REPORT

on Disclosure of Data and Information of
Komercijalna banka A.D. Beograd for the year 2012

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KOMERCIJALNA BANKA

1. INTRODUCTION

- Komercijalna banka AD Beograd (hereinafter: Bank) in accordance with the Law on Banks and the Decision on Disclosure of Data and Information by Banks, further below publishes the Report for the year 2012.
- This Report contains qualitative and quantitative information as prescribed by the above mentioned Decision.
- The Report shall be publicized on the Bank's Internet domain (www.kombank.com).

THE EXECUTIVE BOARD OF THE BANK

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

2. GENERAL INFORMATION ABOUT THE BANK

- Komercijalna banka AD Beograd is the second largest bank in the Serbian market, with market share of over 10%. The registered seat of Komercijalna banka AD Beograd (hereinafter: Bank) is in Belgrade, 14, Svetog Save Street. Clients have at their disposal the largest network of 230 branches and sub-branches throughout Serbia and another nearly 40 branches and sub-branches within the independent banks in Montenegro and Bosnia and Herzegovina.
- The Bank's largest shareholder is the Republic of Serbia (42,6%), which has the strategic agreement with the second largest shareholder EBRD (25%). Among the shareholders of Komercijalna Banka there are also a number of internationally renowned professional investors (IFC, Swed Fund, DEG...), as well as different powerful domestic public and private companies.

3. RISK MANAGEMENT

3.1. Risk Management Strategy

- The Bank has established the comprehensive and reliable risk management system, which allows for management of all risks that the Bank is or may be exposed to on the basis of all business operations and which is proportionate to the nature, scope and complexity of Bank's business activities. The established system of risk management ensures that the risk profile is in line with the determined propensity towards risks, and/or the risk profile of the Bank.
- Risk management system at the Bank's level is defined by the following internal legal documents:
    - Risk Management Strategy, Capital Management Strategy and Capital Management Plan;
    - Risk Management Policies;
    - Risk Management Procedures;
    - Methodologies for Managing Individual Risks;
    - Other internal documents.
- Risk Management Strategy regulates the uniform and consistent managing of risks to which the Bank is or may be exposed in its operations and the same is aligned with the Bank's Business Policy and Strategy.
- The implementation of the Risk Management Strategy shall be the responsibility of the competent authorities of the Bank and those organizational units which implement and participate in risk management system.

General Meeting of Shareholders

- adopts the Bank's business policy and its strategies;
- renders decisions to increase the capital, and/or decides on equity investments in another bank or other legal entities, and also on level of investments in fixed assets of the Bank.

Board of Directors

- responsible for establishing a uniform system of risk management in the Bank and also for supervising such system;
- adopts risk management strategy and policies, along with capital management strategy;
- adopts Business Continuity Plan and Disaster Recovery Plan;
- establishes the internal controls system;
- determines the internal organization, and/or organizational structure of the Bank, which provides separation of duties, powers and responsibilities of the employees in a manner that prevents conflict of interest and allows for transparent and documented process of making and implementing decisions;
- adopts the policy governing the salaries and other allowances and benefits of Bank's employees;
- supervises the work of the Executive Board;
- adopts the program and plan of the internal audit;
- ensures the implementation of the internal capital adequacy assessment process and its compliance with the strategic objectives of business operations.

Executive Board

- implements the risk management strategy and policies, and capital management strategy;
- adopts and analyzes the efficiency of implementation of procedures for risk management, which define more closely the process of identifying, measuring and assessment of risk and risk management and reports to the Board of Directors in connection with those activities;
- implements the Business Continuity Plan and Disaster Recovery Plan, revises them in line with business changes and prompts continuous testing.

Audit Committee

- analyzes and adopts the Bank's draft strategies and policies pertaining to risk management and internal controls system which are submitted to the Board of Directors for review and adoption;
- analyzes and supervises the application and adequate implementation of adopted strategies and policies for risk management along with the implementation of internal controls system;
- at least once a month it reports to the Board of Directors on its activities and identified irregularities and proposes the manner to eliminate such irregularities, and/or the manner to enhance the policies and procedures for risk management and implementation of internal controls system.

Asset/Liability Management Committee (ALCO)

- monitors the Bank's exposure to risks that arise from the structure of its balance sheet liabilities and accounts receivable and off-balance sheet items, proposes the measures for managing interest rate risk and liquidity risk and performs other tasks as stipulated by the internal legal documents of the Bank.

Credit Committee

- decides on loan applications within the framework established by the Bank's internal documents, analyzes the Bank's exposure to credit, interest rate and currency risk, analyzes the loan portfolio and applies the findings of the internal audit within the competence of the Committee, and also proposes the measures to the Bank's Executive Board. Performs other tasks in line with the Bank's internal documents and by order of the Executive Board.

