REPORT

on Disclosure of Komercijalna banka A.D. Beograd

Data and Information for 2011

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1. INTRODUCTION

- Komercijalna banka Bank AD Beograd (hereinafter: the Bank) discloses below, in conformance with the Law on Banks and the Decision on Disclosure of Bank Data and Information, the Report for the period between 01.01.2011 and 31.12.2011.
- This Report includes the qualitative and quantitative information as prescribed by the mentioned Decision.
- The Report is publicly disclosed on the Bank's Internet domain (www.kombank.com).

EXECUTIVE BOARD OF THE BANK

Andrijana Milanović	Ivica Smolić
Executive Board Member	**Executive Board President**

2. BANK GENERAL DATA

- Komercijalna banka AD Beograd is the second largest bank on the Serbian market, with a share over 10%. The Head Office of Komercijalna banka AD Beograd (hereinafter: the Bank) is in Belgrade, Svetog Save 14. Clients have at their disposal the largest network of 230 branches and branch offices Serbia-wide, and additional almost 40 branches and branch offices belonging to independent banks in Montenegro and in Bosnia and Herzegovina.
- The largest shareholder of the Bank is the Republic of Serbia (42.6%), which has a strategic agreement with the second largest shareholder, EBRD (25%). Among the shareholders of Komercijalna banka are also other internationally reputed professional investors (IFC, SWED Fund, DEG …), as well as several domestic public and private companies.

3. RISK MANAGEMENT

3.1. Risk Management Strategy

- The Bank has established a comprehensive and reliable risk management system which allows managing all risks the Bank is or may be exposed to under all business activities, which is proportionate to the nature, volume and complexity of the Bank operation. The established risk management system ensures that the risk profile is in conformance with the identified tendency to risks, or with the risk profile of the Bank.
- The risk management system at the Bank level is defined by the following acts:
  - Risk Management Strategy and Capital Management Strategy, and Capital Management Plan,
  - Risk management policies,
  - Risk management procedures;
  - Individual risk management methodologies,
  - Other acts.
- Risk Management Strategy regulates, in a uniform and consistent manner, management of the risk that the Bank is or may be exposed to in its operation, and is compliant with the Business Policy and Strategy.
- For the Risk Management Strategy are responsible the competent bodies of the Bank and organizational parts which implement and participate in the risk management system.

The Meeting

- adopts the business policy and strategies of the Bank;
- decides on capital increase or capital investment in another bank or other legal entities, and on the level of investment in the Bank's fixed assets.

The Board of Directors

- is responsible for establishment of a single risk management system in the Bank, as well as for supervision over the system;
- adopts the risk management strategy and policies, as well as the capital management strategy;
- adopts the business continuity plan and the disaster recovery plan in the case of catastrophes;
- establishes the system of internal controls;
- defines the internal organization or organizational structure of the Bank which ensures a division of duties, competences and responsibilities of the staff in a manner that prevents the conflict of interests and provides a transparent and documented decision-making and implementing process;
- adopts the policy of remuneration and other emoluments of the Bank employees;
- supervises the work of the Executive Board;
- adopts the internal audit program and plan;
- ensures implementation of the internal capital adequacy assessment process and its compliance with the strategic operation targets.

The Executive Board

- implements the risk management strategy and policy, as well as the capital management strategy;
- adopts and analyzes the efficiency in applying the risk management procedures, which define in a greater detail the process of risk identification, measurement and assessment and the risk management, and informs the Board of Directors in connection with such activities;
- implements the business continuity plan and the disaster recovery plan in the case of catastrophes, and revises them in accordance with business transactions, and a continuous testing;

The Audit Committee

- analyzes and adopts draft risk management and internal control strategies and policies of the Bank that are submitted to the Board of Directors for consideration and adoption;
- analyzes and supervises the application and adequate implementation of adopted risk management strategies and policies, and implementation of the internal control system;
- informs the Board of Directors at least once a month about its activities and the irregularities found, and proposes the mode for elimination of such irregularities or for improvement of the risk management policies and procedures, and for implementation of the internal control system.

The Assets-Liability Committee (ALCO)

- follows up the Bank's exposure to the risk which arises from the structure of its balance sheet receivables, liabilities and off-balance sheet items, as well as the measures proposed for the interest rate and liquidity risk management, and also performs other activities laid down by the Bank acts.

The Credit Committee

- decides on credit requirements within the frameworks defined by the Bank acts, analyzes the exposure of the Bank to credit, interest rate and currency risk, analyzes the credit portfolio and implements the internal audit findings which fall within the scope of the Committee's responsibility, and also proposes measures to the Executive Board of the Bank. It also performs other activities in accordance with the Bank acts and by order of the Executive Board.

Risk Management Function

- an independent business function responsible for risk management:
  - defines and proposes the risk management strategy and policies to the Board of Directors for adoption;
  - defines and proposes the risk management procedures and methodologies to the Executive Board for adoption;
  - develops the models and methodologies for risk identification, measurement, mitigation, monitoring and control;
  - identifies, measures, assesses, monitors and manages the risks to which the Bank is exposed in its operation;
  - informs the competent Bank bodies about the risk management (the Bank's Board of Directors, Audit Committee, Executive Board, Assets-Liability Committee, Credit Committee...)

Operational Compliance Control Department

- is responsible for:
  - identification, monitoring and managing the risk of the Bank's operational compliance;
  - identifies and assesses at least once a year the main risks of the Bank's operational compliance and proposes the plans for managing such risk, of which prepares a report that is submitted to the Executive Board and the Audit Committee.

Internal Audit Function

- performs an independent valuation of the risk management system at the Bank level, and makes regular assessment of the internal control system adequacy, reliability and efficiency.

- The Bank has by its Risk Management Strategy comprised the following:
  - an overview and definitions of all risks the Bank is or may be exposed to;
  - the long-term goals determined by the Bank business policy and strategy, as well as the tendency to risks determined in accordance with such risks;
  - basic principles of risk-taking and risk management;
  - basic principles of the internal capital adequacy assessment process of the Bank.
- The Bank has identified and defined the risks it is or may be exposed to in its operation, namely:
- **Credit risk** which is the risk of possible occurrence of negative effects on the financial result and capital of the Bank due to non-fulfillment of debtors' obligations to the Bank. Credit risk includes:
  - **Residual risk** – the risk that credit risk mitigation techniques are less efficient than expected or that their utilization does not have sufficient influence on the reduction of all risks the Bank is exposed to.
  - **Risk of Receivables' Decreased Value** – the risk of possible occurrence of negative effects on the financial result and capital of the Bank based on decrease in the value of redeemed receivables due to cash or non-cash obligations of the former creditor to debtor.
  - **Settlement/delivery risk** - the risk of possible occurrence of negative effects on the financial result and capital of the Bank based on unsettled transactions or due to non-meeting of the obligation of the other party under free delivery transactions on the contracted settlement/delivery date.
  - **Counterparty risk** - the risk of possible occurrence of negative effects on the financial result and capital of the Bank based on unsettled obligations of the counterparty in a transaction prior to definite settlement of the

transaction related cash flows.

- **Credit FX risk** – represents probability that the Bank will suffer a loss due to non-performance of debtors' obligations within the contractual terms, which arises because of the negative impact of the dinar exchange rate changes on debtor's financial standings.
- **Environmental risk** – the risk of occurrence of negative effects on the financial result, capital and reputation of the Bank due to an event which has or will probably have a negative material impact on the environment, health or security, or the community as a whole.

- **Concentration risk** is the risk which arises directly or indirectly from the Bank's exposure to the same or similar risk factor or risk type, such as the exposure to one person or a group of related persons, economic branches, geographic regions, product and activity types, credit protection instruments, financial instruments, commodities, etc.
- **Investment risk** is the risk that arises from the Bank's investment in other legal entities and in fixed assets.
- **Country risk** is the risk that relates to the country of origin of the person the Bank is exposed to, or the risk of possible occurrence of negative effects on the financial result and capital of the Bank because of the impossibility for the Bank to recover the receivables from the debtor for the reasons that are the consequence of political, economic or social circumstances in the debtor's country of origin. The country risk includes the following risks:
  - **political-economic risk**, which involves the probability of loss because of the impossibility for the Bank to recover the receivables due to the restrictions set forth by the acts of the government and other bodies in the debtor's country of origin, as well as the general and systemic circumstances in that country;
  - **transfer risk**, which involves the probability of loss because of the impossibility to recover the receivables denominated in the currency which is not the official currency of the debtor's country of origin, as a result of the restrictions imposed on making payments of obligations to creditors from other countries in the specific currency, as set forth by the acts of the government and other bodies in the debtor's country of origin.
- **Operational risk** is the risk of possible occurrence of negative effects on the financial result and capital of the Bank due to intentional and non-intentional failures in the work of employees, inappropriate internal procedures and processes, inadequate management of information and other systems in the Bank, as well as due to occurrence of unforeseeable external events. Operational risk includes the legal risk.
  - **Legal risk** is the risk of occurrence of negative effects on the financial result and capital of the Bank based on court and out-of-court proceedings in connection with the Bank operation (labor relations, relations based on contracts and torts, etc.)
- **Liquidity risk** is the risk of possible occurrence of negative effects on the financial result and capital of the Bank because of the inability for the Bank to meet its due obligations due to:
  - **withdrawal of the existing sources of funding** or impossibility of acquiring new sources (risk of liquidity funding sources), or
  - **more difficult conversion of property into liquid assets due to market disruptions (market liquidity risk).**
- **Interest rate risk** is the risk of possible occurrence of negative effects on the financial result and capital of the Bank based on the positions from the Banking Book because of adverse changes in interest rates.
- **Market risks** are the risks of possible occurrence of negative effects on the financial result and capital of the Bank based on losses within balance sheet and off-balance sheet items due to price movements on the market, and comprise:
  - **FX risk** which is the risk of occurrence of negative effects on the financial result and capital of the Bank because of the exchange rate changes for the items maintained in the Banking Book and Trading Book.
  - **Price risk** based on debt and equity securities, which is the risk of possible occurrence of negative effects on the financial result and capital of the Bank based on losses due to market fluctuation of debt and equity securities price in the Trading Book.
  - **Commodity risk** which represents the risk of possible occurrence of negative effects on the financial result and capital of the Bank based on losses due to fluctuation of the price of commodities on the market.
  - **Option risk** which represents the risk of possible occurrence of negative effects on the financial result and capital of the Bank based on losses due to options' price fluctuations on the market.

