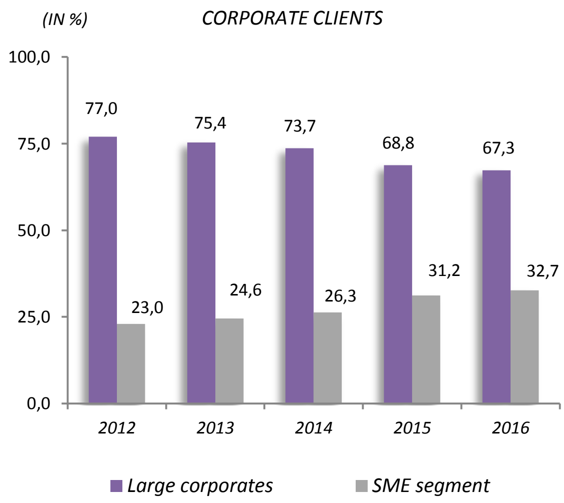
6.2. Corporate operations

Market – key tendencies

Decreasing trends in lending interest rates recorded in 2014 continued also in 2016 as a consequence of competition between banks and a reduction in the price of funding for loans. In 2016 there were two historic lows in lending interest rates (loans with a currency clause below 1.5% and dinar loans blow 4.0%).
As a consequence of mitigating the prising, there was an increase in demand for corporate loans. Increased demand for corporate dinar and FX loans came from the need to finance working capital and capital expenditures and, to a lesser extent, from the need to refinance the existing loans.

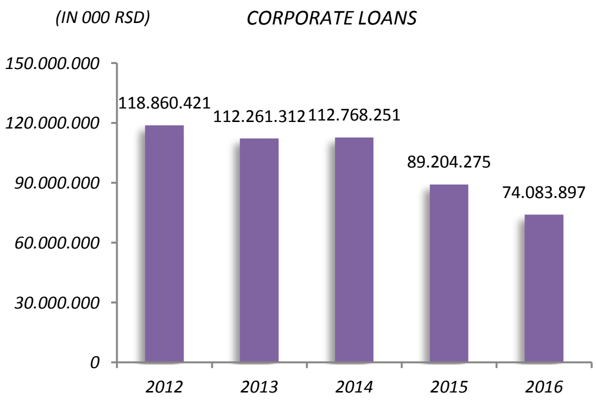
On the other hand, observed in total, lending standards of banks were additionally adjusted to the situation in the market. Banks showed that they were less willing to accept credit risk, they increased standards when it comes to collateral. Observed by maturity structure of the newly-approved loans, one can see that the standards have become more stringent, especially for long-term loans, while standards for short-term loans remained unchanged.

Despite growing demand and increased lending activity, the level of corporate loans in the banking sector in 2016 was lower than at the end of 2015. Neither in 2016 nor in 2015 were there subsidized corporate loans.



Loans[26] - the Bank's operation

Activities were focused on small and medium-sized enterprises. Therefore, during 2016 a range of activities were undertaken in order to maintain the portfolio in this segment: loans from the campaign with fixed interest rate, lending from EIB APEX III/A credit line KOM DIN PROGRESSIVE credit lines, WeBSEFF credit line for energy efficiency.

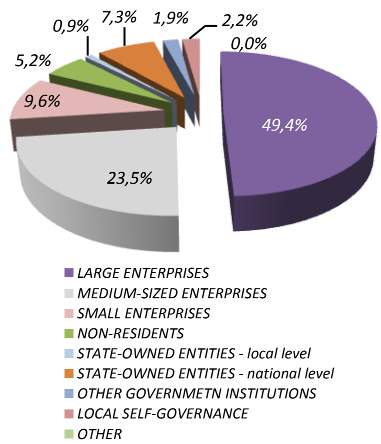


Stability of exchange rate in the environment of additionally lowered interest on loans with currency clause resulted in further decrease in the share of dinar loans in the loan portfolio (31 December 2016 the share of dinar loans is 9.7%).

Great pressure from competitors to reduce interest rated, decrease in portfolio due to prepayments and not using the approved loans (RSD 5 billion) resulted in a significant decrease in interest income in 2016.

As for the competition, throughout 2016 the most active banks were Banca Intesa a.d. Beograd and UniCredit banka Srbija a.d. Beograd, with occasional campaigns of the following banks: ProCredit a.d. Beograd, Erste banka a.d. Novi Sad, Societe Generale Banka a.d. Beograd. All competitors exhibited a noticeably more flexible approach (interest rates, maturities, required security instruments) when approving the loans, compared to previous years.

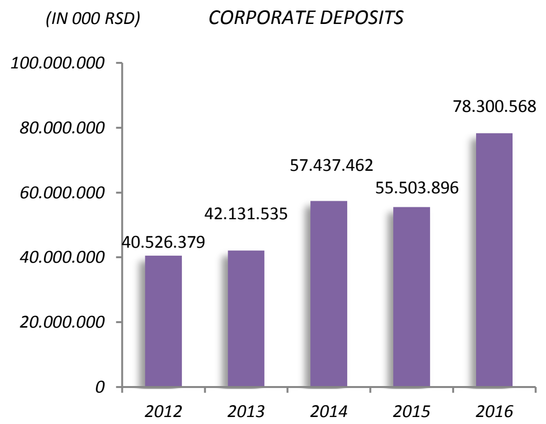
CLIENT STRUCTURE AS OF 31.12.2016



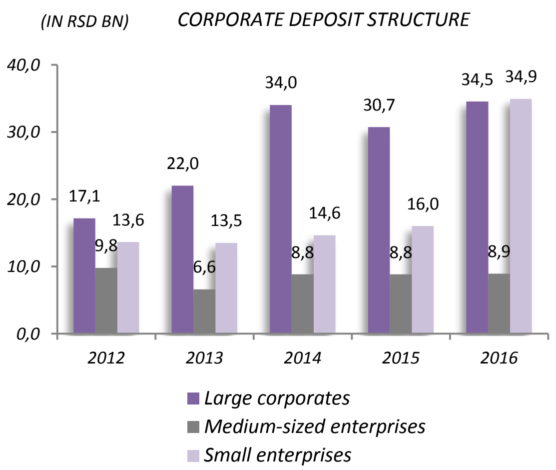
[26] Item loans and deposits to custoemrs does not include other lending.

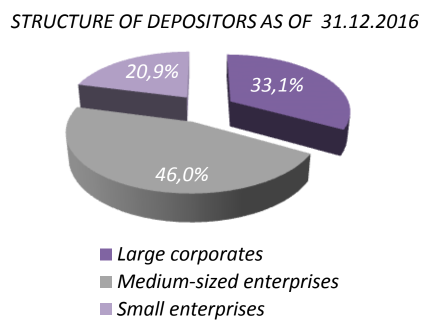
Deposits [27]

Despite further decrease in borrowing interest at the end of 2016, compared to 2015, there was an increase in deposits from legal entities of 41.1%.



Increase in deposits came after two years (2014 and 2015) of relative stability of the amount of received deposits. The amount of received deposits in 2016 was the highest one in the past six years.





[27] Deposits do not include other liabilties and funds received from credit lines.

6.3. Retail operations

Retail segment achieved its planned targets in 2016. Growth in retail loans was generated thanks to the constant innovation in the product offer with the aim of adjusting it to market demands and maintaining competitiveness by introducing new campaign products and product from the Bank's credit line. Significant contribution came also from very competitive foreign credit lines for micro and agro segment, especially the EBRD credit line.

Market – key tendencies

General facts that affect the lending activity and featured in 2016:

- High average unemployment rate of almost 16% during 2016 (13.8% in the third quarter)
- Average indebtedness increased and is EUR 986[28] or 2.5 average salaries (in 2015 – EUR 897), but is still relatively low compared to the countries in the region.
- Decision on reducing the pensions and salaries in the public sector is still in force. This decision reduced the capacity of these customers to borrow and these customers are in focus due to their regular income.
- Decrease in lending and borrowing interest, which is good for loan clients as the loans are getting cheaper.
- Due to slow recovery of corporate lending, the banks redirected their operation to private individuals so the competition is the toughest in this segment in the whole of the banking market.

Also, due to slow growth of net salaries, a large number of private individuals take out cash and refinancing loans to secure additional funds for improving their standard of living. According to the data from the Association of Serbian Banks (UBS), the number of users of retail loans increased from 2015 by 90,151.

On the other hand, although there is a slight increase in the borrowers in default of 1,999 (the number of borrowers who are more than 90 days in default increased by 1,561 and is 123,322). Due to increased lending of private individuals on the level of the banking sector, there is noticeable decrease in the share of NPLs in total retail loans and it amounts to 10% (the latest data as of 30 September 2016) while it amounted 10.9% on 31 December 2015 (official NBS data).

[28] Assosiation of Serbain Banks

The Bank's focus was on attracting new customers but also on protecting the existing portfolio from attempts from other banks to take it over, which offered the customers better interest rates for various loan products, with a special emphasis on loans for refinancing liabilities to other banks. Certain groups of clients, primarily employees in government institutions (police, the military and other budget users) were given special offers with even better terms, primarily when it comes to interest rate. bearing in mind everything mentioned above, the number of refinancing loans increased by as much as 106,355.

In the segment of housing loans for the first time after four years of decline, there was an increase in lending. According to the data from the National Mortgage Insurance Corporation, in 2016 the total amount of disbursed housing loans was 47% higher than in 2015. Non-subsidized loans had a significant increase of 52%, while subsidized ones decreased 3%. The only subsidized type of loan that was offered was the one for the military where Komercijalna banka and other five major competitors participate with 9% of disbursed loans.

Housing loans insured at NMIC without subsidies in 000 EUR					
Year	Banking sector		KB		KB share
	Number	Amount	Number	Amount	
2016	6,940	249,060	879	29,125	11.69%

Subsidized housing loans in 000 EUR					
Year	Banking sector		KB		KB share
	Number	Amount	Number	Amount	
2016	471	17,381	6	268	1.54%

Total insured housing loans in 000 EUR					
Year	Banking sector		KB		KB share
	Number	Amount	Number	Amount	
2016	7,411	266,441	885	29,394	11.03%

Apart from subsidized housing loans, during 2016 subsidized loans for farmers were also offered, as had been the case for many years before.

Loans – the Bank's operation

In 2016 RSD 31.6 bn worth of loans was disbursed, which is 27% higher than in 2015. Disbursement increased in all segments. The greatest increase was realized in the **micro segment** (32%), thanks primarily to the campaign products and the funds from the EBRD credit line.

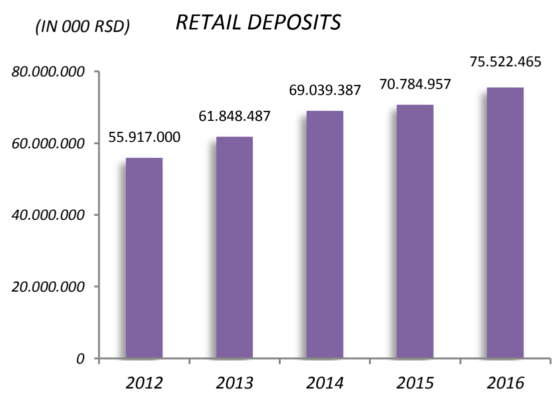
The Bank realized an increase in **agricultural loans** by 30% as a result of combined effect of campaign loans, loans from the regular product range, subsidized loans, funds from credit lines, but also with cooperation with agricultural machinery dealers. Special contribution to this success came from the campaign short-term dinar loan aimed at providing adequate loan support from when subsidized loans started to be granted (granting subsidized loans started at the end of April, while the Bank's campaign loan was on offer from the start of the year until mid-May). With this, the Bank achieved its market share of 21% in the structure of all farmers who use loans.