Risk Management Function

- independent business function responsible for risk management, which performs the following:
  - defines and proposes for adoption the strategy and policies of risk management;
  - defines and proposes for adoption the procedures and methodologies of risk management;
  - develops models and methodologies for risk identification, measuring, mitigation, monitoring and control,
  - identifies, measures, assesses, monitors and manages the risks which the Bank is exposed to in its operations;
  - reports to the competent authorities of the Bank on risk management (Bank's Board of Directors, Audit Committee, Executive Board, Asset/Liability Management Committee, Credit Committee...).

Compliance Division

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

Internal Audit Function

- conducts independent evaluation of the risk management system and performs a regular assessment of adequacy, reliability and efficiency of the internal controls system.

- By its Risk Management Strategy the Bank included the following:
  - overview and definition of all the risks which the Bank is, or may be exposed to;
  - long-term objectives, established by the Bank's Business Policy and Strategy, and also propensity to risks as determined in accordance with those objectives;
  - basic principles of assuming and managing the risks;
  - basic principles of internal capital adequacy assessment process of the Bank.
- The Bank has identified and defined the risks to which it is exposed, or to which it may be exposed in its operations, as follows:
- **Credit risk** is the risk of possible negative effects on financial result and capital of the Bank that might occur due to debtors' failure to discharge their liabilities to the Bank. Credit risk includes:
  - **Residual risk** - risk that the credit risk mitigation techniques may be less efficient than expected, or that their implementation/use has an insufficient impact on reduction of all the risks to which the Bank is exposed.
  - **Dilution Risk**– is the risk of possibility of occurrence of adverse effects on Bank's financial result and capital due to reduced value of purchased receivables as a result of cash or non-cash liabilities of the former creditor to the debtor.
  - **Settlement/Delivery Risk** – is the possibility of adverse effects on the Bank's financial result and capital arising from unsettled transactions or counterparty's failure to deliver in free delivery transactions on the due settlement/delivery date.
  - **Counterparty Risk** – is the possibility of occurrence of adverse effects on the Bank's financial result and capital arising from counterparty's failure to fulfill his part of the deal in a transaction before final settlement of cash flows of the transaction.
  - **Credit – Foreign Exchange Risk** – is the possibility that the Bank shall suffer the loss due to debtor's failure to

discharge his liabilities within the agreed time limits and which arises due to adverse effect of changes in RSD exchange rate on debtor's financial position.
  - **Environmental Risk** (risk of environmental and social protection) – risk of occurrence of adverse effects on Bank's financial result, capital and reputation due to event which has or is likely to have a material adverse effect on the environment, health or safety, or the community as a whole.
- **Concentration Risk** is the risk which directly or indirectly arises from exposure of the Bank to the same or similar risk factor or type of risk, such as exposure to one party or a group of related parties, industries, geographic areas, types of products and activities, credit protection instruments, financial instruments, commodities…
- **Investment Risk** is the risk which arises from Bank's investment in other legal entities and fixed assets.
- **Country Risk** is the risk relating to the country of origin of the entity to which the Bank is exposed, or the risk of possible negative effects on the financial result and capital of the Bank due to Bank's inability to collect claims from such entity/debtor for reasons arising from political, economic or social conditions in such entity's/debtor's country of origin. Country risk includes the following risks:
  - **political and economic risk**, which means the probability of loss due to the inability of the Bank to collect the receivables due to the limitations imposed by state laws and bylaws and other authorities of the country of origin of the debtor, as well as general and systemic conditions in that country;
  - **transfer risk**, which means the probability of loss due to inability to collect the receivables denominated in a currency other than the currency of the country of origin of the debtor and due to limitations in payments of liabilities to the creditors from other countries in a particular currency as determined by legislation of the state and other authorities of the country of the debtor.
- **Operational Risk** is the risk of possible occurrence of adverse effects on Bank's financial result and capital due to unintentional and intentional omissions in the work of employees, inadequate internal procedures and processes, inadequate management of information and other systems in the Bank, as well as due to occurrence of unforeseen external events. Operational risk includes legal risk.
  - **Legal risk** is the risk of occurrence of adverse effects on Bank's financial result and capital on the basis of court or out-of-court proceedings in connection with Bank's operations (labor relations, contracts and torts…)
- **Liquidity Risk** is the risk of possible negative effects on the financial result and capital of the Bank caused by the Bank's inability to meet all its due obligations, on account of:
  - **Withdrawal of the existing funding sources,** or inability to obtain new sources of funding (funding liquidity risk), or
  - **Difficulty of converting assets into liquid assets due to market disruption (market liquidity risk).**
- **Interest Rate Risk** is the risk of possible negative effects on the financial result and capital of the Bank arising from positions in the banking book due to adverse changes in interest rates.
- **Market Risks** are the risks of possible occurrence of adverse effects on Bank's financial result and capital on the basis of losses in the balance sheet and off-balance sheet positions due to market price movements, and the same include the following:
  - **Foreign Exchange Risk** is the risk of occurrence of negative effects on the financial result and capital of the Bank caused by changes in exchange rates for the items that are kept in the banking book and the trading book.
  - **Price Risk** based on debt and equity securities is the risk of possible occurrence of negative effects on Bank's financial result and capital due to losses caused by market price fluctuations of debt and equity securities in the trading book.
  - **Commodity Risk** is the risk of occurrence of adverse effects on the financial result and capital of the Bank due to losses caused by the movement of prices of commodities in the market.
  - **Options Risk** is the risk of possible occurrence of negative effects on Bank's financial result and capital due to losses caused by movement of prices of options in the market.