  The Bank is not exposed to option and commodity risk.
- **Operational compliance risk** is the risk of possible occurrence of negative effects on the financial result and capital of the Bank due to the Bank's failure to make its operation compliant with law, by-laws, its internal acts, procedures relating to anti-money laundering and counter-terrorism financing, as well as with the rules of the profession, good business practices and business ethics, and particularly comprises the risks of the regulatory body sanctions and of financial losses, and the reputational risk.
  - **Reputational risk** is the risk of possible occurrence of negative effects on the financial result and capital of the

Bank due to the loss of confidence on the side of the public or the negative view of the public concerning the Bank operation, regardless of whether grounded or ungrounded.

- **Strategic risk** is the risk of possible occurrence of negative effects on the financial result and capital of the Bank due to the lack of an appropriate business policy and strategy, their inadequate implementation, as well as due to the changes in the environment where the Bank operates or the absence of the Bank reaction to such changes.

Long-Term Objectives

- Long-term objective for the Bank risk management are:
  - to develop activities in accordance with the Business Strategy and possibilities, and the market development for the purpose of creating competitive advantages;
  - to avoid or minimize the risks for the purpose of maintaining the operation within acceptable risk level;
  - to minimize the negative effects on the Bank's capital;
  - to maintain the necessary level of capital adequacy;
  - to diversify the risks the Bank is exposed to.
- The objectives for risk management are adjusted with the Bank's Business Plan and may be modified in the course of the year.
- In taking up the risks, the Bank defines the risk profile and risk appetite on the basis of the capacity for covering the risks.
- Risk management process includes a clear definition and documentation of the risk profile, as well as the risk profile adjustment with the Bank's tendency to risk-taking.
- Risk tendency involves the Bank's intent to take up risks in order to accomplish its strategies and policies, and determination of this risk take-up at an acceptable risk level.

Basic Principles of Risk Take-Up and Management

- Basic principles of risk take-up include:
  - establishment of explicit and clear rules for managing individual risk types, with the pertaining policies and procedures for managing individual risk types with relevant objectives for acting at the Bank level;
  - gathering of complete, timely and accurate data of importance for risk management and for ensuring adequate capacities for the data keeping and processing;
  - conservativeness of risk take-up – means that the attitude vis-à-vis the risk which the Bank takes is that expected returns will significantly exceed the losses that may be incurred by taking up the risk;
  - making business decisions on the grounds of detailed qualitative and quantitative analyses based on applicable risk parameters;
  - use of a larger number of methods for risk identification and measurement – in managing the risks, the Bank also applies, apart from the regulatorily prescribed frameworks and approaches for risk management, the internal methods by taking care of their applicability and justification from the standpoint of investment in their development and justification of their application from the perspective of their complexity and the volume of business activities.
  - development of a quantitative modeling mechanism which enables to measure the effect of the changes taking place in the business and market environment on the Bank's risk exposure profile, and further impact on profitability, liquidity and net value of the Bank.

3.2. Risk Management Policies

- The risk management policy regulates:
  - implementation of the risk management strategy under all risk types: credit, market, interest rate, liquidity and operational risk;
  - mode of organizing the risk management process of the Bank and clear delineation of the staff responsibilities in all phases of that process;
  - mode of assessing the risk profile of the Bank and methodologies for risk identification, measurement or assessment;
  - mode of risk follow-up and control and establishment of the system of limits or the types of limits used by the Bank, and their structure;
  - measures for risk mitigation and the rules for implementing such measures;
  - mode and methodology for implementing the internal capital adequacy assessment process of the Bank;
  - principles for the functioning of the internal control system;
  - framework and frequency of stress tests, as well as acting in the cases of negative stress test results.
- External information of the Bank is carried out in conformance with law and by-law regulations of the National Bank of Serbia.

- The Bank bodies (Board of Directors, shareholders, Executive Board, Audit Committee, ALCO, Credit Committee are internally informed on monthly, quarterly and annual basis.

3.3. Organizational Structure of Risk Management Function

- Risk management function performs its activities through the following organizational parts: Risk Management Department, Credit Risk Management Department, and Risk Placement Management Office – Workout.
- Risk Management Department is composed of Portfolio Monitoring Office, Market Risk Management Office, Credit Risk Management Office, and Operational Risk Management Office.
- Credit Risk Analysis Department is composed of Legal Entity Credit Risk Analysis and of Retail, Micro and Farmer Clients' Credit Risk Analysis Office.

3.3.1. Credit Risk

- Credit risk management policy represents the document which more specifically defines the **credit risk management system**, including the residual risk, the risk of decreased value of receivables, concentration risk, settlement and delivery risk, and the counterparty risk to which the Bank is or may be exposed in its operation, as a part of the risk management system.
- The most important processes of the risk management system are:
  - the process of lending approval;
  - the process of managing the credit risk protection instruments;
  - the process of monitoring the lending for the purpose of early detection of warning signals;
  - the process of lending classification in accordance with the regulations of the National Bank of Serbia;
  - the process of determining the internal rating system in conformance with the Bank's internal methodology;
  - the process of managing risky lending – work out;
  - the process of monitoring the portfolio and the credit risk;
  - the process of calculation of the minimum capital requirement for credit risk and internal capital adequacy assessment;
- The risk profile of the Bank is determined by a more acceptable risk level for the Bank and, in accordance with the Risk Management Strategy, also depends on the Bank's portfolio structure. The purpose of risk management is to minimize the negative effects of the credit risk on the financial result and capital of the Bank, on the basis of balance sheet and off-balance sheet items, as well as on the basis of operation with the counterparty for the positions maintained in the Banking Book and the Trading Book.
- Credit risk identification starts by filing an application for a loan approval.
- The lending approval process starts by gathering and checking all the necessary documentation, information and data on the basis of which is performed a credit analysis of individual loans, as well as of the credit risk factors.
- Individual lending risk analysis includes the analysis of qualitative and quantitative indicators of the client operation, identification of the risk level (determining the classification and the client's internal rating) and control of the extent to which the limits have been used up.
- The process of credit risk measurement is based on two approaches:
  - regulatory approach – classification of the receivables from debtors according to the regulations of the National Bank of Serbia and the process of lending impairment and estimation of the provisions for losses under off-balance sheet items according to International Accounting Standard 39 and International Accounting Standard 37;
  - internal approach – measuring the risk level of individual lending on the basis of the internal rating system.
- Within the lending approval process, exposure relative to regulatory and internally defined limits is reviewed.
- Lending approval limits are defined by the decision-making system which includes the following competences for the decision-making:

  Level I –Branches;
  Level II – Credit Risk Analysis Sector;
  Level III – Central Credit Committee plus the opinion of the Credit Risk Assessment Department;
  Level IV – the Executive Board (up to 10% of the Bank capital);
  Level V – the Executive Board with prior consent of the Board of Directors (over 10% of the Bank capital).
- In order to maintain the risk at acceptable level, the Bank applies the credit risk mitigation techniques at the level of individual lending by observing the exposure limits, diversifying investments, and by acquiring acceptable collateral instruments for the purpose of secondary collection.

- Upon approval of a lending, the lending and the client's operation are monitored through regular and extraordinary monitoring in order to timely identify the warning signals.
- By monitoring and controlling the portfolio as a whole and by individual segments, the Bank makes comparisons with previous years, identifies the trends and causes for the changes in the credit risk level. Also, it monitors the assets quality indicators (NPL trends, NPLs coverage by allowances …).
- Reporting on credit risk at the Bank level includes the system of external and internal reporting on credit risk management. The report on credit risk management includes: total exposure to credit risk, exposure to credit risk according to the criteria of the National Bank of Serbia and Internal rating system, due receivables, risky lending and credits, collaterals, allowances, provisions...
- External reporting is carried out in accordance with the requirements of the National Bank of Serbia and the International Financial Reporting Standard 7 for the credit risk, and internal reporting in accordance with the Bank's internal acts.