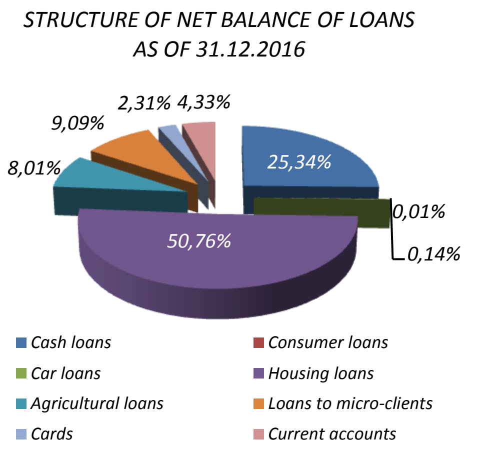
In the segment of **housing loans** there was an increase in disbursement 0f 30%, primarily due to special conditions that were much more favourable than what had been offered the previous year. Additionally, bearing in mind the decreasing trend in interest rates in the market, the Bank has enabled the existing customers with no default in repayment to have decreased interest rate on loans they are currently repaying, with the aim of preserving the quality and the amount of portfolio.

For the first time, the Bank started also granting subsidized loans to professional military personnel.

Increase in disbursement of **cash loans** amounted 23%. An offer in this segment was constantly changed and adjusted during the year, given that this is the most attractive part of the retail market. With the aim of better satisfying customer needs, repayment periods were extended and maximum amounts were increased. Also, an offer for pensioners was updated, as this is an important client segment. New client segmentation was performed so that each client could be given optimum terms and special offer was prepared for premium clients.

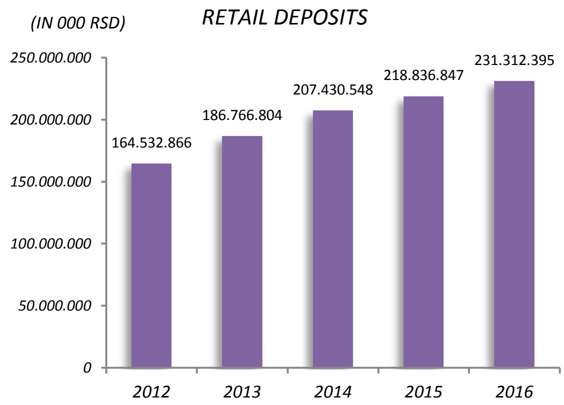
Of the total loans granted in 2016 the majority of disbursed loans were cash loans (50%), followed by loans to micro-clients (25%) and agricultural loans (13%). Of the total disbursed loans, 63% were in dinars. On the other hand share of dinar loans in total loans amounted to 36% of the retail.



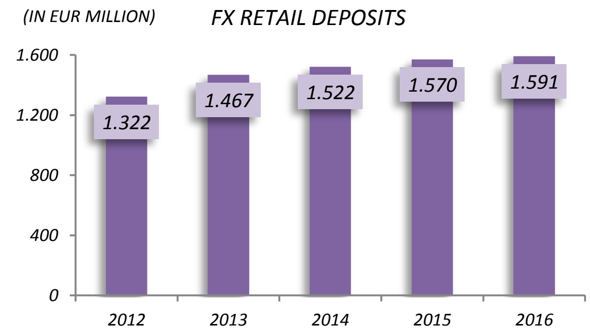


Deposits[29] *- the Bank's operation*

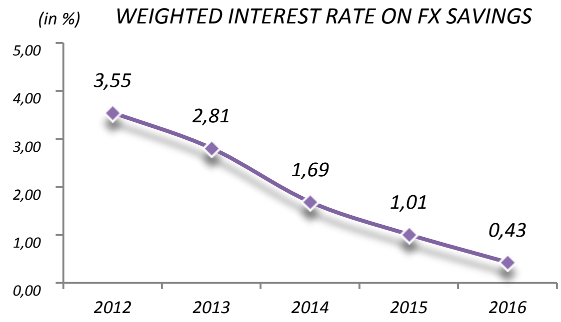
On the level of the banking sector, in 2016 there was an increase in total FX deposits of EUR 334 million, while the Bank, with its growth of EUR 34 million in 2016, despite the decrease in interest rates, kept its leading position in the market with slightly reduced market share of 19,11% (19,46% as of 31.12.2015).



In these market circumstances the right balance was reached between the price, the Bank's image i.e. brand and the desired and stable growth in deposits.

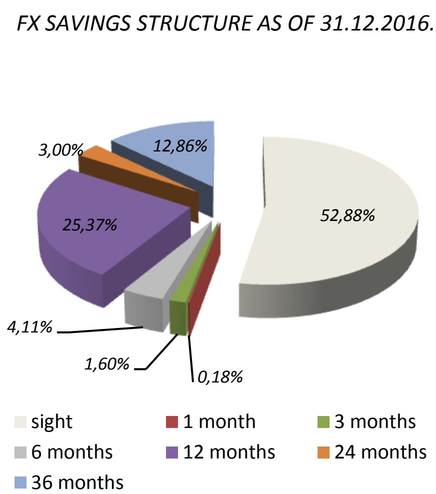


**FX savings do not include special-purpose FX accounts (pensioners) and entrepreneurs.*



**Weighted interest rate on FX savings does not include special-purpose FX accounts (pensioners) and entrepreneurs.*

Price of retail deposits continues to decrease, in accordance with market circumstance. The Bank is still perceived by the customers as the most trustworthy institution. Therefore, deposits are constantly growing although borrowing interest rate is decreasing (interest rate on sight savings was fully abolished in September).



29 Deposits do not include other liabilities and funds received from credit lines.

In FX savings, the share of savings fixed to 12 months or longer is stable and amounts to 41.23%, as well as the domination of deposits of up to EUR 50,000 (in terms of the number of deposits over 99%, in terms of amount 77.2%).

Other products

The year 2016 was characterized also by activities on improving the Bank's product offer, primarily for private individuals. new products were introduced from the area of digital banking, but also product sets. Account sets are adjusted to the most important client segments (employed population, pensioners, premium and young customers). Considerable activities are committed to further development of bancassurance with the aim of providing more complete one-stop offer of financial services to the client and realizing additional fee income.

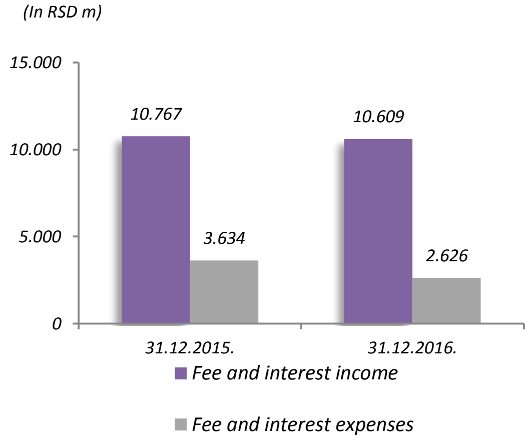
Business network

At the end of 2016 the Bank's business network comprised 23 branches and 2015 sub-branches which puts the bank in a leading position in the market in terms of coverage and availability to customers. Bearing customer needs in mind, the Bank continued with the activities on improving customer experience by improving the appearance of sub-branches, relocating them into new premises, adjusting working hours etc. With the aim of further improving the operation, raising the quality of services and customer satisfaction in order to commit more time to communicating with and advising the customer, a branch network reorganisation project was launched.

Profitability

Interest income was RSD 6,623 million and recorded a decrease compared to 2015 of 7.2% although the weighted interest rate was 14.7% lower than in 2015, while fee income amounted to RSD 3,986 million which is an increase of 9.9% compared to the previous year. Total net interest income and fee amounts was RSD 7,983 million which is a significant increase of 11.9%.

FEE AND INTEREST INCOME AND EXPENSES

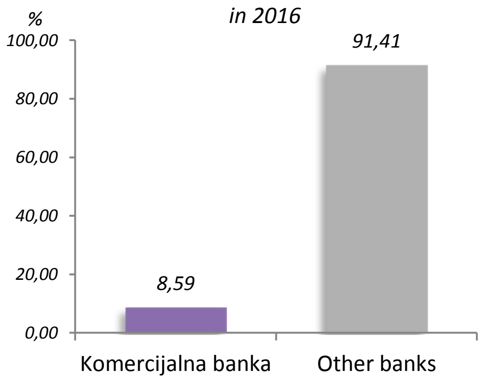


6.4. Asset management

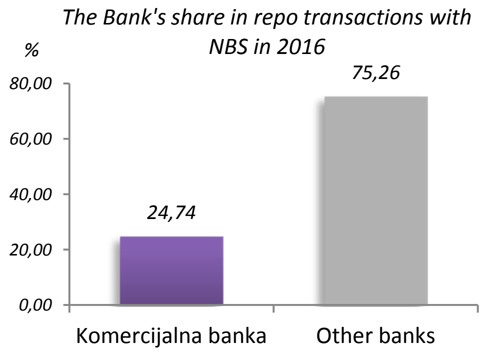
Starting from the Bank's strategic orientation, activities of the Treasury business function were focused on active asset and liquidity management while ensuring unhindered operation of the Bank and fulfilment of the customers' business needs. Environment in which the Treasury operated was marked by a decrease in key-policy rate during 2016 from 4.5% to 4.0 successively, stabilization of interest rates to a relatively low level, decreasing trend in yield on Serbian government securities and negative interest rates in EUR and CHF on foreign markets which, given the fund available, posed a significant challenge in managing liquidity.

In 2016 the Bank's liquidity position was stable and liquid funds were invested mostly into RS Government securities, then in seven-day reverse repo operations and overnight deposits with the National Bank of Serbia as well as through short-term lending in interbank market.

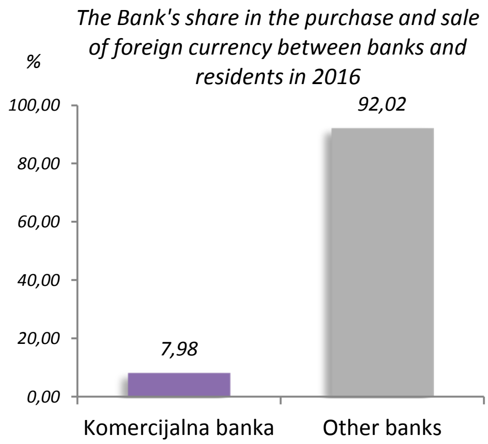
The Bank's share in realized sale of government securities in primary auctions in 2016



High share of the Bank in primary auctions of government securities of the Republic of Serbia was accompanied by active participation in the secondary market. Given the maturity structure of funding sources, the greatest part of short-term liquidity was invested into reverse repo operations with the National Bank of Serbia.