  The Bank is not exposed to options risk or commodity risk.
- **Compliance Risk** is the risk of possible occurrence of negative effects on the financial result and capital of the Bank due to Bank's failure to comply its operations with the law, bylaws, its internal documents, procedures for prevention of money laundering and financing of terrorism, as well as with the rules of profession, sound business practices and business ethics and in particular encompasses the risk of sanctions by the regulatory authority, risk of financial losses and reputational risk.
  - **Reputational Risk** is the risk of possible occurrence of adverse effects on Bank's financial result and capital due to the loss of public confidence and unfavorable public attitude about the Bank's business operations, irrespective of whether there exist the grounds for it or not.
- **Strategic Risk** is the risk of probable negative effects on Bank's financial result or capital due to lack of appropriate business policy and strategy, their inadequate implementation and also due to changes in environment in which the Banks operate, or Bank's failure to properly react to such changes.

Long-term Objectives

- Long-term objectives for Bank's risk management are as follows:
  - development of activities in line with the Business Strategy and opportunities and market development in order to create a competitive advantage;
  - avoiding or minimizing the risk in order to maintain the business operations within the acceptable level of risk;
  - minimizing negative effects on Bank's capital;
  - maintaining the required level of capital adequacy;
  - diversification of risks to which the Bank is exposed.
- The objectives of risk management are aligned with the Bank's Business Plan and can be modified during the year.
- The process of risk management shall include clearly defined and documented risk profile, along with harmonizing the risk profile with the propensity of the Bank to assume risks.
- Propensity to risks shall imply the Bank's intention to assume risks in order to accomplish its strategies and policies and to establish this assumption to be at acceptable risk level.

Basic principles of risk assumption and management

- The basic principles of risk assumption:
  - establishing explicit and clear rules for managing the individual types of risks, with associated policies and procedures for management of individual risk types with corresponding objectives of actions to be taken by the Bank;
  - gathering of complete, timely and truthful information important for risk management and provision of adequate capacities for safekeeping and processing of data;
  - conservative risk taking – implies that the relation towards the risks undertaken by the Bank is such that the expected yields significantly outweigh losses which may incur by risk taking;
  - making business decisions determined by the qualitative and quantitative analysis on the basis of applicable risk parameters;
  - utilization of a number of methods for risk identification and measurement – when managing the risks the Bank, in addition to regulatory prescribed frameworks and approaches for risk management, also applies the internal methods taking into account their applicability and justifiability in terms of investment in their development and justification of their implementation in terms of complexity and volume of business activities.
  - development of quantitative modeling mechanism which allows measurement analysis of the effects of changes in the business and market environment on Bank's risk exposure profile and further impact on profitability, liquidity and net worth of the Bank.

3.2. Risk Management Policies

- Risk Management Policy determines the following:
  - implementation of the risk management strategy by all risk types: credit, market, interest rate, liquidity and operational risk;
  - manner of organizing the risk management process of the Bank and clear division of the employees' responsibilities at all stages of that process;
  - manner of assessing the risk profile of the Bank and methodologies for risk identification, measurement or assessment;
  - methods of risk monitoring 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 rules for applying such measures;
  - manner and methodology for implementing the internal capital adequacy assessment process of the Bank;;
  - principles for the functioning of the internal controls system;
  - framework and frequency of stress tests, as well as actions taken in cases of unfavorable stress test results.
- External reporting of the Bank is conducted pursuant to the statutory regulations and by-laws of the National Bank of Serbia.
- The internal reports are delivered on monthly, quarterly and annual basis to the Bank's competent bodies (Board of Directors, Bank's shareholders, Executive Board, Audit Committee, ALCO, Credit Committee).

3.3. Organizational Structure of the Risk Management Function

- The Risk Management Function conducts its activities through the following organizational units: Risk Management Division, Credit Risk Analysis Division and Workout Department.

- Risk Management Division consists of Credit Risk Management Department, Portfolio Monitoring Department, Market Risks Management Department and Operational Risk Management Department.
- Credit Risk Analysis Division is composed of Department of Credit Risk Analysis for Corporate Clients and Department of Credit Risk Analysis for Retail Clients, Micro Clients and Farmers.