3.3.2. Liquidity Risk

- Liquidity risk management is an important segment of the Bank's conscientious and safe operation. The Bank has defined the liquidity risk in accordance with the principles established by the Basel Bank Supervision Committee and by observing the local regulations.
- The basic objective of the liquidity risk management is to maintain the level of liquid assets necessary for regular and timely settlement of due obligations under balance sheet and off-balance sheet transactions at the Bank.
- The Bank has established an adequate organizational structure, business activities, the lines of decision-making and responsibilities by a clear delineation between the liquidity risk management process (implemented by independent function responsible for risk management) and the liquidity risk management support process, and the process of liquidity risk taking.
- The function that manages liquidity risk independently carries out the following activities:
  - identifies,
  - measures,
  - monitors the limits,
  - proposes measures for risk minimization,
  - develops internal models and calculates capital requirement for liquidity risk, and
  - reports internally and externally on liquidity risk management.
- Liquidity Committee and Assets-Liabilities Committee have within their competences, in both regular and extraordinary circumstances for doing business, a significant and primary role in the process of liquidity risk management. Also, in the process of liquidity risk management other Bank committees whose decisions can influence on the exposure to the mentioned risk have an important role to play in this respect.
- Liquidity Committee monitors the dinar and FX liquidity on a daily basis by determining the manner of placing the surpluses of liquid assets and by analyzing the dinar and FX positions of the Bank and operation within the defined limits. On the basis of the data received by the Committee from the Risk Management Division, a monthly analysis is made of the indicators of early warning of a possible liquidity crisis. If there are certain indications of a crisis emergence, the Liquidity Committee activates the Liquidity Management Plan in Crisis Situations. ALCO monitors on a monthly basis the exposure to liquidity risk and proposes appropriate measures for the risk minimization, and controls implementation of the agreed upon measures.
- At taking up the liquidity risk, the Bank is guided by the following principles: all risk indicators are analyzed or liquidity risk is identified.
- Measurement of the exposure to liquidity risk is determined by the Bank by applying the quantitative and qualitative assessment using the GAP and ratio analysis, which is done minimally on semi-annual basis in regular circumstances for doing business, and more frequently in extraordinary situations.
- The basic principles applied by the Bank liquidity risk management are:
  - maintenance of the liquidity risk level that enables readiness to settle due obligations, through maintenance of the minimum level of liquid assets; all management phases are implemented on a daily level in the case of emergence of extraordinary conditions in doing business and on the market, as well as at introducing new products and activities,
  - maintenance of the match between inflow and outflow of assets by respecting the sequence of the receivables and obligations, as well as the impact of off-balance sheet items on the exposure to liquidity risk, and establishment of planned activities in the case of occurrence of unforeseen events.
- For the purposes of liquidity risk management has been established the system of monitoring the external limits (prescribed by the regulatory body) and internal limits (adopted by the competent Bank bodies). Regulatorily

defined liquidity risk, observed by the Bank, relates to maintenance of the minimum liquidity ratio in a period of 1 day, 3 days, and the average for a month. At defining the limit of the exposure to liquidity risk, several aspects of liquidity risk are analyzed, taking into account the limiting negative effect on the Bank's financial result and capital, the limiting currency and maturity structure of its balance sheet and off-balance sheet items, and liquidity ratios. The Bank has defined internal standards for liquidity risk management, which relate to defined internal limit of the liquidity ratio, limits of liquidity gaps by maturity and currency, structural liquidity limits, identification and quantification of early liquidity crisis elements.

- Liquidity risk monitoring and control involve monitoring of the operation compliance with the defined system of limits, all for the purpose of maintaining the liquidity risk at the level accepted by the defined risk profile of the Bank, as well as for the purpose of monitoring implementation of the measures. Liquidity risk monitoring and control have been established and integrated in all business activities of the Bank and at all levels of liquidity risk management, as has also been the independent control of the assessment of adequacy, reliability and efficiency of the system of liquidity risk management.
- For the purpose of maintaining the liquidity risk at the level accepted by the defined risk profile, the Bank applies the following techniques in the risk mitigation process: reduction, diversification, transfer and avoidance.
- The Bank has established system for liquidity risk reporting, which enables timely notification of the Bank management, competent bodies and organizational parts. The reporting system also includes assessment and analysis of the exposure to liquidity risk, compliance with external and internal limits, results of the stress test analysis and proposal of measures.

3.3.3. Interest Rate Risk in the Banking Book

- Primary objective of interest rate risk management of the Bank is to preserve the economic value of the Bank's capital, with simultaneous minimization of negative effects of interest rate changes on the financial result, for the positions that are maintained in the Banking Book.
- The Bank has adopted the good practice as a recommendation of the Basel Committee in the interest rate management process.
- The Bank has established an appropriate organizational structure, business activities, decision-making lines and responsibilities in the manner that the risk taking and risk management processes are clearly delineated.
- The function that independently manages the interest rate risk performs:
    - identification,
    - measurement,
    - limit monitoring,
    - proposes measures for minimization,
    - develops models and calculates capital requirement for interest rate risk, and
    - makes internal and external reporting on interest rate risk management.
- Assets-Liabilities Committee has within its scope of competence a significant and primary role in the process of interest rate risk management. By analyzing the open position per interest rate type on a monthly level, the Assets-Liabilities Committee defines further guidelines for adjusting the positions per interest rate type. Also, in the process of interest rate risk management other Bank committees whose decisions can influence on the exposure to the mentioned risk have an important role to play in this respect.
- Measurement of interest rate risk represents a quantitative and qualitative assessment of the exposure to interest rate risk. For this purpose are used the gap and ratio analysis, duration and economic value of the capital that are carried out on a monthly basis, and stress-testing which is done semi-annually as a minimum in regular circumstances for doing business.
- Basic principles for managing the Bank's interest rate risk include:
    - maintenance of interest rate risk level which enables minimization of the negative impact of interest rate changes on the market and maintenance of the minimum required interest rate margin,
    - identification, measurement, mitigation, monitoring, control and reporting that are performed monthly, and also frequently when and if necessary, in the case of emergence of extraordinary conditions for doing business and on the market, as well as at introducing new products and activities,
    - maintenance of the match between interest-bearing items, by respecting the maturity of the receivables and liabilities, as well as of the influence of the off-balance sheet items on the exposure to interest rate risk,
    - determination of the activities planned for the case of occurrence of unforeseen events.
- The Bank pursues interest rate risk mitigation continuously by maintaining the risk at the level acceptable for the risk profile, and by determining and applying adequate measures and techniques. In the interest rate management process the Bank applies the system of internal limits (adopted by the competent Bank bodies). At defining the level of exposure to interest rate risk, the Bank takes into account several interest rate risk aspects by limiting the

negative effect on the financial result and economic value of the capital. The Bank has defined the limits of interest-bearing items, limits of the gaps per currencies up to 1 year, which help limit the negative impact on the financial result, and the limit of change in the economic value of the capital by which the negative impact on the capital is limited.

- Interest rate risk monitoring and control include the match between business activities and the defined system of limits, for the purpose of maintaining the interest rate risk at the level accepted by the defined risk profile of the Bank, as well as the follow-up of implementation of the measures. The internal system of interest rate risk management is integrated in all Bank activities, as is also the independent control of adequacy, reliability and efficiency of the interest rate management system.
- The Bank has established the process of monitoring and reporting on the effects of implementation of the applied measures and techniques for risk mitigation, through providing regular reports to the competent committees and bodies, and a clear division of responsibilities, defining of the rules concerning the frequency of reporting on implementation of the measures adopted for risk mitigation.
- In conformance with the established system of reporting on the Bank’s interest rate risk, the Risk Management Division timely informs the Bank management, competent committees and organizational parts thereon. The reporting system includes assessment and analysis of the exposure to interest rate risk, compliance with the external and internal limits, results of the stress test analysis, and proposals of measures.

3.3.4. Market Risk

- The Bank is in its daily operation continuously exposed to foreign exchange and price risk. The Bank is not exposed to option and commodity risks.