Treasury activities in FX market were also intensive. In operation with residents with total purchase of foreign currency in the amount of EUR 857 million (increase of 2.5% compared to the previous year) and with total sale of foreign currency of EUR 850 million (increase of 13.0% compared to the previous year), the Bank is one of the most active participants in FX market.



Considering that the Bank is faced with significant decrease in lending interest rates and that it operated with stable liquidity, with the aim of optimizing the funding sources and creating preconditions for long-term profitable operation the Bank prepaid in 2016 four credit lines, in the total amount of over EUR 85 million.

Treasury strategy in the upcoming period will focus on cautious employment of liquid funds into risk-free and low-risk financial instruments and on further decrease in the price of funding.

New banking technologies and strategic development

Market – key trends

In 2016 there was a noticeable decrease in the price of funding with simultaneous increase in lending activities in eh retail segment. The most common choice for clients is a cash loan but also refinancing loan with additional cash received and with extended repayment period.

Increased activity of competitors is evident, especially among the aforementioned loan products. The banks have entered into a price battle and offer cash loans on quite easy terms. What raised the attractiveness of the offer was a reduction in the price of funding, but also a decrease in margins. As for the age structure of clients, the banks are targeting middle-aged and older customers. Often, the banks expand their target group and offer loans to customers aged 70 – 75 with an adequate life insurance.

It is important to note that simultaneously with the increase in lending activity and stronger competition the cost of risk will inevitably rise, although officially, all banks in the markets still maintain mostly unchanged lending standards.

Strategy of the New Banking Technology and Strategic Development Function

In early 2016 Komercijalna banka occupied a dominant position in the market in terms of the number of branches and its commitment to retail operations. The bank's client structure by age is such that a large part of portfolio is made up of older customers. Bearing this in mind, it is clear that the Bank's strategic orientation is to systemically and structurally focus towards acquiring new customers.

The current situation in the market, which is characterised by reduced potential for further borrowing with simultaneous decrease in credit margin, opens a new chapter in the Bank's operation. As a reaction to market trends the Bank will pursue growth by targeting the untapped potential – higher income and younger customers, the so called Millenials. This type of customers have different expectations and demands for better quality services and for new banking products.

The Bank's strategic orientation is digitalization of products and services. The strategy can be summed up in the activities aimed and bringing Komercijalna banka closer to the concept of a utility bank, with innovative approach and the use of digital technologies, as well as increase in fee income.

6.5. Division for New Banking Technologies and Digital Banking

In March 2016 digitalisation goal and task setting team was established. The initial focus is on digitalisation and development of products and services for retail and it is planned to expand development activities for corporate entities. In order to fulfil all these requirements, Komercijalna banka set up an organisational unit, within the Function of New Banking Technologies and Strategic Development – Division for New Banking Technologies and Digital Banking that will run the digitalisation program, monitor the latest positive world banking trends and in fintech industry, adjust them to the local market conditions and create innovative and modern solutions for the needs of the targeted groups of customers.

The following targets have been set for the digitalisation program:

- attracting customers with higher purchasing power,
- attracting younger customers,
- increasing average number of products per customer,
- increase in fee income and
- increased use of services/products the Bank has offered its customers.

Digitalisation targets have been turned into a range of activities that are grouped into a so-called "pro-digi" program. Pro-digi program consists of five project flows, each of which is aimed at developing certain new products, strategic grouping of products for better sales or improvement of existing products, which was implemented in 2016.

Flow A. Accounts – Development and implementation of account sets with special additional value for users.

Flow B. Cards – Optimisation of operation and offer, development and implementation of HCE cards for contactless payments, electronic trade, P2P transfer, payment of EUR at ATMs, mPOS and dynamic currency conversion.

Flow C. Loans – development of projects intended for customer retention and development and implementation of projects for acquiring new micro business customers.

Flow D. Services – development and implementation of a new bancassurance model and currency conversion project for added value in account sets.

Flow E. Front-end – development, visual and functional improvement and implementation of digital services, new design of the customer experience, electronic and mobile banking.

Key results of the business function with its special parts

In March 2016 the Banks started the digitalisation program and the Division for New Banking Technologies and Digital Banking, which runs the digitalization program, started its work. Below are the results of implemented activities (by date):

- May 2016 (Flow B. Cards) – contribution to government digitalisation – Komercijalna banka won a tendering competition advertised by the Business Registers Agency in order to allow the users of BRA's services easy payment of fees and expenses to the BRA on the Internet, using payment cards (e-commerce). Completion of this task depends solely on the BRA and is expected in the first quarter 2017.
- June 2016 pilot, launch of accout sets (Flow D. Services) – Increased volume of exchange transactions via e-bank and m-bank as part of the Currency Conversion project which offered the best exchange rate in the market. During the pilot stage only the number of transactions increased 500% and the volume increased 1000%. By the end of 2016, compared to 2015, an increase in the volume was almost 900%. The number of transactions increased by more than 400%, while earnings increased 23%.
- August 2016 (Flow B – Cards) – Introduction of e-commerce system of payment in instalments vie the Internet – the first one in the market. It was modelled on payment in instalments via the Internet. It was introduced as a tool for increasing customer satisfaction and volume.
- August 2016 (Flow B Cards) – Introduction of the service of dynamic currency conversion in POS (DCC) increases customer satisfaction who use foreign cards from MasterCard issuer because they know the exact value of transaction they perform and the Bank generates additional revenue from each transaction.
- September 2016 (Flow B. Cards) – Generating additional payment transactions vie P2P payments (KOMeKEŠ service).
- December 2016 (pilot in November) (Flow A. Accounts) – On the basis of strategic decision on increase in the average number of products per customer and increase in fee income the Bank designed current account sets Start (intended for

young people), Active (for employed population), Classic (for pensioners) and Premium (for customers who expect the highest service standards and benefits). All these account sets offer grouped products, from accounts to cards to electronic and other services. During the first month, as many as 16,083 current account sets were sold. In order to make the offer of account sets as attractive as possible, but also in order for the Bank to increase its revenue from bancassurance, successful partnership was made with Generalli insurance company for bancassurance products. With the introduction of bancassurance in this form into each of the account sets, as designed, conditions will be met for better sale of account sets and the plan is to increase the Bank's income from bancassurance more than nine fold in the first year, compared to the previous year, RSD 6,300,000. All this makes a cumulative contribution to the effect the Bank will have from selling the account sets.

- December 2016 (Flow E. Front-end) – Front-end project creates conditions for the full effect of sales of account sets. In the negotiations which the digitalisation program successfully carried out with vendors, as part of the negotiations for Flow E, the digitalisation program team successfully made savings in implementation costs for electronic and mobile banking by 32%. The first effect and the confirmation of good work are seen in the fact that this team successfully made improvements of the existing mBank application and launched the new and improved version in June 2016. This increased the number of users in 2016 by as much as 77% compared to 2015. On the basis of that improvement, we have good reason to expect that after a complete redesign and update of mBanking, the volume of transactions and the number of users of this channel will increase even further.
- (Flow E. Front-end) – Completely new and modern mBank application which, apart from new services such as KOMeKEŠ, offers also profile administration and card administration and also introduction of digital card for contactless payment via mobile phone (HCE) and which is a part of the new mBank application. With the introduction of HCE digital card Komercijalna banka will be the first bank in the market with such functionality integrated into the mBank application. Unlike the competitors, our users will be able to apply for this card in the mBank application, without going to the branch. From the idea to launching this service in the market, everything was finished in eight months (launched in January 2017).
- (Flow E. Front-end) – Redesigned website of the Bank and uniform appearance of the website, e-bank and m-bank, with the aim of improving the impression the customers have, which will result in increased sales of account sets, while at the same time, contribute to retaining old customers and activation of those who have not used these channels so far (implementation January – February 2017).
- (Flow E. Front-end) – Opening a digital online branch that will allow the customers and those wishing to become the Bank's customer to finish on the Internet almost all tasks they would in a brick-and-mortar branch, but without queuing and going to the bank:
  - opening new account sets,
  - filing a request for payment cards,
  - filing a request for current account overdraft with an option to:
  - sign it digitally or
  - have it delivered to home address.

  (launch – January 2017).
- (Flow B. Cards) – Introduction of mPOS device (mobile POS device for payment traffic) that functions in cooperation with the application on a mobile device. It is convenient for merchants that need quick flow of money and efficient payment and which allows to the users mobility, flexibility and speed, with the aim of increasing corporate clients' satisfaction (e.g. delivery services, taxis, etc.) (Launch is planned in the first quarter of 2017).

In the fourth quarter of 2016, as part of the Division for New Banking Technologies and Digital Banking, a product development department and team was founded. The first goal is to prepare a catalogue of all the bank's products and laying the foundation for monitoring profitability of products. Product catalogue was prepared in a clear and transparent form and foundation was lain for development of features that will monitor product profitability.

6.6. Omni-Channel Distribution Division

Omni-Channel Distribution Division participated actively and made an exceptional contribution to Flow E. Front-end, and apart from these results, also accomplished the following:

- Increased number of sales calls from our call centre by almost four times, compared to 2015;
- Increased number of mBank application users by as much as 77% compared to 2015. This, as has already been mentioned, is attributed to improved mBank application that was launched in June 2016. This data is even more significant if we know that the increase in the number of mBank application users between 2014 and 2015 was 30%.

- There was an increase in the volume of transactions in mBank by as much as 124% compared to 2015.

6.7. Payment Cards Division

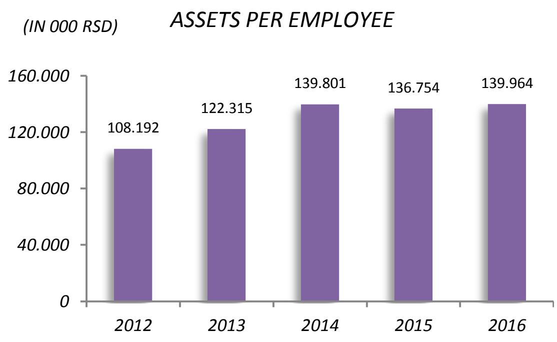
Payment Cards Division actively participated and made great contribution with its work to the achievement of results from Flow B. Cards and, apart from these results, compared to 2015, there was:

- an increase in the number of POS terminals of 6%;
- increase in the volume of transaction on POS terminals of 15%;
- increase in the volume of transaction in ATMs of 12.5%;
- increase in the number of issued cards of 2.7%;
- increase in the volume of card transactions of 12.6%;
- sale in instalments at no interest was made in a total of 1,626 locations, which is an increase of 16.5% compared to 2015, when the number of locations was 1,396, while the volume of transactions in instalments increased by 30.0%.

All this contributed to the stability of the Bank’s operation and to the quality of its products and also provided the Bank with arguments to retain the existing clients but also acquire new ones.

6.8. The Bank's Human Resources

The mission of HR management in Komercijalna banka is to develop and maintain a high level of employee professionalism and motivation with the aim of achieving the Bank's business plans. With continuous optimisation of the number and structure of employees in the past couple of year, the Bank's efficiency increased considerably, when measured as assets per employee. This indicator decreased slightly at the end of 2015 and then again increased at the end of 2016. The Bank continuously invests into employee training and development.