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 dilution risk, concentration risk, settlement/delivery risk, and the counterparty risk to which the Bank is or may be exposed in its operations, as a part of the risk management system.
- The most important processes of the risk management system are:
  - The loan approval process;
  - The process of managing the credit protection instruments;
  - The process of monitoring the loans for early detection of warning signs;
  - The process of credit risk measurement in accordance with the regulations of the National Bank of Serbia and with the Bank's internal methodology;
  - The process of portfolio and credit risk monitoring;
  - The process of non-performing loan management – work out;
  - 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 an 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 credit 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 operations with the counterparty for the positions kept in the banking book.
- Credit risk identification starts by filing an application for loan approval.
- The loan approval process consists of gathering and verification of all the necessary documentation, information and data on the basis of which a credit analysis of individual loans is performed, as well as of the credit risk factors.
- Individual loan analysis includes the analysis of qualitative and quantitative indicators of the client's operations, identification of the risk level (establishment of classification and the client's internal rating), and the control of the extent to which the limit has been used up.
- When analyzing the individual loan, consideration is also given as to the impact on capital requirement for credit risk.
- The process of credit risk measurement is based on two approaches:
  - regulatory approach – the loan impairment process and estimation of the provisions for losses under off-balance sheet items according to the International Accounting Standard 39 and the International Accounting Standard 37, as well as classification and calculation of provisions pursuant to the regulations of the National Bank of Serbia
  - internal approach – measurement of the risk level of an individual loan on the basis of the internal rating system.
- Within the loan approval process, exposure relative to regulatory and internally defined limits is reviewed.
- Loan approval limits are defined by decision-making system, depending on the types of clients and the level of exposure: for loans within the defined limit, the decisions are made by credit committees of the branches and in certain cases the consent of the organizational unit for risk management is required. Under the competence of the central credit committees (depending on the types of clients) are the loans above the defined limits, where the decisions are rendered by obtaining a prior opinion of the organizational unit for risk management. The Executive Board and the Board of Directors pass the decisions depending on the level of exposure.
- In order to maintain the risk at acceptable level, the Bank applies the credit risk mitigation techniques at the level of individual loan by observing the exposure limits, diversification of investments, and by acquiring acceptable collaterals for the purpose of secondary collection.
- Upon approval of a loan, the loan itself and the client's operations are monitored through regular and extraordinary monitoring in order to timely identify the warning signs.
- By monitoring and controlling the portfolio as a whole and by individual segments, the Bank makes comparisons to previous periods, identifies the trends and the causes of changes in the level of credit risk. Likewise, it monitors the asset quality indicators (NPL trends, NPL coverage by allowance for impairment...), as well as the exposure to regulatory and internally defined limits.
- For the purpose of concentration risk control the Bank has established the internal exposure limits with the same or similar risk factors (by sectors/industry, types of products, geographic areas, individual debtors or groups of related

entities, credit protection instruments...). Establishment of appropriate exposure limits is the basis for diversifying the loan portfolio.

- Reporting on credit risk at the Bank's level includes the system of external and internal reporting on credit risk management. External reporting is carried out in accordance with the requirements of the National Bank of Serbia and the International Financial Reporting Standard 7 for credit risk, and the internal reporting in accordance with the Bank's internal documents.
- 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 the Internal rating system, due receivables, risky placements and loans, collaterals, provisions for estimated losses, allowance for impairment, required reserves, exposure risks, exposure and concentration limits...