Foreign Exchange Risk Management

- The purpose of managing the foreign exchange risk is to ensure safe operation of the Bank through minimization of the negative effects of exchange rate fluctuations of the domestic currency on the Bank’s financial result and capital, for the positions maintained in the Banking Book and the Trading Book.
- The Bank has established an adequate organizational structure, business activities, decision-making lines and responsibilities by having made a clear delineation between the process of the exchange rate risk take-up and the process of its management and support.
- The Bank monitors open FX positions on daily level, based on data and information. Also, in the process of foreign exchange management a significant role is played by ALCO and other Bank committees whose decisions may influence on the exposure to the mentioned risk.
- Foreign exchange risk measurement represents a quantitative and qualitative assessment of the Bank’s exposure to foreign exchange risk. For this purpose are used the gap and ratio analyses that are made on a daily and monthly basis, back testing that is carried out quarterly, and stress testing which is done semiannually as a minimum in regular conditions for doing business, and more frequently in extraordinary conditions.
- The basic principles for foreign exchange risk management of the Bank are:
  - maintenance of FX risk level within the externally and internally defined limits at which is minimized the negative impact of inter-currency relations on the market. The Bank maintains the FX risk level which allows minimize the negative impact of inter-currency changes on the market;
  - identification, measurement, mitigation, monitoring, control and reporting are performed daily, as well as at introducing new products and activities;
  - maintenance of the match of currency positions;
  - determination of activities planned for the case of occurrence of unforeseen events;
- The Bank pursues continuously the mitigation of FX risk by maintaining the risk at the level acceptable for the risk profile and by establishing and applying adequate measures and techniques, and also by monitoring implementation of the measures. The Bank applies the system of external (regulatorily prescribed) and internal limits (adopted by the Bank’s competent bodies) established on the basis of FX risk ratio. At defining the limit of the exposure to FX risk, several aspects of FX risk are taken into account by limiting the negative effect on the Bank’s financial result and capital. The Bank has defined internal limits of FX risk indicator per individual currencies and aggregately on a more rigorous level relative to regulatory limits, as well as the limits of transactions which influence on the financial result.
- The system of internal FX risk control is integrated in all business activities of the Bank, as is also the independent control of the assessment of FX risk management adequacy, reliability and efficiency.
- As a part of FX risk management, the Bank uses derivatives and other instruments and measures in the segment of assets and funding sources in order to minimize and mitigate the exposure to the mentioned risk. The Bank has established the process of monitoring and reporting on the effects of implementation of the applied measures and

techniques for risk mitigation through regular notification of the competent committees and bodies, as well as a clear division of responsibilities, definition of the rules concerning the frequency of, and reporting on the implementation of the measures adopted for FX risk reduction.

- The Bank has established a reporting system which includes external and internal reporting. In conformance with the said reporting system, the National Bank of Serbia and the Bank management, as well as the competent committees and organizational parts of the Bank member banks are furnished with regular reports by the Risk Management Division. The internal reporting system also includes an assessment and analysis of the exposure to foreign exchange risk, compliance with external and internal limits, results of the stress test analysis, and proposals of measures.

Price Risk Management

- The Bank has established an adequate organizational structure, business activities, lines of decision-making and responsibilities by making a clear delineation between the front office process and the middle- and back-office process, guided by the principles of risk management system organization of the Trading Book.
- The Executive Board and Assets-Liabilities Committee play an important role in the risk management process of the Trading Book based on the data and information furnished by independent function that deals with the process of measurement of the exposure to the price risk and independent valuation of the Trading Book. Also, in the process of price risk management important roles are also played by other Bank committees whose decisions may influence on the exposure to the mentioned risk.
- Basic principles for the Bank’s price risk management are:
    - maintenance of the risk level in accordance with externally and internally defined limits;
    - market risk management at the level of the Trading Book;
    - monitoring the changes on the market that may influence on increased exposure to the Trading Book risks;
    - determination of the measures for mitigating the exposures to risk in the circumstances when the Bank tends to the upper limit of the accepted risk profile of the risk exposure.
- The Bank pursues continuously the mitigation of price risk by maintaining the risk at the level acceptable for the risk profile and also by establishing and applying adequate measures and techniques. Definition and application of relevant protection and prevention measures, definition of the limits of exposure and definition and application of measures for price risk mitigation characterize the phase of price risk mitigation. The Bank has in place the established system of internal limits adopted by the competent Bank bodies, namely: the exposure limits for all positions of the Trading Book, investment limits per product and transaction type, limits according to the type of issuer of securities and the issuer’s participation in total portfolio…
- The system of price risk internal control is integrated in all business activities of the Bank, as is also the independent control of the assessment of adequacy, reliability and efficiency of the price risk management system. Price risk control also includes a regular control of each transaction.
- In conformance with the established system of reporting on the Bank’s price risk, the Bank carries out external and internal reporting. The Risk Management Division submits regular reports to the Bank management, competent committees and organizational parts.

3.3.1. Operational Risks

- Operational risk management represents an important segment of conscientious and safe operation of the Bank. The Bank has defined the operational risk in accordance with the principles established by the Basel Committee for Bank Supervision.
- The basic objective of operational risk management is to identify, to measure, mitigate, monitor, control, and report on operational risk events in accordance with the requirements and deadlines set by the regulations.
- The Bank has established an adequate organizational structure, business activities, decision-making lines and responsibilities by having made a clear delineation between risk acceptance and the risk management, guided by the principles of organization that are in conformance with the good practice of operational risk management.
- In order to minimize occurrence of an operational risk event, the Bank established an appropriate process which includes: the process of identifying the operational risk events, the process of classifying the operational risk according to risk level, the analysis of the operational risk event, the process of monitoring the operational risk, the process of monitoring the measures for operational risk mitigation, and the system of early detection of operational risk event.
- At acceptance of operational risk, the Bank is guided by the following principles: analysis of the key risk indicators that lead to occurrence of an operational risk event; current exposure to operational risk is measured and its exposure is estimated on the basis of introduction of new products and activities in implementing the measures that are intended to minimize the operational risk event.

- Basic principles of operational risk management applied by the Bank are: operation in accordance with good operational risk management practices; timely identification and continuous monitoring of operational risk event, minimization of operational risk occurrence by implementation of the measures; and provision of adequate controls for the operational risk management.
- The Bank continuously mitigates the operational risk, which involves maintenance of the risk at the level acceptable for the risk profile. By the procedure of operational risk mitigation the Bank establishes the measures for operational risk mitigation. The measures for operational risk mitigation involve: definition of the exposure limit; definition and application of the operational risk mitigation measures; a system of physical controls; a Business Continuity Plan, and a Disaster Recovery Plan in the case of a catastrophe. Through the efficiently established system the Bank defines the limit of the maximum acceptable amount of loss which occurs as a consequence of operational risk.
- Through the process of self-assessment and analysis of individual events that cause losses based on operational risk, the Bank defines and implements the measures for mitigating the occurrence of operational risk events.
- Operational risk monitoring and control involve the monitoring of the operation compliance with the defined system of limits for the purpose of maintaining the operational risk at the level accepted by the defined risk profile of the Bank, as well as the follow-up of implementation of the measures. Operational risk monitoring and control have been established and integrated in all business activities of the Bank and at all levels of operational risk management, as has also been established the independent control for assessing the operational risk management system adequacy, reliability and efficiency.
- The Bank has established the process of monitoring and reporting on the effects of implementation of the applied measures and techniques of operational risk mitigation through regular reporting of the competent committees and bodies, and a clear division of responsibilities, definition of the rules with regard to frequency of reporting on implementation of the measures adopted for operational risk mitigation.
- The Bank has in place the system for operational risk reporting by which the Risk Management Divison furnishes timely reports to the Bank management, competent committees and organizational parts which accept the risk. The reporting system involves timely reporting on operational risk events per event type and business lines, the causes and sources of the event occurrence, significance of the event, exposure trend, measures intended to be taken or already taken for the purpose of mitigating and limiting the consequences of the events, and activities entrusted by the Bank to third parties.

3.3.2. Country Risk

- Country risk management policy represents an official document which defines more specifically the system for managing the country risk to which the Bank is or may be exposed in its operation, as a part of the risk management system.
- The Bank has established an appropriate organizational structure, business activities, lines of decision-making and responsibilities by having made a clear delineation between the risk taking process and risk management process, guided by the organization principles which are in conformance with a good country risk management practice.
- The objective of country risk management is to ensure minimum exposure through adequate country risk measurement by applying the adopted methodology and defined limits of exposure to countries or a group of countries on the basis of the country rating.
- The basic principles that have to be observed at identifying the country risk are the following:
  - comprehensive and updated gathering of inputs necessary for identifying the country risk, which particularly include the information about the debtor’s country of origin, country rating...;
  - realistic and correct analysis of all pieces of information that can be identified;
  - correct recording of information through the Bank’s information system;
  - analysis of current causes of the exposure to country risk on the basis of current and historical data, as well as the exposure to country risk that may occur in a future period;
  - analysis of the impact of new products and activities on the country risk.
- The Bank defines the procedure for country risk monitoring and control as monitoring of the limit and of the measures adopted for mitigating the country risk, as well as the control process.
- The Bank has in place the system for country risk reporting by which the Risk Management Division timely informs the management, competent committees and organizational parts of the Bank.

3.3.3. Investment Risk

- The Bank has established an appropriate organizational structure, business activities, lines of decision-making and responsibilities by having made a clear delineation between the front office process and middle office process, guided by the principles of organization which are in conformance with a good investment risk management practice.
- The Bank's risk profile is determined by the acceptable risk level for the Bank. The acceptable level of exposure to investment risk is in accordance with the defined Risk Management Strategy and depends on the level of the Bank's exposure to investment risk.
- The basic risks that have to be observed at identifying the investment risk are the following:
  - comprehensive and updated gathering of inputs necessary for identifying the investment risk;
  - analysis of all investment risk factors;
  - definition of annual capital investment plan;
  - correct recording of information through information systems of the Bank;
  - analysis of current causes of the exposure to investment risk on the basis of current and historical data, as well as the exposure to investment risk that may occur in a future period;
  - analysis of the impact of new products and activities on the investment risk.
- The Bank defines the procedure for investment risk monitoring and control as monitoring of the limit and of the measures adopted for mitigating the country risk, as well as the control process.
- The Bank has in place the internal and external system for reporting on investment risk.