At the end of 2016 the bank presented the internal talent development program designed with the aim of recognizing and developing leader potential of employees – the Kombank Academy. The first module of the Academy is focused on development and improvement of attendees' professional knowledge. A structured, multidiscipline approach allows the attendees to have a better insight into the entirety of banking processes and support activities and allows them to gain a deeper understanding of banking business. During this program the attendees have -an opportunity to work with lecturers and mentors employed in the Bank, including the Bank's management team. In the following modules, it is planned to further develop the employees' skills and capacity through training, workshops and eventually the implementation of acquired knowledge and skills of the best attendees with their participation in some of the development projects in the Bank. Additionally, such integrative approach to management and to employee skill development will improve motivation, loyalty, interpersonal relations and team spirit among the employees working in various organisational units.

Development activities in 2016 point to continued qualitative and proactive approach to implementing training, based, above all on identification of training needs and adjusting the content of training, defining and securing internal training, organisation of internal and external training, measurement and improvement of training quality and training process.

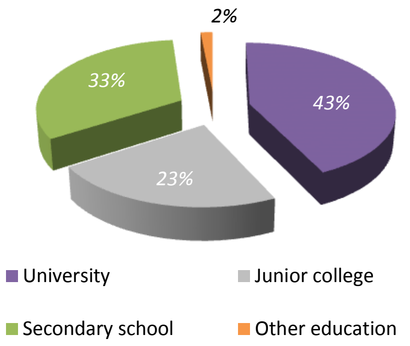
Number of employees	2.858				
Branches	1.783				
Divisions	1.075				
Sex	Men		Women		
	781		2.077		
Employment status	Permanent	Temporary	Frozen		
	2.779	76	3		
Education structure	University degree	Junior college	Secondary education	Unskilled/Skilled/highly skilled	
	1.226	651	938	43	
Age structure	20-30	31-40	41-50	51-60	61+
	95	1.086	777	846	54

If observed by type of training, the most common is professional training aimed at acquiring new and improvement of existing knowledge. According to the criteria of importance of the subject and the scope of training, in the sense of the number of attendees, the most important training sessions during 2016 were: knowledge about the Bank's products and their cross-selling; prevention of money laundering and terrorism financing, prevention of fraudulent activities, bancassurance, continuous education; sales and product presentation skills, coaching in the function of improving sales, leader skills.

This year, four internal online training sessions and testing for 5,627 employees were organized: IT security, processing cash in accordance with the NBS Decision, deposit insurance, business activities and CHD application. The Bank pays special attention to organising internal professional training and external skills training aimed at developing the skills the employees need to successfully perform their job (sales skills, presentations, management, etc.)
Since 2008 the Bank has been implementing performance appraisal on the basis of set annual targets, monitoring the achievement of such targets, but also the skills the employees have exhibited in the process of achieving the targets. Annual performance appraisal is also the basis for bonuses (the bonus system was developed in cooperation with the German consultant ADG), career planning and planning the training budget and program.

Bonus principles for employees are clearly defined in the Remuneration Policy adopted by the Board of Directors at the proposal of the Compensation Committee, the body of the Board of Directors. The aim of this policy is not only to adequately reward the employees, but also to motivate them to achieve better work results.

QUALIFICATION STRUCTURE OF EMPLOYEES IN 2016



6.9. Balance-Sheet as of 31 December 2016

(in 000 RSD)

No.	ITEM	31.12.2016.	31.12.2015.	INDICES	% OF SHARE AS OF 31.12.2016
1	2	3	4	5	6
	ASSETS				
1.	Cash and funds at the central bank	55.153.209	63.523.715	86,82	13,79
2.	Pledged financial assets	-	-	-	-
3.	Financial assets at fair value through P&L intended for trade	242.920	851.056	28,54	0,06
4.	Financial assets initially recognized at fair value through P&L	-	-	-	-
5.	Financial assets available for sale	136.123.853	128.756.408	105,72	34,03
6.	Financial assets held to maturity	-	-	-	-
7.	Loans and receivables from banks and other financial organisations	40.601.413	16.844.000	241,04	10,15
8.	Loans and receivables from customers	150.411.409	162.742.565	92,42	37,60
9.	Change in the fair value of items subject to risk hedging	-	-	-	-
10.	Receivables for financial derivatives intended for risk hedging	-	-	-	-
11.	Investment in affiliates and joint ventures	-	-	-	-
12.	Investment in subsidiaries	2.611.859	5.480.888	47,65	0,65
13.	Intangible investment	362.507	216.830	167,18	0,09
14.	Property, plant and equipment	5.856.458	6.139.572	95,39	1,46
15.	Investment property	2.217.816	2.744.026	80,82	0,55
16.	Current tax assets	-	37.017	-	-
17.	Deferred tax assets	-	-	-	-
18.	Fixed assets intended for sale and funds from discontinued operations	183.170	63.314	289,30	0,05
19.	Other assets	6.252.855	6.040.483	103,52	1,56
	TOTAL ASSETS (from 1 to 19)	**400.017.469**	**393.439.874**	**101,67**	**100,00**

(in 000 RSD)

No.	ITEM	31.12.2016	31.12.2015	INDICES	% OF SHARE AS OF 31.12.2016
1	2	3	4	5	6
	LIABILITIES				
1.	Financial liabilities at fair value through P&L intended for trade	-	-	-	-
2.	Financial liabilities initially recognized at fair value through P&L	-	-	-	-
3.	Liabilities from financial derivatives intended for risk hedging	-	-	-	-
4.	Deposits and other liabilities to banks, other financial organisations and central bank	7.834.962	17.159.317	45,66	1,96
5.	Deposits and other liabilities to other customers	322.621.360	300.005.903	107,54	80,65
6.	Changes in fair value of items that are subject to risk hedging	-	-	-	-
7.	Issued treasury shares and other borrowed assets	-	-	-	-
8.	Subordinated debt	6.178.390	6.077.962	101,65	1,54
9.	Provisions	1.787.294	2.109.020	84,75	0,45
10.	Liabilities for assets intended for sale and assets from discontinued operations	-	-	-	-
11.	Current tax liabilities	-	-	-	-
12.	Deferred tax liabilities	23.592	329.258	7,17	0,01
13.	Other liabilities	6.147.569	4.920.368	124,94	1,54
14.	**TOTAL LIABILITIES (from 1 to 13)**	**344.593.167**	**330.601.828**	**104,23**	**86,14**
	CAPITAL				
15.	Equity	40.034.550	40.034.550	100,00	10,01
16.	Treasury shares	-	-	-	-
17.	Profit	349.698	179.550	194,76	0,09
18.	Loss	8.063.183	6.061.358	133,03	2,02
19.	Reserves	23.103.237	28.685.304	80,54	5,78
20.	Unrealized losses	-	-	-	-
21.	Non-controlling stakes	-	-	-	-
22.	**TOTAL CAPITAL (from 15 to 21)**	**55.424.302**	**62.838.046**	**88,20**	**13,86**
23.	**TOTAL LIABILITIES (14 + 22)**	**400.017.469**	**393.439.874**	**101,67**	**100,00**

6.10. Profit & Loss Account for 2016

(in 000 RSD)

No.	ITEM	31.12.2016	31.12.2015	INDICES
1	2	3	4	5
	OPERATING INCOME AND EXPENSES			
1.1.	Interest income	16.689.075	19.094.582	87,40
1.2.	Interest expenses	-3.226.341	-5.326.500	60,57
1.	**Interest gains**	**13.462.734**	**13.768.082**	**97,78**
2.1.	Fee and commission income	6.252.370	6.004.106	104,13
2.2.	Fee and commission expenses	-1.435.056	-1.104.159	129,97
2.	**Fee and commission gains**	**4.817.314**	**4.899.947**	**98,31**
3.	Net gains from financial assets intended for trade	70.478	3.186	2.212,12
4.	Net gains / (loss) from hedging against risk	-	-	-
5.	Net gains / (loss) from financial assets initially recognised at fair value through profit&loss	-	-	-
6.	Net (loss) / gains from financial assets available for sale	69.062	-8.664	-
7.	Net loss from FX differences and the effects of agreed currency clause	-9.282	-13.439	69,07
8.	Net gains / loss from investment in affiliates and joint ventures	5.143	-	
9.	Other operating income	573.235	460.419	124,50
10.	Net expenses from impairment of financial assets and credit risk bearing off-balance-sheet items	-14.907.539	-13.008.526	114,60
11.	**TOTAL NET OPERATING INCOME**	**4.081.145**	**6.101.005**	**66,89**
12.	Cost of salaries, allowances and other personnel expenses	-4.498.212	-4.121.590	109,14
13.	Depreciation costs	-666.025	-797.401	83,52
14.	Other expenses	-7.294.544	-7.357.899	99,14
15.	**(LOSS) / PROFIT BEFORE TAX (from 1 to 14)**	**-8.377.636**	**-6.175.885**	**135,65**
16.	Profit tax	-	-	
17.	Gains from deferred taxes	314.453	114.554	274,50
18.	Loss from deferred taxes		-27	-
19.	**PROFIT/LOSS AFTER TAX (from 15 to 18)**	**-8.063.183**	**-6.061.358**	**133,03**
20.	Net profit from discontinued operations	-	-	-
21.	Net loss from discontinued operations	-	-	-
22.	**RESULT FOR THE PERIOD – (LOSS) / PROFIT (from 19 to 21)**	**-8.063.183**	**-6.061.358**	**133,03**

7. INVESTMENT IN ENVIRONMENTAL PROTECTION

The Bank observes the highest international standards and values in creating financial products and services, develops and implements activities related to environmental protection and protection of human and employee rights. With the adoption of the Policy and Procedure in these areas, the Bank set the standards for identifying, monitoring and managing social and environmental risks in the process of approving and monitoring loans. The aim of the environmental risk management system is to introduce a system into the lending activity and into loan monitoring, as well as to increase possibility of acceptable and sustainable economic development from the viewpoint of environmental protection and minimizing the possibility of environmental and socially adverse effects.

The Bank defined also the process for resolving complaints and providing answers to them, regarding direct or indirect effect of the Bank's business activity on social and natural environment.

By agreeing credit lines for financing investments that will raise energy efficiency and for developing renewable energy, the Bank granted loans that contribute to a reduction in energy consumption and CO_2 emission.

Also, the Bank continuously monitors extraordinary events that occur at its clients and which may have an adverse effect on the environment, health and safety or to the community as a whole and informs the management bodies and the Bank's shareholders of that.

With the aim of protecting the environment and minimizing the possibility of events that may have an adverse material effect on the environment, health or safety or the community as a whole, the Bank does not finance the activities related to the production or trade in arms and ammunition and its lending to the clients whose key business activity is related to the production or trade in alcoholic beverages, tobacco and gambling (games of chance) is minimal, in accordance with the set limits.

Approaches to managing this risk include two management levels: on the level of individual loan and on the level of the total portfolio. For each of the client's business activity the Bank defines the risk level i.e. risk category from the aspect of social and environmental effect.

8. SIGNIFICANT EVENTS AFTER THE END OF THE BUSINESS YEAR

From 1 January 2017 until the end of February 2017, one General Meeting of the Bank's Shareholders was held:

- Regular General Meeting of the Bank's Shareholders was held on 25 January 2017. The following decisions were adopted at the meeting:
  Decision to sell the bank's shares in the following legal entities: Jubmes banka ad Beograd, Politika ad Beograd, Kompanija Dunav osiguranje ad Beograd, Beogradska berza ad Beograd, Tržište novca ad Beograd.
  Information regarding Article 77 of the Law on Banks and Report in Accordance with Article 78 of the Law on Banks.