3.3.2. Liquidity Risk

- The basic objective of the liquidity risk management is to maintain the level of liquid assets in order for liabilities due on balance sheet and off-balance sheet operations of the Bank to be properly and timely settled, or to minimize the negative effects on the financial result and capital of the Bank.
- The Bank has established an adequate organizational structure, business activities, the lines of decision-making and responsibilities by a clear delineation of the liquidity risk management process (implemented by the independent function responsible for risk management) and the liquidity risk management support process from the process of liquidity risk taking.
- Liquidity Management Committee and the Asset/Liability Management Committee have a significant and primary role in risk liquidity management process, within the scope of their competence, in ordinary and extraordinary business conditions. Also, the other Bank's Committees have a role in liquidity risk management process and their decisions may have an impact on exposure to the stated risk.
- Basic principles of liquidity risk management:
  - the readiness to respond to matured obligations, through maintenance of minimum level of liquid assets;
  - maintenance of the match between inflow and outflow of assets by limiting the currency and maturity mismatch of receivables and liabilities;
  - establishment of planned activities in the case of occurrence of unforeseen events (liquidity crisis).
- Identification of liquidity risk implies the analysis of all the indicators that lead to occurrence and increase of liquidity risk, monitoring the level of available liquid assets (liquidity reserves) and reviewing the types and the amount of funding sources, through the assessment of stability of deposits.
- The process of liquidity risk measurement includes the assessment of the current and the future exposure to liquidity risk and the same is conducted by applying the regulatory and internally defined methods and models:
  - Regulatory approach – application of liquidity ratio and more specific liquidity ratio;
  - Internal approach – application of GAP and ratio analysis, stress testing (sensitivity analysis and scenario analysis) and simulation.
- In order to manage the liquidity risk, the limit monitoring system has been established. Regulatory defined liquidity limits which the Bank observes relate to maintenance of minimum liquidity ratios over the period of 1 day, 3 days and the average for a month. When defining the exposure limit to liquidity risk, a number of aspects of liquidity risk are considered, taking into account the limitation of negative effect on the financial result and capital of the Bank, and limitation of currency and maturity mismatch. The Bank has defined the internal standards for liquidity risk management, which refer to defined internal limit of liquidity ratio, limits of liquidity gaps by maturity and currencies, structural liquidity limits, identification and quantification of early elements of liquidity crisis.
- Monitoring and control of liquidity risk include the monitoring of business activity compliance with the defined limit system, in order to maintain the liquidity risk at the level accepted by the defined risk profile of the Bank, as well as to follow up and monitor the implementation of measures. The 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 established an independent control of the assessment of adequacy, reliability and efficiency of the liquidity risk management system.
- In order to maintain the liquidity risk at the level accepted by the defined risk profile, the Bank applies the techniques and measures of liquidity risk mitigation in the conditions when the exposure to liquidity risk tends to the upper limit of the defined risk profile of the Bank. The techniques applied by the Bank relate to maintenance of sufficient level of liquidity reserves, or marketable liquid assets in major currencies, diversification of funding sources by maturity and currency, reducing the concentration of funding sources by sector structure, for the purpose of establishing a stable base of sources of funds.
- The Bank has in place the established system for liquidity risk reporting which includes assessment and analysis of the

exposure to the 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

- The objective of interest rate risk management is to preserve the economic value of the Bank's capital, with simultaneous minimization of negative effects of changes in interest rates on the financial result, for the positions that are kept in the Banking Book.
- The Bank has established an appropriate organizational structure, business activities, decision-making and responsibilities lines, by clear delineation of risk assumption process from risk management process.
- Asset/Liability Management Committee has a significant and primary role in interest rate risk management process, within its competence. Likewise, in interest rate risk management process other Bank's Committees have their role and their decisions may have an impact on exposure to the above stated risk.
- Basic principles of Bank's interest rate risk management are:
    - maintenance of interest rate risk level which allows for minimizing the negative effect of changes in interest rates on the market and also the maintenance of minimum required interest rate margin;
    - limitation as to maturity and currency mismatch for the purpose of preserving the economic value of capital, or minimizing the negative impact of interest rate changes on exposure to interest rate risk;
    - optimization of the cost of funds with adaptation and caution during the formation of competitive interest rates on Bank's products.
- Identification of the interest rate risk implies the analysis of all the indicators and factors which lead to occurrence and increase of exposure to interest rate risk, along with the type of interest rate risk to which the Bank is exposed.
- Measurement of interest rate risk represents the quantitative and qualitative assessment of the exposure to interest rate risk and is conducted by applying the internal models of gap and ratio analysis, economic value of capital and stress testing.
- Mitigation of interest rate risk is conducted by the Bank continuously by maintaining the risk at acceptable level for risk profile and by establishing and implementing the adequate measures and techniques. In interest rate risk management process the Bank applies the internal limits system. When defining the exposure limit to interest rate risk the Bank takes into account multiple aspects of interest rate risk, thus limiting the negative effect on the financial result and the economic value of the capital. The Bank has defined the limits of interest-bearing positions, gap limits by currencies up to 1 year, which leads to limitation of the negative impact on the financial result, and 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 compliance of business activities with 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 and monitoring of implementation of the measures. The system of internal interest rate risk control is integrated in all business operations of the Bank, as is also the independent control of the assessment of adequacy, reliability and efficiency of the interest rate risk management system.
- The Bank has established the process for monitoring and reporting on the effects of implementation of applied risk mitigation measures and techniques, that are aimed at maintaining the match of interest rate-sensitive positions, diversification of funding sources by type of interest rate, maturity, and by repricing and currency and at optimizing the cost of funds.
- The system of reporting on exposure to interest rate risk includes the assessment and analysis of the exposure to interest rate risk, compliance with the external and internal limits, results of stress test analysis and proposals of measures.

3.3.4. Market Risk

- In its everyday operations the Bank is continually exposed to foreign exchange risk and price risk.

Foreign Exchange Risk Management

- The objective of foreign exchange risk management is to ensure safe operation of the Bank through minimization of the negative effects of changes in the exchange rate of the domestic currency on the financial result and capital of the Bank, for the positions that are kept in the banking book and the trading book.
- The Bank has established an appropriate organizational structure, business activities, decision-making and

responsibilities lines, by clear delineation of foreign exchange risk assumption process from the process of its management and the support process.