4. BANK CAPITAL

- The Bank's Capital Strategy and Plan concretely stipulate and specify the implementation of the strategic objectives and guidelines for capital planning, and set the time horizon for their accomplishment in view of the impact of macro-economic indicators and changes in economic cycle trends on the strategic plans, the manner in which the Bank will respond to capital requirements in the future, relevant limitations on the capital, as well as the general plan for acting in unforeseen circumstances.
- In conformance with the defined targeted values, the Bank takes measures for their materialization and maintenance.

Capital Structure 000 RSD

No.	Name	31 Dec. 2011
1.	**INITIAL CAPITAL (1.1.+1.2.+1.3.+1.4.-1.5.)**	**41,749,118**
1.1.	Nominal value of paid up shares, except preference cumulative shares	13,881,010
1.1.1.	Paid up ordinary shares	8,709,310
1.1.2.	Paid up priority non-cumulative shares	373,510
1.1.3.	Paid up preference convertible bank shares	4,798,190
1.2.	Issue premium	14,581,543
1.3.	Reserves from the profit	12,635,440
1.4.	Profit of current year	2,500,000
1.5.	Deductable items from initial capital	848,875
1.5.1.	Intangible investments	555,415
1.5.2.	Amount of bank shares taken in pledge, except preference cumulative shares	229,520
2.	**SUPPLEMENTAL CAPITAL**	**5,852,703**
2.1.	Part of revaluation reserves of the bank	620,658
2.2.	Subordinated obligations	5,232,045
3.	**ITEMS DEDUCTIBLE FROM CAPITAL**	**20,655,322**
3.1.	Direct and indirect investment in banks and other entities in the financial sector in an amount higher than 10% of the capital of such banks or other entities	5,555,355
3.2.	Required reserve from the profit for estimated losses under balance sheet assets and off-balance sheet items of the bank	15,099,967
4.	**REGULATORY CAPITAL**	**26,946,499**

- The Bank calculates the capital adequacy ratio and capital requirements in accordance with the regulations of the National Bank of Serbia by using the standardized approach for credit risks, market risks and operational risks.
- Regulatorily prescribed minimal value of capital adequacy is 12%.

Overview of total capital requirements according to standardized approach RSD 000

Capital Requirements	31.12.2011
Credit risk, counterparty risk and delivery/settlement risk based on free deliveries	**17,057,078**
Exposures to states and central banks	-
Exposures to territorial autonomies and local self-government units	76,206
Exposures to international development banks	–
Exposures to banks	478,388
Exposures to corporate entities	10,189,603
Exposures to natural persons	2,713,780
Exposures secured by mortgages on real property	2,029,002
Due outstanding receivables	83,599
Other exposures	1,486,501
Market Risks	**-**
Capital requirement for price risk based on debt securities	-
Capital requirement for price risk based on equity securities	-
Capital requirement for foreign exchange risk	-
Capital requirement for commodity risk	-
Operational Risks	**1,692,643**
Exposure to operational risk	1,692,643
Total capital requirements	**18,749,721**
Capital adequacy ratio (minimum 12%)	**17.25%**

- The Bank does not calculate capital requirements for FX risk since the FX risk ratio is below 2%. Also, the Bank includes the Trading Book positions in the calculation of the capital requirement for credit risk since the value and share of the Trading Book in total operations do not oblige the Bank to appropriate special capital requirements for market risks.

4.1. Internal Capital Adequacy Assessment Process – ICAAP

- The Bank has established the Internal Capital Adequacy Assessment Process (hereinafter: ICAAP) in accordance with its risk profile.
- ICAAP is included in the risk management process and decision-making in the Bank and is regularly revised and adjusted, particularly when it is exposed to new risks or major changes.
- The Bank has established the Capital Management Strategy and the Capital Management Plan. Capital Management Plan includes:
  - strategic goals and periods for their implementation, taking into account the impact of macroeconomic environment and economic cycle phases;
  - mode of organization of internal capital management process;
  - procedures for planning adequate internal capital level;
  - mode of accomplishment and maintenance of adequate internal capital level;
  - Business plan in the case of unforeseen events which can influence on internal capital amount.
- ICAAP is a documented process which is carried out on a continued basis and in accordance with the Risk Management Strategy and individual Risk Management Policies, and the Capital Management Strategy. Basic conditions met by ICAAP implemented in the Bank:
  - it is based on the process of risk identification and measurement, or risk assessment;
  - it provides a comprehensive risk assessment, as well as monitoring of the significant risks the Bank is or may be exposed to in its operation;
  - ensures adequate internal capital in accordance with the Bank's risk profile;
  - is incorporated in the Bank's management system and decision-making in the Bank;
  - is subject of regular analysis, monitoring and checking.
- ICAAP objective is a clear establishment of the capital level that is sufficient to cover all risks the Bank is exposed to.
- By determining the potential for risk coverage, the Bank indirectly sets the maximum level of the risk it is ready to accept. Apart from internal capital requirements, internal capital is also assessed through ICAAP. Planning of internal capital also ensures the level of the capital that can support the growth of placements, future funding sources, dividend policy...
- The framework of internal capital adequacy assessment process reflects the Risk Management Strategy, Capital Management Strategy and Capital Management Plan, and the limits set where ICAAP serves as a comprehensive managing model.
- The Bank continuously assesses the risk profile and regularly revises the procedure for internal capital adequacy

assessment developing at the same time the methodologies for assessment of other risk types in order for the comprehensive risk management at the Bank level to be as efficient as possible.

- The basic principles of the internal capital adequacy assessment process of the Bank are:
  - establishment of the internal capital adequacy assessment process of the Bank in accordance with the risk management objectives and principles for risk taking and management;
  - identification, measurement (assessment), mitigation and monitoring of all risks as a basis for capital adequacy assessment;
  - establishment of the internal capital adequacy assessment process of the Bank in accordance with the volume, type and complexity of the Bank operation;
  - ensuring the internal capital in accordance with the risk profile of the Bank.

ICAAP Phases:

- establishment of materially significant risks − Quantitative and qualitative criteria are established based on the methodology, serving to determine the materially significant risks that will be included in the internal capital adequacy assessment process in accordance with the type, volume and complexity of the transactions the Bank deals with, as well as the specificities of the markets on which it operates. In assessing the risk materiality, the Bank considers all risks to which it is exposed or which it takes. All taken risks can be divided into significant, which require allocation of a part of the capital, and those which do not require such allocation since they have been assessed as non-material or the Bank manages them through the established risk management system.
- The amount of the necessary internal capital is calculated for individual risks − the Bank uses the methods prescribed for calculation of minimum capital requirements, as well as the internal approaches to measurement. The Bank performs the stress testing for all materially significant risks and internal capital, which include the risk factors specific for the environment in which the Bank operates. The stress test results are taken into account at assessing and maintaining the internal capital at a certain level. The methodologies applied by the Bank for risk inclusion in ICAAP if assessed as materially significant:
  - **Credit risk, counterparty risk and settlement/delivery risk** – The Bank applies standardized approach with the stress test, while the country risk, credit/FX risk and residual risk are included in ICAAP through scenario definition.
  - **Operational risk** – VaR methodology is applied with a confidence interval of 99.9 which depicts the stress conditions.
  - **Market risk (foreign exchange and price risk)** – VaR methodology is applied and also stress testing.
  - **Interest rate risk** – methodology of standardized interest rate shock, which also incorporates the change of factors, is applied.
  - **Liquidity risk** – for ICAAP needs is analyzed by applying the stress test;
  - **Concentration risk** – internally defined methodology is used
  - **Investment risk, environmental risks, receivable value decreased risk, legal risks, compliance risk, reputational risk and strategic risk** are included in ICAAP through the policy and procedure system, limit system, and decision-making system.
- Determination of total internal capital also includes the stress test results.
- Comparison of the capital amount calculated in accordance with regulatory requirements and the amount of the necessary internal rating.

5. EXPOSURE TO RISKS

5.1. Credit Risk and Receivable Value Decreased Risk

- **In the credit risk analysis and assessment the Bank uses two parallel approaches:**
  - Regulatory approach – classification of the receivables according to the regulations of the National Bank of Serbia and calculation of the reserves for estimated losses which represent a certain form of protection against possible negative consequences if lent assets are not repaid when due in their full amount. The National Bank of Serbia has prescribed the criteria for the classification of debtors' receivables, as well as the rules concerning the impact of the collateral on the classification of placements.
  - Internal approach – measuring the receivables' risk level based on the internal rating system which represents support in the procedure of a lending impairment and estimate of the provisions for losses under off-balance sheet items in accordance with the International Accounting Standards 39 and 37.
- The positive difference between the calculated reserve for estimated losses (on the basis of regulatory approach), on one side, and the allowance and provisions for contingent losses (on the basis of internal approach), on the other, provides the necessary reserve for estimated losses which represents a deductable item from capital.
- **The Bank defines due outstanding receivables** as all receivables not recovered at maturity (principal, interest and

fees, as well as the interventions under guarantees, sureties and other forms of warranty, unpermitted overdraft in client accounts, and other due client obligations).