Description of events after the business year is presented in item 40. Notes to financial statements for 2016.

9. PLAN FOR THE BANK'S FUTURE DEVELOPMENT

The Bank's strategic targets in the upcoming period are:

- development of digital banking – more economical distribution channels:
  - improvement of sales in digital channel (introduction of credit products and process automation);
  - improving the Bank's efficiency and customer satisfaction;
- controlling business expenses, especially opex:
  - the Bank plans a whole range of measures aimed at controlling opex level in order to improve overall efficiency;
- regionalization of market space:
  - strengthening the Bank's presence in regions with high potential for development (Vojvodina, Belgrade);
- customer base:
  - change in customer structure towards customers with above average income and towards younger population;
  - change in the structure of loans towards private individuals with greater

purchasing power, greater lending to agriculture and micro-clients;

- improving the existing ones and introduction of new products:
  - development and improvement of retail loan products;
  - development and improvement of functionality of cards by adding financial benefits for customers;
- portfolio restructuring;
- focus on growth in non-interest income – response to challenges present in the environment of low and decreasing interest rates.

After the transition in management, especially in 2016, the Bank will continue with the transformation of the manner of business, especially towards further improvement of sales-driven culture and disciplined and profitable growth that is managed with the aim of maximizing the value of founder's equity.

RETAIL

- increased number of active customers, primarily by relying on the current customer base;
- active change in the Bank's client structure by targeting younger population and those with higher standard and better creditworthiness;
- continuous focus on cross selling;
- increased customer loyalty and income per customer.

In the upcoming period the lending activity will continue to be dominated by cash and housing loans secured by mortgage. The Bank's activities will focus on retaining the existing customers with fuller use of their credit potential, but also on attracting new creditworthy customers from competitors.

The Bank will try and direct the customers to use modern communication channels – the Internet and electronic banking, with the aim of further developing digital banking.
In the upcoming period the bank's aim will be to improve the retail customer structure by increasing the share of employees and pensioners in it. The aim is to expand the customer base with customers who have regular monthly earnings and to whom a wider range of the Bank's products may be offered (loans, cards, web bank…).

The Bank's share in market potential differs by region, with the lowest share in Vojvodina, given that the banks headquartered in Vojvodina have a better developed business network in this region and the customers are traditionally oriented towards them. For this region the Bank will enhance its activities on acquiring customers from Vojvodina and Belgrade.

AGRICULTURE

- considerable growth potential;
- long-term lending, granting loans with maturity longer than 10 years.

Agricultural lending is a segment where the Bank will, on the one hand, make efforts to preserve its existing market position, customers, and on the other try to take the opportunities for growth in the upcoming period. In the upcoming period, the Bank's goal is to acquire customers with bigger land plots and higher creditworthiness from the region of Vojvodina and a part of Central Serbia. The Bank is planning to launch credit lines for purchase of land with maturity of 10 years and longer, as well as loans for purchasing equipment with more flexible collaterals.

MICRO-CLIENTS

- very important segment, low credit risk;
- higher-income entrepreneurs and micro-clients are in focus.

lending to micro-clients will be in the bank's focus both for risk dispersion and limited demand for loans by creditworthy large corporate entities.
Bearing in mind the recognized potential that exists, as well as the need to prepare an adequate approach primarily to high-income customers, the Bank increased considerably the number of sales people in front-office and activities are being carried out with the aim of performing a credit analysis and approving loans within the shortest possible time (optimisation of the contents of loan proposal and greater automation of the lending process – implementation of preliminary loan approval).

The focus will be on the largest urban centres: Belgrade, Nis and Novi Sad. Emphasis is on entrepreneurs and micro-clients with income higher than EUR 500,000 and campaign offers and promotion of cross-selling packages that will be adjusted to market demand.

CARDS

- digitalization of operation;
- offer of cards based on the latest technologies.

In the upcoming period the Bank will place an emphasis on digitalisation of services in the area of cards and on further rationalisation of the

Bank's services conditioned by customer requests and modern trends.
For the upcoming period it is planned to introduce new technology in card operations, NSE technology (contactless payments using mobile phones). With the introduction of NSE technology, the Bank will become a leader in the banking sector, given that this is the latest payment technology that is in its infancy in Serbia. Simultaneously with the introduction of NSE technology, the Bank will develop also the contactless acceptance network. Development of innovative products should attract younger an technologically more advanced customers with higher standard of living, credit worthiness and also increase the number of products per customer. All this should contribute to further strengthening of the Bank's competitive position and confirming its position as one of the market leaders in this segment of business.

SAVINGS

- maintain leading position in terms of share in total FX savings;
- current account sets – new services for different segments.

The Bank's aim is to maintain a leading position in retail FX deposits, as well as further increase in the amount and number of the so called "minor deposits" which are loyal to the Bank, as was showed in the past, and have low sensitivity to the level of interest. All this should contribute to the Bank keeping its leading position in the coming years when it comes to FX savings, along with ta decrease in interest expenses.
The Bank will develop products intended for customers with higher purchasing power. the first step in that direction was made with new "current accout sets' – the aim is to offer a large number of other banking products and facilities for current account holders, apart from the standard current account.

PROFITABILITY

- generate growth in operating profit;
- control of operating expenses.

Over the past period, the banking sector was marked by considerable decrease in lending and borrowing interest i.e. there was a considerable decrease in interest margin. No further considerable decrease in lending and borrowing rates are expected. The Bank will make an effort to offer new products and improve the existing products in order to increase fee income.

CORPORATE OPERATION

- improved use of the existing customer base;
- improved efficiency in the loan approval process;
- growth in balance-sheet and off-balance-sheet portfolio together with a change in structure;
- maintaining profitability;
- introducing new products.

The Bank's focus in the upcoming period will be on better use of the existing corporate client base, increased lending activity in SME segment with a tendency to increase market share in the corporate portfolio, constant monitoring of market trends and adjustment of price, introduction of new loan products (involving the Bank in project financing), maintaining profitability, middle-office centralization in the risk management function.
Also, a proactive approach is planned and a new attempt at establishing a business relation with a group of clients that currently do not need loans or work with other banks only. The Bank also plans to develop the project finance model, bearing in mind the new law that relates to accelerated procedure of issuing construction permits, existence of demand and the lack of premium office space and new flats of adequate structure in better locations, as well as the fact that the prices of property have relatively stabilized.

Large corporate entities, local self-governance, large and special projects

- syndicated financing;
- cross-border loans;
- project finance;
- guarantees and L/Cs – off-balance-sheet operations.

Large corporate entities will be supported by syndicated lending. The Bank will grant large individual loans together with one or several banks.

As the only bank from Serbia with subsidiaries in Bosnia and Herzegovina and Montenegro, the bank will perform a part of its lending activity in the upcoming period also outside the territory of the Republic of Serbia by granting the cross-border loans. In this manner the Bank will lend to quality clients which cannot be financed by the Bank's subsidiaries on their own due to capital limitations.

Next year local self-governments will be in focus, particularly given the fact that a number of

municipalities need to refinance their loans in order to replace expensive loans with cheaper ones with longer repayment period. Such arrangements will be carried out through bilateral negotiations with the management of municipalities.
the Bank will provide lending to projects, will participate in project financing, especially projects related to mini hydroelectric plants, biogas facilities and improvement of energy efficiency.
As a result of greater foreign trade it is also expected that there will be more demand for issuing guarantees and letters of credit from large corporate entities.

Small and medium-sized entities (SMEs)

- network reorganisation – direct communication: headquarters – sales people – clients;
- changes and acceleration of the loan approval process (pre-approval + scoring);
- continued involvement in infrastructure projects – off-balance-sheet activities;
- preserving the healthy part of the client base and increase in lending to first-class clients;
- increase in the number of small clients in the Bank's portfolio, while increase in the number of medium-sized enterprises is based on the existing client base and a possible increase in exposure to creditworthy clients;
- extending the average loan maturity to small and medium-sized enterprises to 36 months, compared to the current maturity of 23 months for small enterprises and 27 months for medium-sized enterprises;
- focus on the growth of portfolio and the number of clients in Belgrade and Novi Sad, given that penetration in these cities is currently considerably lower than in the rest of the business network.

Key targets in operations with small and medium-sized enterprises are: maintain the existing level of the loan portfolio and the client base with an increase in the number of clients and growth of portfolio, particularly in Belgrade and Novi Sad branches.

In the segment of small enterprises the Bank will try to increase the share of this segment of portfolio in the total loan portfolio, especially through more intensive lending for permanent working capital and through investment loans, as well as with issuing more guarantees.
Business network is one of the most important competitive advantages of the Bank when it comes to SME business.

TREASURY

- active management of assets and liquidity;
- adequate reserves of liquid assets;
- non-interest income.

Activities of the Treasury business function will focus in the upcoming period on active management of assets and liquidity, while ensuring unhindered functioning of the Bank and satisfying the customers' business needs. Starting from the Bank's strategic orientation, the key targets and business activities of Treasury in the upcoming period will focus on: further optimisation of funding sources and improvement of structure and the ratio of own and borrowed funds, obtaining the adequate funding, bearing primarily in mind their long-term stability and price, maintaining current liquidity by employing the funds at adequate level and currency structure for unobstructed payment of all due liabilities, ensuring adequate liquidity buffer in the form of high quality assets that can quickly be turned into cash, investing liquid funds into money market and capital market in order to generate profit and maintain interest margin, increased focus on generating non-interest income, considering the possibility of prepaying a portion of foreign credit lines.

Deposit potential

- retail FX savings remains the dominant funding source;
- active management of funds from abroad (credit lines and subordinated debt).

Retail FX savings will still be the most important funding source. The Bank's strategic orientation is to be a leader in this segment and to maintain its image of the biggest national bank, while trying to optimize the price and structure of this source.
Investment of funds into securities relates primarily to bonds and T-bills of the Republic of Serbia in RSD and EUR.
bearing in mind the high credit rating of the Bank, funds from credit lines and funds that can be obtained from subordinated debt are also available. The Bank will use these funding sources if needed.

Risk management

The Bank's operation in the upcoming period will focus on maintaining stable market share at an acceptable level of credit risk. The Bank's loans will be focused on medium and small corporate clients. When it comes to the lending potential of the retail segment, the Bank will focus in the upcoming period to financing private individuals, creditworthy client and clients with greater purchasing power who have clean credit history, financing agricultural holdings in accordance with their creditworthiness, bearing in mind the cyclical nature of this production, frequent changes in market prices in agriculture as well as financing micro-clients. In 2017 and 2018, in accordance with the expected economic growth, the Bank expects also a gradual increase in the retail segment due to the expected increase in the number of employees in the private sector, so the Bank's strategy in the upcoming years will be based on attracting as many clients from the private sector as possible as well as focusing towards younger population and clients with greater purchasing power.