- ALCO and other Bank's Committees have a significant role in foreign exchange risk management process and their decisions may have an impact on the exposure to the above mentioned risk.
- Identification of the foreign exchange risk refers primarily to consideration of transaction and balance sheet exposure, and also to exposure arising from introduction of new products and activities and to analysis of internal and external factors. Identification of exposure to foreign exchange risk is conducted at the level of exposure to a single currency and also at the level of entire foreign exchange portfolio for all the currencies.
- Measurement of foreign exchange risk includes the assessment of the current and the future exposure to foreign exchange risk and is performed by applying the regulatory and internally defined methods and models:
  - Regulatory approach – application of foreign exchange risk ratios;
  - Internal approach – stress testing (sensitivity and scenario analysis) and simulations, value at risk and back testing.
- The Bank conducts a continuous mitigation of foreign exchange risk by maintaining the risk at acceptable level for risk profile, and also by establishing and applying the appropriate measures and techniques, and by follow up and monitoring of implementation of the measures. The Bank implements the system of external and internal limits, established on the basis of foreign exchange risk ratio. When defining the exposure limit to foreign exchange risk multiple aspects of foreign exchange risk are taken into account, thus limiting the negative effect on the financial result and capital of the Bank. The Bank has defined the internal limits of foreign exchange risk ratio by individual currencies and aggregated at more rigorous level than the regulatory limits, as well as limits on transactions that affect the financial result.
- As a part of foreign exchange risk management the Bank uses standard and derivative 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 a process of monitoring and reporting on the effects of implementation of the measures and techniques applied to mitigate the operational risk, through regular reporting to the competent committees and bodies, and by clear division of responsibilities, defining rules on the frequency and reporting on the implementation of measures adopted to reduce operational risk.
- The Bank has established a reporting system which 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 appropriate organizational structure, business activities, decision-making and responsibilities lines, by clear delineation of risk assumption process from the process of its management and support, and guided by the principles of the risk management system of the trading book.
- The Executive Board has a significant role in the risk management of the trading book. Other Bank's Committees and Boards also have a role in price risk management process and their decisions may affect the exposure to the stated risk.
- Basic principles for Bank's price risk management are:
  - maintenance of the risk level in compliance with the internally defined limits;
  - monitoring the changes on the market that may lead to increased exposure to the trading book risks;
  - determination of the measures for mitigating the exposure to risks in the circumstances when the Bank tends to the upper limit of the accepted risk profile of the risk exposure.
- Identification of the risk of trading book operations includes the analysis of all the indicators and factors which lead to occurrence and increase of the risk profile of the Bank.
- Measurement and assessment of the risk of trading book operations includes the following implementation:
  - standardized (regulatory prescribed) approach
  - internal model by using Value at Risk methodology.
- Mitigation of price risk is conducted continuously by maintaining the risk at acceptable level for risk profile and by establishing and implementing the adequate measures and techniques. Defining and applying the appropriate safeguards and preventive measures, defining the exposure limit and defining and implementing the measures for price risk mitigation characterize the phase of mitigating the price risk. The Bank has in place the established system of internal limits adopted by the competent Committees and Boards of the Bank, as follows: exposure limits for all trading book positions, limits on investment by products and types of transactions, limits by type of issuer of the securities and the participation of the issuer 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.

- Pursuant to the established system of reporting on Bank's price risk, the Bank performs external and internal reporting.

3.3.1. Operational Risks

- In order to minimize occurrence of an operational risk event, the Bank establishes an appropriate framework which includes: the process of identifying the operational risk event, the process of classifying the operational risk events according to risk level, the analysis of the operational risk event, the process of monitoring the operational risk event, the process of monitoring the measures for operational risk mitigation, and the system of early detection of operational risk event.
- When assuming the operational risk the Bank is guided by the following principles:
  - managing business operations in accordance with the good operational risk management practices;
  - provision of adequate controls for operational risk management;
  - timely identification and continuous monitoring of the operational risk event, minimization of operational risk occurrence by implementation of the measures;
  - analysis of key risk indicators that lead to occurrence of operational risk event,
  - measurement of operational risk by applying the regulatory approach (operational risk ratio) internal approach (stress testing, value at risk and back testing)
  - measurement of the current exposure to operational risk and the assessment of the exposure based on the introduction of new products and activities on the implementation of measures to minimize the operational risk events.
- The Bank continuously mitigates the operational risk, which involves maintenance of the risk at the acceptable level through determination of measures to minimize the operational risk, which include the following:
  - definition of the exposure limit;
  - definition and application of the operational risk mitigation measures;
  - system of physical controls;
  - Business Continuity Plan and
  - Disaster Recovery Plan.
- Operational risk monitoring and control involve the monitoring of the compliance of business operations 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 and monitoring 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 adequacy, reliability and efficiency of the operational risk management system.
- 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 to 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 to minimize the operational risk. The reporting system includes timely reporting on the operational risk events by 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

- 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.
- Identification of country risk includes the analysis of all the indicators that give rise to and increase the country risk, carried out at the level of the individual placement and the overall portfolio.
- Prerequisite for achieving the defined objectives of the country risk management is the existence of adequate and updated database containing the recorded information provided by the business sectors on client's domicile country and his place of residence.
- Measurement of country risk is based on external credit ratings of client's domicile country, on the basis of which the loans are classified/grouped to certain level of risk.
- The Bank defines the procedure for country risk monitoring and control as monitoring of the limit and of the measures adopted to reduce the country risk, as well as the control process.
- The Bank has in place the established system for country risk reporting by which the Bank's Management, competent

committees and boards and organizational units are timely informed.