- **Exposures with performed allowances** are defined as exposures where assessment of their recovery is made, or where reduction is made by the expected loss amount.
- The Bank has the clearly defined criteria for credit and receivable assessment and recognition, and the criteria for assessing and recognizing the provisions for contingent liabilities in accordance with the Decision of the National Bank of Serbia Classifying Balance Sheet Assets and Off-Balance Sheet items, and by also observing the International Accounting Standards (IAS) 39 and 37 and the International Financial Reporting Standard (IFRS) 7.
- For the purposes of a careful and timely determination of losses based on credit impairment, and interventions based on contingent liabilities so as to be protected the performance of the Bank operation in the period when the loss is definitely confirmed (realized) by the impossibility to recover the contracted amounts or by the outflow of assets for settling the contingent liabilities, the Bank calculates allowances for balance sheet assets and provisions for losses under off-balance sheet items.
- Placements are impaired and provisions made only in the case of justified or objective proof of the impairment as a consequence of the events occurring after the initial recognition of the receivable, and which have an adverse impact on regular settlement of debtors´ liabilities to the Bank.
- The main elements in assessing the impairment of placements are: missing the deadline for payment of the principal or interest, difficulties in cash flows of loan beneficiaries, fall in the credit rating or changes of the original contract terms and conditions, etc.
- Impairment of placements is made on the basis of the assessment of expected future cash flows from clients' operation, and realization of the collateral if assessed that there is a realistic possibility for the loan to be recovered from such assets.

Calculation of Allowance for Balance Sheet Assets

- The Bank identifies the receivables for which allowance for balance sheet assets is calculated on individual or group basis. All clients are grouped in five solvency groups depending on the degree of the risk according to the internal rating system of the Bank.
- The procedure for impairment assessment is done on individual level when there is objective proof of loan impairment, for each materially significant loan, and at group level for materially less significant loans. The impairment amount is assessed individually as a difference between the bookkeeping value and the present value of expected future cash flows, determined by discounting, by application of the effective interest rate of a concrete loan.
- Impairment for materially less significant loans is assessed on a group basis, for each group separately, in view of their similar characteristics in terms of credit risk, as a percentage of migrations of the relevant group to the worst group, adjusted by the percentage of the loan recovery.
- If during individual assessment of materially significant loans no objective proof of the loan impairment is found, such loan will be impaired by the percentage of impairment of the solvency group it belongs to.
- Loan impairment that reduces the value of a loan is recorded in the allowance account in the balance sheet, and recognized as an expense in the income statement.

Calculation of Provisions for Losses under Off-Balance Sheet Items

- The Bank calculates the provisions on individual and group basis. Contingent liabilities with a high degree of probability to entail an outflow of assets are estimated individually, while the rest of contingent liabilities are assessed on group level.
- Assessment of the provisions on group level is done based on the migrations of the risk categories by taking into consideration all elements of the internal rating system, in the manner identical to the one applied in the procedure in the framework of balance sheet items.
- Provisions are recorded within liabilities in the balance sheet and are recognized as an expense in the income statement of the period in which the probability originated.

Overview of Exposures to Credit Risk per Assets Class — RSD 000

Exposure to Credit Risk	Exposure	Average
States and central banks	87,072,706	82,757,008
Territorial autonomies and local self-government units	1,649,888	1,623,984
International development banks	64,309	32,155
Banks	15,865,004	14,385,188
Companies	99,156,339	96,014,010
Natural persons	32,292,979	31,886,139
Exposures secured by mortgages on real property	25,330,272	23,147,687

Due outstanding receivables	4,650,660	2,866,247
Other exposures	26,210,901	25,959,928
Total	**292,293,058**	**278,672,346**

**Note: gross exposure reduced by allowances and provisions for assessed losses and adjusted for conversion factors for off-balance sheet items.*

Sector Exposure Distribution per Classes of Assets RSD 000

Exposure to Credit Risk	Value of Exposure
States and central banks	90,939,250
Finance and insurance sector	60,320,636
Public sector	30,618,460
Foreign persons sector	154
Territorial autonomies and local self-government units	**1,645,782**
Public sector	1,270,095
Foreign persons sector	375,687
International development banks	**64,309**
Finance and insurance sector	64,309
Banks	**16,038,021**
Finance and insurance sector	1,965,195
Foreign persons sector	14,072,826
Companies	**84,913,359**
Finance and insurance sector	4,773,145
Public enterprises sector	1,769,894
Company sector	76,940,347
Entrepreneurs sector	477,056
Public sector	2,060
Foreign persons sector	600,797
Other clients' sector	121,549
Households corporate firms with employees and agricultural households	228,511
Natural persons	**30,153,110**
Finance and insurance sector	903
Public enterprises sector	1,999
Company sector	4,645,253
Entrepreneurs sector	26,645
Public sector	28,178
Households sector	22,229,303
Foreign persons sector	713
Households corporate firms with employees and agricultural households	3,151,021
Other clients sector	69,094
Exposure secured by mortgages on real property	**24,647,481**
Finance and insurance sector	771
Company sector	3,591,413
Entrepreneurs sector	198,906
Households sector	20,562,620
Households corporate firms with employees and agricultural households	256,738
Other clients sector	37,032
Due outstanding receivables	**666,972**
Company sector	522,628
Entrepreneurs sector	12,962
Households sector	93,163
Households corporate firms with employees and agricultural households	36,647
Other clients sector	1,572
Other exposures	**25,542,630**
Finance and insurance sector	2,129,995
Company sector	567,261
Entrepreneurs sector	1,414
Public sector	9,496
Foreign persons sector	388,946
Other clients sector	72,577
Other	22,300,796
Total	**274,610,915**

**Note: gross exposure reduced by allowances, provisions for assessed losses and necessary reserve, and adjusted for conversion factors for off-balance sheet items and upon application of mitigation techniques*

Gross exposure where allowance and provisioning under off-balance sheet items was made RSD 000

Exposure to credit risk	Gross exposure where allowance or provisioning was made	Allowance and provisions
Territorial autonomies and local self-government units	**454,053**	**10,813**
Public sector	454,053	10,813
Banks	**215,579**	**215,554**
Finance and insurance sector	1,652	1,627
Foreign persons sector	213,927	213,927
Companies	**96,251,913**	**2,634,626**
Finance and insurance sector	4,830,314	31,380
Public enterprises sector	640,464	148
Company sector	84,729,964	2,542,279
Entrepreneurs sector	518,308	2,358
Public sector	1,088	4
Foreign persons sector	5,150,143	51,501
Other clients sector	123,646	1,708
Households corporate firms with employees and agricultural households	257,986	5,248
Natural persons	**24,592,922**	**505,681**
Finance and insurance sector	1,051	17
Public enterprises sector	2,326	37
Company sector	2,567,341	90,705
Entrepreneurs sector	1,099,569	32,342
Public sector	32,787	526
Households sector	20,484,794	309,424
Foreign persons sector	830	13
Households corporate firms with employees and agricultural households	323,828	71,326
Other clients sector	80,396	1,291
Exposures secured by mortgages on real property	**26,308,763**	**17,866**
Finance and insurance sector	823	1
Company sector	4,649,134	10,315
Entrepreneurs sector	202,852	899
Households sector	21,150,102	6,130
Households corporate firms with employees and agricultural households	266,256	519
Other clients sector	39,596	2
Due outstanding receivables	**16,974,497**	**12,343,361**
Finance and insurance sector	150,207	150,207
Public enterprises sector	125	126
Company sector	11,769,862	7,706,984
Entrepreneurs sector	240,692	207,689
Public sector	30,018	30,018
Households sector	1,925,230	1,559,672
Foreign persons sector	70,591	70,591
Households corporate firms with employees and agricultural households	327,946	232,589
Other clients sector	2,459,826	2,385,485
Other exposures	**13,022,108**	**3,307,080**
Finance and insurance sector	1	-
Corporate clents sector	682,966	30,791
Entrepreneurs sector	1,133	58
Public sector	1,870	27
Other clients sector	62,771	4,022
Other	12,273,367	3,272,182
Total	**177,819,835**	**19,034,981**

**Note: presented is the gross exposure of items where allowance and provisioning for off-balance sheet items was made, as well as the allowance and provisioning for assessed losses for off-balance sheet items*

Geographic exposure according to materially significant areas, per classes of assets RSD 000

Exposure to credit risk	Exposure value
States and central banks	**90,939,250**
Republic of Serbia	90,939,096
Bosnia and Herzegovina	154
Territorial autonomies and local self-government units	**1,645,782**
Republic of Serbia	1,645,782
International development banks	**64,309**
Other	64,309
Exposure to banks	**16,038,021**
Republic of Serbia	1,965,195
Germany	10,043,821
Switzerland	1,493,147
United States of America	786,203
Great Britain	619,211
Other	1,130,443
Companies	**84,913,359**
Republic of Serbia	84,312,562
Other	600,797
Natural persons	**30,153,110**
Republic of Serbia	30,135,620
Other	17,490
Exposures secured by mortgages on real property	**24,647,481**
Republic of Serbia	24,638,960
Other	8,521
Due outstanding receivables	**666,972**
Republic of Serbia	666,969
Other	3
Other exposures	**25,542,630**
Republic of Serbia	25,153,778
Other	388,852
Total	**274,610,915**