In the upcoming period, the Bank will continue with cautious, conservative lending policy, with an emphasis primarily on stability and quality of the loan portfolio, with enhanced monitoring of client's business, financed projects and collaterals in order to timely identify all the warning signals that may point to the client's inability to settle their liabilities or which may point to difficulties in collection of the Bank's receivables. The Bank's strategy in the upcoming period will continue to be focused on active collection of loans and their settlement in the earliest maturity stage, as well as intensified activities on selling the foreclosed assets. Rescheduling of loans to longer maturities and lower instalments will continue in order to facilitate the collection of loans. Also, the Bank will foreclose on collaterals in order to preserve their value until favourable market conditions are reached for their sale. Preconditions for successful liquidity risk management in the upcoming period lie in: cautious lending policy with an emphasis on stability and quality of loan portfolio with enhanced monitoring of loan collection, with the aim of reducing exposure to credit risk with direct effect on liquidity risk; consider the idea of selling the receivables (mostly NPLs) or transferring short-term and long-term receivables to other financial institutions with the aim of securing liquid assets.

NETWORK DEVELOPMENT

- business centres network, instead of branches; the Bank will organize its network through a smaller number of business centres;
- back-office centralisation; reducing the management structure; centralised support to sub-branches;
- improved efficiency of lending process and the work of credit committees;
- optimisation of certain business processes – optimisation of procedure and automation of processes that result in shorter process and less employee time;
- uniform appearance of sub-branches.

After a period of expansion and growth of business network, in accordance with the Bank's strategy, a period of consolidation and quality development has come. Our intention is to increase customer base and strengthen market share in the upcoming period, especially in Belgrade branch and in branches that operate in Vojvodina where, in the existing market potential, there is room for increase in the Bank's market share. Given that overall economic trends and the level of economic development have limited the possibility of more significant growth and trends in interest rates placed a limit on interest margin, the primary strategic targets of the business network are: increase in efficiency and the overall volume of business, change in organisation structure of the business network, reprioritizing by setting new weights in the branch performance appraisal system, improvement of the branch management system.

IT Strategy

Continuing the practice of defining the IT strategy as the outline of IT service management, the Bank opts to continue transition from „operational efficient“ to „strategically focused“ approach in application of ICT (information-communication) technologies, which represents an important prerequisite for survival in the market, which increasingly views a modern bank as digital and technological institution.

In addition to preparation and support to Bank’s privatization, the main directions of the further strategic development of the information system of the Bank are based on the following three areas:

- Business and regulatory requirements,
- Architecture ICT infrastructure and IT security, and
- IT services and IT services and organization.

Business and Regulatory Requirements

Strategic directions of IT development are defined in such a manner as to address the existing and the future needs of the Bank, and/or to be based on improvement of IT services to business users while assuming new, proactive roles that the modern IT should have in the banks. As the most important activities in the segment of business requirements, we emphasise the following:

- Reorganisation of the business network through establishing business centres for the purpose of improving the sales capacity, standardisation of business processes in the network and optimisation of work process.
- Centralisation of domestic and foreign currency payment system transactions (e.g., account opening for corporate entities and entrepreneurs, complaints, collaterals, etc.) accompanied with optimisation of centralized processes in order to increase productivity and also to reduce the operational risks.
- Enhancement of efficiency of credit process with the abolition of credit committees, and then the introduction of unified decision-making process when approving loans to customers and standardisation of credit analysis.
- Continuation of initiated activities within the digitisation process of the Bank initiated during 2016: beginning of functioning of the digital sub-branch, withdrawal of currency at ATMs and further improvements of mBank and eBank solutions. Completion of the first phase of digitisation creates the preconditions for activities on so called internal digitisation to be considered in the forthcoming period, such as introduction of digital signature and implementation through automation and optimisation of business processes in the Bank.
- The introduction, development and application of statistical internal models for credit risk management for Banks' certain products.

- In the area of regulatory requirements, the following projects stand out:
- Implementation of new NBS' Decision on Capital Adequacy, which implements the Basel III standard in part of calculation of capital requirements for credit risk, market risk, operational risk and calculation of capital.
- Implementation of the new International Financial Reporting Standard 9, by which the methodology for classification of balance sheet positions and calculation of provisions for potential losses of the Bank is changed.
- Improvement of the system for identification of suspicious transactions and introduction of automated monitoring of transactions in subsidiaries with the aim of establishing the uniform legal and international standards pertaining to area of AML/CFT at the level of KB Group.

Architecture, ICT infrastructure and IT security

Optimisation of business operations in terms of IT means the improvement of the system in order to reduce the operational costs of labour, as well as implementation of modern solutions to support new services and products of the Bank, with an optimal ratio of investment and maintenance costs.

Applications, information, mobility – Improvement of architecture of software solutions is focused on introduction of the new models and distribution channels of service, implementation of solutions having the purpose of optimising business processes, consolidation of service-oriented architecture to integrate different business applications and systems, as well as replacement of old technology with new one.

In order to improve the user experience in the field of business reporting, the plan is to implement appropriate tools in the context of the Bank's reporting system which meets the criteria of performance and functionality.

In the coming period the development of mobile applications will be continued and the use of reports on mobile platforms will be enabled. The focus will be on distribution of the existing reports and internally developed applications through implemented MDM (Mobile Device Management) solution.

The analysis will be conducted and the trends available in the so called "Big data" technology will be examined and their applicability determined within the Bank's IS, with the aim of introducing modern concepts of predictive analytics. Improvements in the area of automation and control of implementation of mass data processing are planned, in order to reduce the risk of influence of the human factor and to shorten the duration of processing.

ICT infrastructure - In the infrastructure domain, a number of activities will be undertaken with the aim at further optimising the existing operational costs, enhancement of technical capabilities of service delivery, as well as setting the adequate infrastructure environment for potential new services. Given the high degree of virtualisation of server infrastructure, as well as the benefits it brought on, this approach will continue in the future. In addition, the application of a flexible, so called software-defined infrastructure in the Bank's environment will be analysed through the regular renewal of ICT equipment in Bank's Data Centres. Based on the conducted analysis of alternative solutions for so called storage infrastructure, in the coming period the transition is anticipated to technologically more sophisticated devices, which deliver better performance and higher capacity while optimising maintenance costs. In order to improve the security of access to Bank's IT services the implementation of modern network security solutions is foreseen, bearing in mind that the support of manufacturers for the current, so called "Firewall" devices, shall cease and that the maintenance costs will increase. Additionally, the introduction of new security systems is planned, as a support to the introduction of new digital products. In order to reduce operating costs in the area of collaboration, defining the cost effective concept in the form of IP telephony implementation is planned. In the area of client infrastructure, the improvement activities in line with the trends focused on improving working conditions and systems safety, will continue. For this purpose it is planned to move to newer versions of operating systems, primarily Windows 10.

IT services and organisation

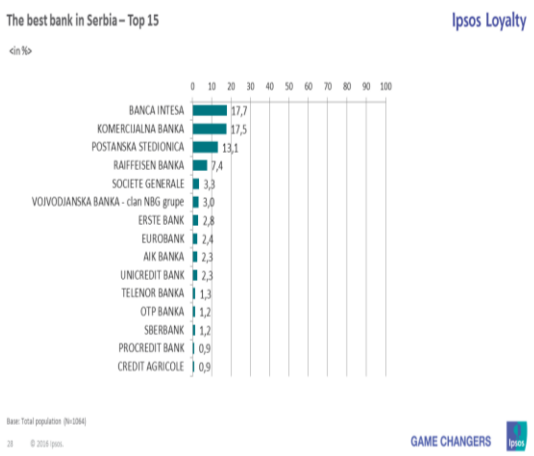
Progress in the field of IT and innovations in terms of new distribution channels of banking services, as well as the changed habits of customers as a result of technological development, created complex systems very difficult to maintain and promote, where old approach to IT becomes unsustainable. The Bank continues its successful path to transition from a traditional to a service organisation with a clearly defined IT processes in order to continuously increase the quality of IT services, which enables business functions to achieve the desired business results in acceptable and measurable limits of accessibility and functionality, without having to know the complex architecture of the IS. This approach shifts the focus to the service as a support to the business process rather than the technology that is behind it, which makes IT more efficient. In this way the components that affect the critical business processes and form a measure for reducing the risk of their effect both through the regular maintenance, as well as through the use of recovery plans (BCP and DRP plans), are identified. Managing information technologies is conducted via the established relevant IT processes based on ITIL (IT Infrastructure Library) guidelines. A development in this area in the past has created the basis for certification in the field of IT service management in accordance with the requirements of ISO / IEC 20000. The very acquiring of the ISO / IEC 20000 certificates will be one of the goals in the future. The introduction and implementation of the said standards ensure quality management of IT services, and thus ensures compliance of IT services with the needs of business users, as well as with the best practices, proper documentation, efficiency, effectiveness and continuous monitoring and improvement of IT processes.

10. RESEARCH AND DEVELOPMENT

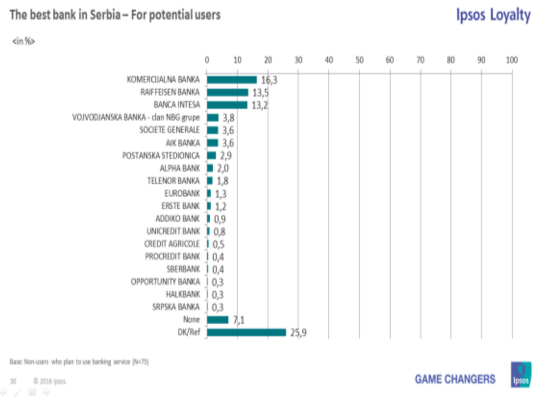
Introducing digitalization in business marked the financial market in the last year. Following these occurrences and changes on the market, KB prioritized the digital market in the segment of new, but also improvement and modification of the existing products and services, so as to keep the leading position on the market, which has been indicated by researches carried out so far.

Market positioning of KB as brand, its products and services, were tested during 2016 as well, through banking Omnibus, carried out by the research agency IPSOS, specialized for this type of research. The research shows that KB has been for some time keeping one of the leading positions in public perception, measured by the criteria of recognition, quality and satisfaction by products and services that the clients use. All results of research are presented on the internal portal of the bank, to be introduced to the target groups due to the additional strengthening of Komercijalna Banka brand.
The report of the last banking omnibus (November 2016), shows that we take the second place among the best banks in Serbia according to the opinion of the examinees (there is a minimal difference compared to the first-rated bank), but KB takes a conclusive first place for potential users.

The best banks in Serbia:



The best banks for potential users:



11. REPURCHASE OF OWN SHARES AND STAKES

KB had no own shares on December the 31st 2016, nor did it own any during 2016.

The Bank neither has the intention to acquire own shares in the future.

12. FINANCIAL INSTRUMENTS OF IMPORTANCE FOR THE ASSESSMENT OF THE FINANCIAL POSITION

In the end of fiscal 2016, the following financial instruments were of the key importance in terms of the financial position of KB:
- At the right side (assets):
  - Loans and receivables from customers,
  - Loans and receivables from banks and other financial institutions,
  - Financial assets available for sale and
  - Cash and funds held with the Central Bank.
- At the right side (liabilities):
  - Deposits and other liabilities to other customers,
  - Deposits and other liabilities to banks, other financial institutions and the Central Bank,
  - Subordinated liabilities, and
  - Capital.