3.3.3. Investment Risk

- The Bank has established the internal and external system for reporting on investment risk, thus ensuring that the investment outside the financial sector does not exceed 10% of the Bank's capital, and that the Bank's investments in financial sector and in fixed assets do not exceed 60% of the Bank's capital.

4. BANK'S CAPITAL

- The Bank's Capital Strategy and Plan substantiate 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 strategic plans, the manner in which the Bank will respond to capital requirements in the future, and relevant limitations on the capital, as well as the general plan for acting in unforeseen circumstances.
- Pursuant to the defined targeted values, the Bank undertakes measures for their realization and maintenance.

Capital structure RSD 000

Name	31.12.2012.	31.12.2011.
CORE CAPITAL	**50.696.348**	**41.749.118**
Nominal value of paid up shares, except for cumulative preferred shares,	17.191.466	13.881.010
Paid up ordinary shares	8.709.310	8.709.310
Paid up non-cumulative preferred shares	373.510	373.510
Paid up convertible preferred bank shares	8.108.646	4.798.190
Issue premium	22.843.084	14.581.543
Reserves from the profit	14.785.440	11.635.440
Profit of current year	-	2.500.000
Deductible items from core capital	4.123.642	848.875
Intangible investments	600.438	555.415
Amount of bank shares taken in pledge, except for cumulative preferred shares	151.903	229.520
Non-realized losses arising from securities available/held for sale	7.016	63.940
Required reserves from profit for estimated losses under balance sheet assets and off-balance sheet items of the bank	3.364.285	-
SUPPLEMENTARY CAPITAL	**5.329.728**	**5.852.703**
Part of revaluation reserves of the bank	780.996	620.658
Subordinated liabilities	4.548.732	5.232.045
DEDUCTIONS FROM CAPITAL	**15.648.210**	**20.655.322**
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	5.555.355
Required reserve from profit for estimated losses under balance sheet assets and off-balance sheet items of the bank	10.092.855	15.099.967
TOTAL CORE CAPITAL	**40.377.866**	**26.946.499**
TOTAL SUPPLEMENTARY CAPITAL	**-**	**-**
TOTAL REGULATORY CAPITAL	**40.377.866**	**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.
- Regulatory prescribed minimum capital adequacy ratio is 12%.

Overview of total capital requirements according to standardized approach RSD 000

Capital Requirements	31.12.2012.	31.12.2011.
Credit risk, counterparty risk and settlement/ delivery risk based on free deliveries	**20.319.961**	**17.057.078**
Exposures to states and central banks	-	-
Exposures to territorial autonomies and local government units	70.875	76.206
Exposures to international development banks	1.362	-
Exposures to banks	758.374	478.388
Exposures to companies	12.126.365	10.189.603
Exposures to private individuals	2.832.817	2.713.780
Exposures secured by mortgages on real property	2.414.031	2.029.002
Due outstanding receivables	610.519	83.599
Other exposures	1.505.618	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	**1.823.619**	**1.692.643**
Exposure to operational risk	1.823.619	1.692.643
Total capital requirements	**22.143.580**	**18.749.721**
Capital adequacy ratio (minimum 12%)	**21,88%**	**17,25%**

- The Bank does not calculate capital requirements for foreign exchange risk in conformity with the standardized approach, since the FX risk ratio is below 2% and in accordance with the regulations of the National Bank of Serbia there is no obligation for allocation thereof.
- Likewise, the Bank includes the trading book positions in calculation of capital requirements for credit risk, taking into consideration that value and share of trading book in total operations do not obligate the Bank to allocate special capital

requirements for market risks. The conditions met by the Bank are as follows:
- value of trading book positions does not exceed 5% of value of total operations of the Bank, or it is not higher than RSD 1,5 billion for more than three working days in calendar month;
- value of trading book positions does not at any given time exceed 6% of value of Bank's total operations, or it is not higher than RSD 2 billion;