**Note: gross exposure was reduced by allowances, provisions for assessed losses and necessary reserve, and adjusted for conversion factors for off-balance sheet items and upon application of mitigation techniques*

Maturity distribution of all exposures per classes of assets RSD 000

Exposure to credit risk	Exposure value
States and central banks	**90,939,250**
up to three months	63,314,362
from three months to 6 months	18,500
from 6 months to 1 year	11,964,896
over 1 year	15,641,492
Territorial autonomies and local self-government units	**1,645,782**
up to three months	379,722
from three months to 6 months	–
from 6 months to 1 year	9,955
over 1 year	1,256,104
International development banks	**64,309**
up to three months	64,309
from three months to 6 months	–
from 6 months to 1 year	–
over 1 year	–
Banks	**16,038,021**
up to three months	15,359,413
from three months to 6 months	–
from 6 months to 1 year	174,313
over 1 year	504,295
Companies	**84,913,359**
up to three months	8,779,985
from three months to 6 months	13,456,390
from 6 months to 1 year	12,391,294
over 1 year	50,285,690
Natural persons	**30,153,109**
up to three months	4,819,828
from three months to 6 months	1,717,873
from 6 months to 1 year	4,660,888
over 1 year	18,954,521
Exposures secured by mortgages on real property	**24,647,481**
up to three months	100,700
from three months to 6 months	152,293
from 6 months to 1 year	245,638
over 1 year	24,148,851
Due outstanding receivables	**666,972**
up to three months	174,654
from three months to 6 months	65,999
from 6 months to 1 year	24,726
over 1 year	401,594
Other exposures	**25,542,630**
up to three months	14,068,467
from three months to 6 months	38,410
from 6 months to 1 year	262,636
over 1 year	11,173,117
Total	**274,610,915**

**Note: gross exposure was reduced by allowances, provisions for assessed losses and necessary reserve, and adjusted for conversion factors for off-balance sheet items and upon application of mitigation techniques*

Changes in allowance and provisions 000 RSD

	Loans and deposits	Interest and fee receivables	Securities	Interest in capital	Other placements	Other assets	Off-balance sheet exposure	Total
As at 01.01.2011	10,554,659	1,732,257	262	371,757	2,857,092	143,597	405,969	16,065,593
Increase	6,359,889	571,626	7,554	-	244,024	69,134	438,497	7,690,724
Decrease	(6,194,971)	(553,644)	(3,254)	(1,568)	(252,683)	(39,485)	(342,449)	(7,388,054)
Exchange differentials	205,990	12,471	49	-	(9,696)	(115)	-	208,699
Write-offs	(261,075)	(83,460)	-	-	(44,788)	(13,058)	-	(402,381)
Other changes	25,755	(39,352)	-	-	(3)	3,716	-	(9,884)
As at 31.12.2011	**10,690,247**	**1,639,898**	**4,611**	**370,189**	**2,793,946**	**163,789**	**502,017**	**16,164,697**

**Note: Allowances for fixed assets, intangible investments and inventories are not included in the allowance and provisions changes.*

Exposure according to categories of classification and client type as at 31.12.2011 000 RSD

Risk category	Corporate clients	Banks	Retail clients	Total
A	56,699,659	15,768,259	50,520,697	122,988,616
B	36,128,635	49,699	2,513,571	38,691,906
V	18,365,051	448,903	3,031,399	21,845,352
G	2,901,550	-	339,471	3,241,021
D	20,630,620	1,617,469	4,408,288	26,656,376
Total	**134,725,514**	**17,884,330**	**60,813,425**	**213,423,270**

**Note: total exposure per credit risk, risk category and client type is shown in gross amount before mitigation effect based on the amount of impairment*

Overview of calculated and necessary reserve for estimated losses per client type as at 31.12.2011 000 RSD

Client type	Calculated reserve	Necessary reserve
Corporate clients	24,668,786	13,150,040
Banks	1,685,798	68,329
Retail clients	4,420,967	1,881,598
Total	**30,775,551**	**15,099,967**

Use of credit ratings

- For the class of exposure to states and central banks the Bank uses the credit assessments of the states determined by export credit agencies, signatories of the agreement of the Organization for Economic Cooperation and Development (hereinafter: OECD), in the **"Arrangement on Guidelines for Officially Supported Export Credits"**, by assigning the rating to each state from the list that is posted on the OECD internet page.
- For exposures in the form of financial instruments from the Banking Book, the Bank does not use the credit ratings of the issuers or their specific issues due to their non-existence. For financial instruments issued by the Republic of Serbia, the Bank applies the preferential risk weight of 0%.

Credit rating assignment to credit risk levels

Risk country classification in accordance with te list of export credit agencies (of OECD)	0	1	2	3	4	5	6	7
Categories of lowest export insurance premiums	0	1	2	3	4	5	6	7
Credit risk weight	0%	0%	20%	50%	100%	100%	100%	150%

Overview of classes of exposure to states and central banks per credit quality level and risk weight

Categories of lowest export insurance premiums	Credit risk weight	Exposure amount before application of credit protection instruments	Exposure amount after application of credit protection instruments
States and central banks		87,072,706	90,939,250
0	0%	87,072,706	90,939,250

Credit Risk Mitigation Techniques

Valuation of credit protection instruments and their managing

- The Bank has regulated by its internal acts the valuation of credit protection instruments and their managing.
- The types of security for the receivables and instruments on that basis are in each concrete case determined by the special provision of the Agreement between the Bank and the applicant, and their procuring after the conclusion of the agreement and prior to realization of the placement.
- The Bank regularly assesses/values the collaterals prior to the conclusion of the loan agreement and during the agreement validity. Securities are assessed on a monthly basis.
- The acceptable loan amount and collateral value ratio is based on the collateral factor for the offered instrument of security, which serves to correct the assessed collateral value and assess the liquidation value of the collateral that the Bank can collect.

Description of basic types of credit protection instruments

- The Bank is using the following credit protection instruments:
  - material credit protection;
  - non-material credit protection;
- Among the instruments of material credit protection, the Bank uses the financial instruments by applying the complex method in accordance with the regulations of the National Bank of Serbia. As to financial instruments, the Bank uses as appropriate instruments of protection:
  - cash and cash equivalents deposited with the Bank, such as the deposits placed as an instrument of security;
  - securities, which involve debt securities issued by the states and central banks, and shares.
- As a form of non-material credit protection, the Bank uses guarantees, other forms of warranty counter-guarantees, etc.

Basic types of credit protection providers

- In the case of using the guarantee as a credit protection instrument, the Bank uses the guarantees issued by:
  - states,
  - banks, or
  - territorial autonomies.
- A guarantee as a credit protection instrument is taken only if the guarantor's risk weight is more favorable than the counterparty's risk weight.

Data about market or credit risk concentration within applicable mitigation techniques

- The Bank follows up and manages the credit and market risk concentration in the segment of large exposures by also analyzing the issuers of eligible instruments of security. Also, the Bank monthly informs the management about large exposures.
- In order to manage the risk concentration in the framework of used credit risk mitigation techniques:
  - analysis is made of indirect exposure to the credit protection provider, in the credit process framework; and
  - of the established exposure limit system.
- In non-material credit protection mostly are guarantees of the Republic of Serbia Government

Exposures secured by credit protection instruments per classes of assets RSD 000

Exposure to credit risk	Amount of exposures secured by material credit protection instruments	Amount of exposures secured by non-material credit protection instruments
States and central banks	–	–
Territorial autonomies and local self-government units	–	–
International development banks	–	–
Banks	–	–
Companies	1,348,559	4,121,058
Natural persons	1,367,998	23
Exposures secured by mortgages on real property	6,818	–
Due outstanding receivables	13,604	–
Other exposures	2,938	–
Total	**2,739,917**	**4,121,080**

**Note: exposure presented after application of the conversion factor and volatility factor*

5.2. Counterparty Risk

Counterparty Risk

- Counterparty risk is the risk of possible occurrence of negative effects on the financial result and capital of the Bank based on non-settlement of the counterparty's obligations in a transaction before final settlement of the transaction's cash flow. Out of all transactions that are subject to the counterparty risk, the Bank performs transactions in the Trading Book and Banking Book in connection with:
  - financial derivatives;
  - repo and reverse repo transactions
- For the needs of calculating the exposure of the positions that are subject to calculation of the capital requirements for the counterparty risk, the Bank uses:
  - the current exposure method for financial derivatives;
  - the complex method for calculation of adjusted transaction and collateral value in the case of repo and reverse repo transactions, and for the lending and borrowing transactions. A characteristic of „repo" transactions performed by the Bank with the National Bank of Serbia is that the collateral cannot be used as an eligible credit instrument since the collateral issuer and the counterparty is one and the same.