Loans and receivables from customers, banks and other financial organizations at the end of 2016 amounted to RSD 191,012.8 million, and account for 47.8% of the total balance sheet assets, while at the end of 2015, loans and receivables amounted to RSD 179,586.6 million and participated in the total assets with 45.6%. During 2016, loans and receivables increased by RSD 11,426.3 million or 6.4%. Given the fact that loans and advances make approx. 50% of the total assets, KB gave a special importance to the risk management system in the previous period, with a special focus on credit risk. Today, the Bank has a loan portfolio that has been secured by the appropriate amount of provisions for impairments and reserves formed from profit.

The financial assets available for sale amount to RSD 136,123.8 million at the end of 2016 (34.0% of the total assets) and comparing to the balance from the end of 2015 (RSD 128,756.4 million, 32.7% of the total assets) increased by RSD 7,367.4 million or 5.7%. The financial assets available for sale mostly refer to the securities of the Republic of Serbia.

Cash and funds held with the Central Bank as of December 31st 2016 amount to RSD 55.153,2 million, and compared to the beginning of the year decreased by 13.2%, or RSD 8,370.5 million. In the structure of this position a dominant amount refers to the funds on the drawing account and funds allocated with the National Bank of Serbia in the form of required reserve.
Bearing in mind the structure of assets, we can state that the assets sensitive to the credit risk are being maintained at the optimum level, with a reasonable policy of taking the risk. By conducting considerably more restrictive assessment of credit risk, KB's management secured the protection of its loan portfolio and reality of declared financial reports, as well as start of 2017 with no significant burdens arising from this type of expenses.

As of December the 31st 2016, deposits and other liabilities to other customers (including the funds acquired in the form of credit lines) amounted to RSD 322,621.4 million, and participate in the total liabilities with 80.7%. Compared to the beginning of the year, deposits and other liabilities to other customers increased by RSD 22,615.5 million or 7.5%. Deposit potential of the Bank predominantly consists of foreign currency retail deposits, with existing large diversification of deposits, or a large number of deposits in smaller amounts. KB kept the scope of retail deposits despite the decrease of interest on debit account compared to the previous years. Retail FX deposits recorded growth in the end of 2016 to the amount of EUR 20.8 million compared to the end of 2015.

Deposits and other liabilities to banks, other financial institutions and the Central Bank as of December the 31st 2016 amount to RSD 7,835.0 million, which accounts for 2.0% of the total KB's liabilities.

In order to strengthen the capital base, KB raised a portion of funds in the form of subordinated debt by IFC. As of December the 31st 2016, subordinated liabilities amount to RSD 6,178.4 million and make 1.5% of total liabilities.

Total capital of the Bank at the end of 2016 amounts to RSD РСД 55,424.3 million, which makes 13.9% of total liabilities. In the observed fiscal year, the capital reduced by RSD 7.413,7 million or 11.8%. Capital reduction was the result of booked loss to the amount of RSD 8,063.2 million. The Bank achieved capital adequacy of 26.97% at the end of 2016, which was above the legal minimum of 12.0%.

Based on the above, one may conclude that KB provided the necessary diversification of the funding sources.

13. RISK MANAGEMENT

13.1. Targets and policies of managing financial risks

Managing risks is the key element of business management, considering that risk exposure arises from all business activities, as inseparable part of the banking business managed through identification, measurement, mitigation, monitoring and control, and through reporting or establishing risk limitation, as well as reporting in line with the strategies and policies.

KB established an overall and reliable risk management system that includes: strategies, policies and procedures of risk management, methodologies for managing individual risks, appropriate organizational structure, effective and efficient system of managing all the risks to which KB is exposed, adequate internal controls system, appropriate information system and adequate process of internal capital adequacy. Also, KB's Recovery Plan has been integrated into the risk management system as a mechanism of early identification of a situation involving grave financial disturbance, when the Bank can take measures or apply defined options of recovery in order to prevent entering the phase of early intervention, when regulator takes active participation, or betterment of already deteriorated financial state. By the risk management strategy and capital management strategy, KB has set up the following objectives within the risk management system: minimizing adverse effects to financial result and capital through defining frameworks of the acceptable level of risk, maintaining the required level of capital adequacy, developing activities of the bank in line with business opportunities and development of the market in order to achieve the competitive edge. KB has been permanently monitoring the expected changes in regulatory framework and taking measures for timely adjustment of its business with the new regulations, such as implementation of Basel III standards and international financial reporting standard 9 (IFRS 9). Through clearly defined process of introducing new products, the Bank analyses the influence of its new services and products on the future risk exposure in order to optimize its income and expenses for the assessed risk, as well as minimizing all potential adverse effects on the financial result of KB. More detailed overview of the objectives and risk management policies of KB has been presented in the Item 4. Notes to financial statements.

Policy of protection from credit risk exposure

In order to protect from credit risk exposure, the Bank has been applying the techniques of mitigating credit risk by acquiring acceptable security instruments (collaterals) as secondary sources of loan collection. The Bank seeks to do business with creditworthy clients, assessing in the moment of submission of the application and by regular monitoring of the debtor, loan and collateral, to the effect of timely undertaking of proper activities in the collection procedure. Types of collateral obtained to protect the claim depend on the assessment of the debtor's credit risk, and these are establishes in every specific case individually, with obtaining of collateral after concluding the agreement but before loan disbursement.
By internal regulations, KB has regulated evaluation of credit protection instruments and management of these instruments.
When assessing the collateral value, the Bank hires authorized assessors so that the potential risk would be reduced to the least possible, and the real-estate, goods, equipment and other movables items that are the subject of pledge must be secured with the insurance company acceptable for the bank with the insurance policies endorsed in favor of the Bank.

In order to protect from change in the market value of collateral, the assessed value is adjusted by the defined percentages of reduction, depending on the collateral type and real-estate location, which are regularly re-assessed and reviewed.

KB pays particular attention to collateral monitoring and undertakes the activities to provide new assessments of value, but also to acquire additional collaterals, primarily when it comes to the clients with identified problems in business, but also the clients whose collateral coverage has been reduced due to fall in value of the acquired collateral. In order to improve the risk management process, KB made organisational and process changes in the risk management function (including the activities of credit risk analysis when approving the loan, monitoring and managing the risks, as well as the process of prevention and managing risk loans, including the adequate identification of the potentially risky clients (watch list), mitigating credit risk of clients having the above referred to status, as well as undertaking measures and activities in order to protect KB's interests and prevent adverse effects to the financial result and capital of the Bank.

Methodology regulating calculation of impairments and evaluation of collateral has been improved in order to have a consistent application of the accounting standards and amended regulatory requirements, as well as in the part of an adequate application of security instruments when calculating provisions for impairments and off-balance sheet items By changing the Strategy and Policy of Risk Management the criteria have been defined for determination and key criteria of managing the bad assets and highest acceptable level of bad assets for KB. In accordance with the amended regulatory requirements, credit risk management relating to the comprehensiveness of definition of risk loans, suspension of reprogramming, change of definition and manner of classification of restructured loans has been improved; this has also been done in terms of implementation of provisions enabling relaxing of calculated level of the required reserve for estimated losses, and based on the proactive management and reduction of level of NPLs.

Methodology for evaluation of securities has been improved in order to include market relevant information of evaluating fair values of securities.

Considerable increase of loan provisioning in 2016 mostly resulted from deterioration of loan quality portfolio, new risk loans, lower assessments of mortgage value and foreclosures. Also, the increase in the level of total provisions for impairment came as the result of assessment of funds acquired through collection and investment properties, as well as the impairment of share in equity of subsidiaries (KB Budva, KB Banja Luka), based on assessment of value carried out by an independent assessor in line with the IAS 36.

13.2. Exposure to risks (price, credit, liquidity risk and cash flow risk) with the strategy for risk management and assessment of their effectiveness.

In its operations, KB is particularly exposed to the following types of risks:
1. Credit and related risks.
2. Liquidity risk.
3. Market risk.
4. Interest rate risk in the banking book.
5. Operational risk.
6. Investment risk.
7. Risk of exposure.
8. Country risk, as well as all other risk that may appear in the regular operation of KB.

Credit risk is the possibility of negative effects on financial result and capital due to non-fulfilment of debtor's obligations to the Bank. Credit risk is caused by the debtor's creditworthiness, regularity in settling liabilities to the Bank, as well as the quality of collateral. Acceptable level of credit exposure of KB is in accordance with the defined risk management strategy and depends on the structure of the Bank's portfolio, which is the basis that allows limiting negative effects on the financial result and equity while minimizing capital requirements for credit risk, settlement and delivery risk and counterparty risk in order to maintain capital adequacy at acceptable levels. The Bank grants loans to customers (legal entities and natural persons) that are estimated as creditworthy by performing credit analysis, or quantitative and/or qualitative measurement and assessment of credit risk. The process of credit risk measuring is based on measuring risk level of an individual loan based on the internal rating system, as well as by applying the regulations of the National Bank of Serbia which requires classification of every loan based on the prescribed criteria and calculation of reserve for estimated losses. In that sense, KB classifies receivables and calculation of the required level of reserves for estimated losses. By monitoring and controlling the portfolio in its entirety and by segments, KB compares with previous periods, identifies trends and causes of changes in the level of credit risk. It also monitors the asset quality indicators (NPL movement, coverage level by NPL provisions etc.), as well as the exposure to regulatory and internally defined limits. The process of monitoring of the loan quality enables KB to assess potential losses, as a result of risks to which it has been exposed, and to take corrective measures. On the other hand, KB does not invest in high-risk loans such as investments in potentially profitable projects involving high risk, in investment funds with high risk portfolios etc.

Liquidity risk represents the possibility of negative effects on financial result and equity due to inability of the bank meet its payment obligations when due, as well as to quickly provide liquid assets without major costs. Liquidity risk arises from the Bank's difficulty in meeting its due obligations in the event of insufficient liquidity reserves and inability to cover for unexpected outflows of other liabilities. The Bank operates in accordance with the basic principles of liquidity, maintaining a sufficient level of liquid assets to cover liabilities incurred in the short term, or respects the principle of solvency by establishing the optimal structure of its own and borrowed funds and the formation of a sufficient level of liquidity reserves which do not compromise realization of the projected return on equity. Liquidity risk arises from the Bank's inability to transform certain parts of assets in liquid assets in the short term. The Bank performs a risk analysis of funding sources and market liquidity risk. The problem of liquidity in terms of funding sources relates to the structure of liabilities, i.e. commitments and is expressed through potential significant share of unstable and short-term sources or their concentration. Funding liquidity risk is actually a risk that the Bank will not be able to meet its obligations due to the withdrawal of unstable sources of funds, or the inability to obtain new sources of funding. On the other hand, liquidity risk also manifests through deficiency of liquidity reserves and difficulty or inability to obtain liquid assets at reasonable market prices.

KB actively takes preventive measures in order to minimize exposure to the liquidity risk.

Market risk represents the possibility of negative effects on financial result and equity due to changes in market variables and comprises the foreign exchange risk for all business activities performed by the bank and the price risk of the trading book positions.

The Bank is exposed to foreign exchange risk, which is manifested through the possibility of negative effects on financial result and capital due to the volatility of foreign exchange rates, relations, changes in the value of the domestic currency in relation to foreign currencies or changes in the value of gold and other precious metals. In order to minimize exposure to foreign exchange risk, the Bank diversifies the currency structure of its portfolio and currency structure of liabilities, by matching open positions in certain currencies pursuant to the principles of maturity transformation of funds. During 2016, the Bank was in compliance with regulatory indicator of foreign exchange risk expressed as 20% of regulatory capital.