Exposure to counterparty risk RSD 000

Risk type	Exposure value
Exposures to counterparty risk	11,502,616

5.3. Liquidity Risk

- The Bank may be exposed to the risk of inability of settling due obligations, as well as of possible occurrence of a liquidity crisis on the basis of external and internal factors. Internal factors relate to the structure of the Bank's liabilities in terms of the deposit potential and the participation of adequate sources of funding in liabilities (funding sources risk), while external factors relate to exposure to non-marketability of assets in the case of need to procure the sources of funding.
- The Bank manages the liquidity risk on a short-term basis by following up and controlling the positions in all major currencies in order to have a timely idea about the needs for additional sources of financing in the case of maturity of relevant positions. In the long-run, the Bank plans the structure of its sources and lending so as to provide enough stable sources and sufficient liquidity reserves.
- In the short run, the Bank manages the liquidity ratio that it has limited to 1 on daily level. In the long run, the Bank has defined the financial leverage at the level of max. 83%.
- On monthly level, the Bank bodies monitor the liquidity crisis indicators and the structure of liquidity reserves.
- The Bank tests the Liquidity Management Plan in Crisis Situations (Liquidity contingency plan) which enables to identify a possible crisis, to test the survival period and solvency of the members in presumed crisis conditions, and also analyzes the accessibility of the sources for covering potential obligations and/or estimates the accompanying organizational support (public relations and the Plan for the case of occurrence of unforeseen events).
- The Bank has developed an internal approach for the needs of determining the capital necessary for covering the liquidity risk.

5.4. Interest Rate Risk Management in the Banking Book

- The Bank is exposed to:
  - the risk of change in prices (repricing risk), which arises from the mismatch of assets and liabilities items relative to the remaining maturity (for positions with fixed interest rate) and price re-setting (for positions with changeable interest rate);
  - yield curve risk;
  - the basis risk due to changes of various reference interest rates in the case of interest rate sensitive items with similar characteristics in terms of maturity or price re-setting,
  - option risk, to which it may be exposed due to contractual provisions in connection with interest rate sensitive items, as well as built-in minimum and maximum interest rates options.
- The Bank measures monthly the exposure to interest rate risk by GAP and ratio analysis, interest rate shock and duration, and by stress tests and simulations semiannually, as a minimum.
- For the needs of preparation of interest rate GAP, the above positions are categorized in the following manner:
  - positions with contracted fixed interest rate are categorized according to maturity period,

  - positions contracted with market variable interest rate are categorized according to the period of the interest rate re-setting (repricing), if that period is shorter than the maturity period,
  - positions with contracted variable interest rate in accordance with the business policy are categorized according to the maturity period, assets and liabilities not having a defined maturity or having the maturity other than the contracted are categorized in relevant time frames based on the analysis of such positions in the previous period (assessment and prior experience).
- The Bank regularly performs the stress testing of the interest rate risk by which it assesses the impact of the change in the key factors on the Bank's interest rate risk. In modeling the scenarios, apart from the changes in interest rates, the impact of early withdrawal of deposits and early loan repayments are particularly taken into consideration, which are analyzed by the bank on the basis of historical trends and expert assessment. The Bank has performed the assessment of the trends of transaction deposits, sight deposits household savings by applying relevant statistical models from the domain of time series analysis.
- The Bank has limited on 20% the impact on the economic value of capital and has internally developed a model for calculation of capital requirements for the interest rate risk.

5.5. Market Risks

- The Bank is exposed to the risk of changes in the exchange rate of inter-currency pairs on the positions of the Banking Book and Trading Book (foreign exchange risk) as well as to the change in the price of equity and debt securities maintained in the Trading Book (price risk).
- In the structure of currency exposure, dominant is the exposure to the EURO, followed by that to CHF, and to USD.
- In the structure of price risk exposure, trading bonds have a dominant share, while the share of equity instruments is insignificant.
- The Bank is insignificantly exposed to the price risk, which is also demonstrated by the share of the Trading Book in total operations of the Bank, which is below 1%.
- The Bank has developed an internal approach for the purpose of establishing the necessary internal capital for covering the foreign exchange and price risk, for the application of which it has not asked permission of the National Bank of Serbia. The Bank calculates the minimal capital requirements for these risks by using the standardized approach.

5.6. Exposure Based on Equity Investments in the Banking Book

- Strategic goal of the Bank is to offer a broad spectrum of financial services to clients, which also requires, apart from the Bank products and services, an offer of other financial products and services, as well as the presence and growth on the new markets.
- Equity investments in the companies founded by the Bank in order to expand the offer of financial products and services have taken place for economic reasons or local regulations that impose that the offer of certain financial products and services must be made through companies exclusively founded for that purpose. This is the reason why the Bank has founded Komercijalna banka AD Budva, Komercijalna banka AD Banja Luka, as well as the Investment Fund Management Company (Kombank INVEST AD Beograd).
- In addition to majority stakes in subordinate companies, the Bank also holds minority equity investments in companies, which enables it to perform certain types of financial services.
- As to the investments in capital, intention is to hold them for an indefinite time period. These investments may be sold depending on liquidity needs or in the case of change in market prices.
- Investments in the capital of subordinate legal entities are shown at acquisition value on the Bank's books, while investments in the capital of other legal entities are shown at fair value. If it is not possible to reliably establish the market value of the investment in capital, such investment is shown at acquisition value with the obligation of assessing on the balance sheet date whether such value can be compensated; if it is found that the investment is impaired, allowance is made in order to write-down that investment to compensable value.
- Equity stakes are initially estimated at acquisition value plus transaction costs that may be directly related with the purchase of these holdings (recognized as an expense in the income statement), and on the balance sheet date are assessed at market value, if known. The change in the market value is shown within the capital in favor or against the revaluation reserves, as long as alienation of such financial assets takes place when the revaluation reserves are transferred to revenues / expenses. In revaluation reserves are not recognized the gains and losses from the change in the value of investments based on exchange rate movements (if the investment is in foreign currency) and impairment of the investments. They are recognized as revenues or as expenses in the income statement.
- The Bank uses the date of settlement at recording the purchase and sale of the holdings in capital, or the date when

the holding is delivered to the Bank or when delivered by the Bank.

Exposure per investment purpose as at 31.12.2011 000 RSD

Equity investments in Banking Book	Bookkeeping value	Allowances	Fair value	Realized gain/loss	Non-realized gain	Non-realized loss
Subordinate legal entities in the country	140,000	-	140,000	-	-	-
Subordinate banks abroad	5,340,888	-	5,340,888	-	-	-
Banks and financial organizations	117,998	5,794	112,204	-	-	17,487
Securities available for sale	79	-	79	-	-	12
Enterprises and other legal entities	405,008	364,395	40,613	-	762	46,441
Foreign entities abroad	189,878	-	189,878	-	189,878	-
Total	**6,193,851**	**370,189**	**5,823,662**	**-**	**190,640**	**63,940**

Exposure value as at 31.12.2011 000 RSD

Exposure type	Bookkeeping value	Fair value
Holdings and investments in capital	**6,193,772**	**5,823,583**
quoted on stock exchange	261,825	261,825
not quoted on stock exchange	451,059	80,870
subordinate legal entities	5,480,888	5,480,888
Securities available for sale	**79**	**79**
quoted on stock exchange	79	79
not quoted on stock exchange	-	-
Total	**6,193,851**	**5,823,662**

- In 2011, the Bank did not achieve realized gain / loss which arises from the sale or close of the positions based on equity investments.
- Total non-realized gain/loss based in equity investments is presented in the table, while the amount of non-realized gains included in the calculation of supplementary capital is reduced by 10 %. Non-realized losses are not reduced at inclusion in supplementary capital.

5.7. Banking Group

- Komercijalna banka AD Beograd Group is composed of Komercijalna banka AD Beograd, as a parent bank and three subordinate legal entities.
- Financial reports of all Banking Bank members are consolidated by full consolidation method in accordance with relevant IAS/IFRS.

Banking Group members

- Komercijalna banka AD Budva (100% in the Bank ownership) was incorporated in November 2002 and entered in the Central Register of the Economic Court of Podgorica on 6 March 2003,
- Komercijalna banka AD Banja Luka (99.99% in the Bank ownership) was incorporated in September 2006 and entered on 15 September of the same year in the Court Register based on the Ruling of the First-Instance Court of Banja Luka.
- Investment Fund Management Company - Kombank Invest AD Beograd (100% owned by the Bank) was established in December 2007 and registered on 5 February 2008.

- The parent bank does not have related persons to whose financial reports the method of proportional consolidation and stake method would apply or which would be excluded from consolidation because of a Bank member's participation that represents a deductible item of the Bank capital.

5.7.1. Overview of Consolidated Reports Differences

		Consolidation for supervision		Consolidation pursuant to IFRS	
Company type	**Company name**	**Consolidation method**		**Consolidation method**	
		Full	Stake method	Full	Stake method
Bank	Komercijalna banka AD Beograd	X		X	
	Komercijalna banka AD Budva	X		X	
	Komercijalna banka AD Banja Luka	X		X	
Management company	KomBank INVEST AD Beograd		X	X	

5.7.2. Legal and other Obstacles for Capital Transfer

- There were no legal or other obstacles in the previous period for a timely transfer of capital and settlement of obligations between the parent bank and subordinate companies in the frameworks of the Banking Bank operation.
- In the forthcoming period, difficulties are not expected in the cash flows between the Banking Bank members or any legal and other obstacles in operation.