Interest rate risk is the risk of negative effects on financial result and equity arising from the banking book positions due to unfavorable changes in interest rates. In a comprehensive and timely manner the bank determines causes of the current and estimates future factors of exposure to interest rate risk. Exposure to this type of risk depends on relation between the interest rate sensitive assets and liabilities. Managing the interest rate risk aims at maintaining the acceptable level of exposure to interest rate risk from the aspect of impact on the financial result and economic value of equity, by maintaining an adequate policy of maturity match between period of reprising and adjustment of funding sources with loans, according to the level of interest rate and maturity structure.

Operational risk is the possibility of negative effects on financial result and equity due to failures by employees, inadequate internal procedures and processes, inadequate management of information and other systems in the bank, as well as occurrence of unforeseen external events. Operational risk includes legal risk, which represents the risk of negative effects on financial result and equity of the bank arising from court of off-the-court procedures. The bank takes measures aimed at mitigating the operational risk and pro-active reaction to potential events of operational risks through permanent monitoring of all activities, application of an adequate and reliable information system, which during its implementation makes business practice better and optimizes the business processes of the Bank. In order to minimize legal risk and its impact to financial result, the bank continues to improve its business practice in the area of timely provisioning for claims against the bank, an in accordance with the assessment of future expected loss on this basis.

Investment risk of the bank represents the risk of investing in other legal entities and fixed assets and investment properties. In accordance with the regulations of the National Bank of Serbia, level of permanent investment is monitored and then the bodies and committees of the Bank are being informed thereof. In this way, KB ensures that its investment in one person not pertaining to the financial sector does not exceed 10% of the bank's capital, and that the bank's investments in persons not pertaining to financial sector and in fixed assets and investment properties do not exceed 60% of the bank's capital.

Large exposure of KB to one person or a group of related persons, including the persons related to the bank, is the exposure that amounts at least 10% of the bank's capital. During 2016, KB abided by the regulatory and internally defined exposure limits.

Country risk is the risk related to the country of origin of the entity to which the Bank is exposed, and the risk of negative effects on financial result and equity due to inability to collect receivables from debtors for reasons arising from political, economic or social conditions in the country origin of the debtor. KB's exposure to the country risk is at an acceptable level.

The detailed overview and explanation of the risks to which the bank is exposed in its business is presented in the Item 4, Notes to financial statements.

14. SOCIALLY RESPONSIBLE BUSINESS

Project and Project Portfolio Management

A total of 7 projects with the aggregate budget of EUR 911,400 were implemented in 2016, while on December the 31st 2016 there were 9 projects left in the KB's portfolio.

Closed projects in 2016

Category	Number of projects
Regulatory	1
Optimization Improvement	1
IT projects	5
Total	7

The most important closed projects in 2016 were:

- Introduction of sets – refers to the core banking application of KB, which meant implementation of the solution for activation and work with the account packages in the core banking application in order to make the account packages available in the teller application in all bank's branch offices.
- Introducing Kom@Cash service – KB's clients enabled to make transfers of funds via cell phones to the recipients of their choice, who do not need to be KB's clients. These are „cash out"transfers, and their realization, i.e. withdrawal of cash will be enabled in all KB's ATMs ne payment card required. Nobody offers this type of service on the Serbian market.
- DDC solution implementation (dynamic currency conversion) on KB' POS terminals – this functionality enables the conversion of payment currency into the currency of the client's choice in real time. This functionality is primarily intended to the foreign citizens who use the cards issued by foreign banks. Such functionality already exists on KB's ATMs, and the bank generates income from conversion. The bank is also considering the possibility to introduce m-POS terminal (mobile POS terminals that use mobile application to process the transactions, more precisely the application is upgraded on cell phones and tablets).
- By introducing the advanced technologies (OCR/ICR technologies), KB implemented the optimization in working with cheques and transfer orders in its outlets and did the reorganization of these transactions in back office units so as to introduce the automation and acceleration of transactions, followed by huge disburdening of the FO (front office).
- Implementation of SMARAGD TCM module ''PEP identification''- this project achieved more efficient management of the financial, reputational and regulatory risk of the bank, particularly in the part that implies identification of natural and legal persons involved in money laundering and financing of terrorism, bribe, corruption and external frauds.
- Implementation of SAP ERP module (real-estate management) – flexible management of the real properties; SAP ERP module was designed to cover all business demands in the processes related to the real-estate, providing complete picture of all business transactions in the life cycle of each real estate included in this module.

Projects initiated on December the 31st 2016:

Category	Number of projects
Strategic	4
Regulatory	2
Standard	6
Lower priority	3
Total	15

The most important initiated projects on December the 31st 2016 are the following:

- Implementation of IFRS9 standard – In line with the new international financing reporting standard published on 24.07.2014 by the International Accounting Standards Board, as of 01.01.2018, KB shall be obliged to comply it classification and methodology of calculation of provisioning costs (impairment methodology) with the rules specified in the IFRS9. This is a regulatory requirement which includes both the Bank and the Banking Group.
- New networks structure – This project has been initiated with the goal to improve selling of products, and thus generate higher operating income. The project anticipates that all the activities currently performed in branches, and are not of a selling character, are to be re-organized so to be performed in the Head Office. In this way the employees in the selling centers and outlets have more time to sell additional products to the clients, which will result in improvement of the bank's business results.
- Project of back-office activities centralization – initiated with the aim to move the back-office operations currently mostly carried out in bank's branches to Head Office. This project is in direct correlation with the project of new retail operations

organizational structure aimed to form the new network structure of KB, which will primarily operate the selling activities and cooperation with the customers.

- Upgrade of RMS and AML tools – project initiative anticipates implementation of RMS and ALM tools, which was a part of the Basel II program scope. Additional imitative includes introduction of Basel III standards.
- MDS solution 4.11 – The goal of the project is to implement software to execute legal requirements related to monitoring of business and analysis of clients and transactions. The project includes upgrade and transfer to SMARAGD MDS 4.11 new version of the software in KB Belgrade, as well as the implementation of this software version in KB Banja Luka and KB Budva subsidiaries.
- Improvement of internal models – included the scope of project within the program of Basel II, in the part of improving internal models and supply of the software necessary to improve internal models of credit risk management. Due to technical complexity of internal model upgrade, a static tool is necessary.
- Implementation of „storage“ solution – considering that the storage is one of the key elements in the information communication infrastructure whose operation holds the stability of services the IT is providing, supply of the new storage is required both from the financial and technological point of view. In the meantime, since the last purchase of storage five years ago, a dramatic change has occurred related to the concept of the very storages, by introduction of ultra-fast discs, which potentially may provide quicker response of the IT services, or the services which KB provides to its clients.

Marketing and CSR Activities

2016 marketing plan continued promoting the products and services, both the existing and the new ones, with steady reminding and refreshing of the brand.

The first half of 2016 was marked by the campaigns related to the existing products and services of the bank, more specifically, the cash loans campaign, campaigns related to pensioners and agricultural loans. The campaign for cash and refinancing loans with more beneficial terms began in August – special offer that lasted until year end. In the second part of the year the focus was on the promotion of new products and services. Campaign for a new and unique service on our market KOMeCASH began in September, and campaign related to the new current accounts started in December.

Implemented campaigns were integrated, which means that they coordinated a numerous communication channels used to send clear and more attractive message about the bank and its product. In addition to the traditional communication channels, KB continued with the comprehensive communication through social networks: Facebook, Twitter, YouTube, Google+, Instagram, and LinkedIn. In this way the effects of promotion were at the highest level, given that advantages of both traditional and modern media have been fully exploited.

We promoted the agro loans in the agricultural fair in Novi Sad, Plum Fair in Osečina and Šumadija Agriculture Fair in Kragujevac.

Particular contribution to preservation and increase of corporative image value came from the CSR activities, which were carefully chosen and supported by the Bank, and in which KB actively cooperated, together with its partners. Action „Together for the babies“ continued during the entire 2016, as well as the support to Ivana Španović, Milica Mandić, Tijana Bogdanović and other sportsman and women who achieved great results in 2016.

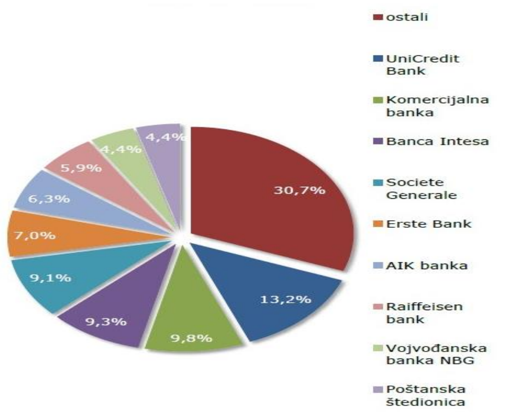
We were present at the International Festival of Knights "Despot Stefan Lazarević - Manasija 2016", Sports Games for the youth in Split, Days of Comedy in Jagodina and Vuk's Assembly in Tršić.

High quality exploit of the title sponsorship of Kombank arena, as the most prestigious sports and concert facility in the country, continued.

In 2016, KOMBANK ART HALL, our gallery space is also attracted the attention of the media and the public through 18 conceptually different exhibitions, organized in cooperation with the Faculty of Applied Arts.

The modern market economy cannot be imagined without the appropriate PR support. KB clearly and specifically communicated with its stakeholders in order to achieve mutual understanding and a favorable view of the company so as to maintain the acquired image and reputation. More than in previous years, the statements of the members of the management about the operations and plans of KB in the coming period have contributed to the important role of public relations.

Pro rata representation of business banks in the media (December 2016)



All our marketing activities can be seen on our web page: www.kombank.com

Corporate Governance Rules

Corporate governance rules in the bank are based on the appropriate legal regulations (primarily the Law on Banks and Company Low).

Competences and authorities of all bank's bodies (General Meeting of Shareholders, Board of Directors, Executive Board, Audit Committee, Assets and Liabilities Management Committee (ALCO), Compensation Committee, credit committees and other committees) are based on the appropriate legal regulations and defined by internal enactments (Memorandum on Association, Articles of Association, terms of reference of bank's bodies and other internal regulation).

In accordance with the Bank's Executive Board Decision No. 8373 dated 09.04.2013, the Bank has been applying the Corporate Governance Code of the Commercial Chamber of Serbia to its business activities („Official Gazette of RS, No. 99/2012), adopted by the Assembly of the Commercial Chamber of Serbia.

Rules of corporate governance have been implemented through internal enactments of the bank and there are no deviations in the application of these rules.

Principles of the corporate practice have been established by the Corporate Governance Code, which must be abided by the corporate governance shareholders of the bank in business. The aim of the code is to introduce good business customs in the area of corporate governance, equal influence of all stakeholders, current and potential shareholders, clients, bank's bodies, state etc. The final objective is to provide long-term and sustainable development of the bank.

The text of Corporate Governance Code has been published on the internet presentation of the Commercial Chamber of Serbia (www.pks.rs/PoslovnoOkruzenje.aspx?id=1412&p=3) and the internet page of the bank (www.kombank.com/korporativno-upravljanje).