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 and decision-making process in the Bank and is regularly revised and adjusted, particularly when the Bank 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 time periods for their implementation, taking into account the impact of macroeconomic environment and economic cycle phases;
  - Manner of organization of available internal capital management process;
  - Procedures for planning the adequate level of available internal capital;
  - Manner of accomplishment and maintenance of adequate internal capital level;
  - Business plan in the case of unforeseen events which can influence the amount of available internal capital.
- 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, as well as with the Capital Management Strategy and Capital Management Plan. 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 operations;
  - Ensures adequate internal capital in accordance with the Bank's risk profile;
  - It is incorporated in the Bank's management system and in decision-making process in the Bank;
  - It is subject to regular analysis, monitoring and verification.
- 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 assessment of internal capital requirements, internal capital is also assessed through ICAAP. Planning of internal capital also ensures maintaining the level of capital that can support the growth of loans, future funding sources, dividend policy...
- The Bank continuously assesses the risk profile and regularly revises the internal capital adequacy assessment process, developing at the same time the methodologies for assessment of other risk types in order for the comprehensive risk management at the Bank's 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's operations;
  - provision of 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 Bank's business operations, 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 assumes. All assumed 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.
- Calculation of the amount of the internal capital requirements 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. For the purpose of inclusion of materially significant risks in ICAAP, the Bank applies the following methodologies for the following:

- **Credit risk** – standardized approach with stress testing by applying econometric models;
- **Operational risk** – Monte Carlo VaR model with a confidence interval of 99,9%, with application of stress testing.
- **Market risk (Foreign exchange risk)** –VaR methodology with application of stress testing as well.
- **Interest rate risk** – methodology of standardized interest rate shock, which also incorporates the changes of factors and stress testing of interest rate risk.
- **Liquidity risk** –testing "hypothetical" level of liquidity crisis and the calculation of the amount of missing funds;
- **Residual risk** – stress testing of deteriorating efficiency of applied mitigation techniques;
- **Credit Foreign exchange risk** – stress testing;
- **Materially insignificant risks** are included in ICAAP through the system of policies and procedures, system of limits, decision-making system...

- Determination of the total internal capital incorporates also the stress test results.
- Comparison of the capital amount calculated in accordance with regulatory requirements and the amount of the available internal capital, as well as the minimum capital requirements and the internal capital requirements.

5. EXPOSURE TO RISKS

5.1. Credit Risk and Dilution Risk

In the credit risk analysis and assessment the Bank uses two parallel approaches: internal and regulatory.

- Internal rating system is not only the instrument for shaping the individual decisions and the assessment of risk level of an individual loan, but instead it represents the basis for portfolio analysis, support in loan approval process and in process of loan impairment and also in assessment of provisions for losses under off-balance sheet positions/items in order to rank the risk exposure level of a loan and to express the real value of claims. Internal rating system is subject to regular audit and improvement.
- In credit risk analysis, in addition to Internal rating system, the Bank also uses the principles prescribed by the regulations of the National Bank of Serbia, which require the classification of each loan based on stipulated criteria and calculation of reserves for credit risk assessment. Application of these criteria allows the Bank to cover the unexpected losses that may incur due to inability of the client to settle his liabilities at maturity in line with contractually defined terms. Therefore, the Bank classifies the receivables and calculates the required level of credit loss reserves, which is a form of protection from possible negative consequences if invested funds are not repaid when due and in full amount.
- Positive difference between calculated credit loss reserves (based on regulatory approach), on the one hand, and the allowance for impairment and provisions for potential losses (based on internal approach), on the other hand, provides the required credit loss reserves, which represent a deductible item from capital.

The matured unsettled receivables the Bank defines as all receivables not recovered at maturity (principal, interest and fees, as well as the interventions under guarantees, guarantees of a bill and other forms of sureties, illicit overdraft in client accounts, and other due obligations of the clients).

Exposures with performed allowances for impairment are exposures where assessment of their collectability is made, or where reduction is made for the amount of the expected loss.

- 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 on Classification of Balance Sheet Assets and Off-Balance Sheet Items and also by observing the requirements of the International Accounting Standards (IAS) 39 and 37.
- Loans 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 debtor's liabilities to the Bank.
- The main elements in assessing the impairment of a loan are: overdue payment of principal or interest, difficulties in cash flows of loan beneficiaries, fall in the credit rating or changes of the original contractual terms and conditions, etc.
- Loan is impaired based on the assessment of expected future cash flows from clients' operation, and by realization of the collateral if assessed that there is a realistic possibility for the loan to be recovered from such funds.

Calculation of Allowances for impairment for Balance Sheet Assets

- The Bank assesses the impairment of receivables as individual and group assessment. All clients are grouped pursuant to the internally prescribed methodology based on the Bank's internal rating system.
- 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 carrying value and the present value of expected future cash flows, determined by discounting the expected inflows from the loan through application of the last agreed effective interest rate of the specific loan. In case of interventions under guarantees and other forms of sureties, the present value is determined by discounting the expected inflows through application of the average annual default interest rate.
- 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 it is assessed that there is no objective proof of the loan impairment, such loan will be impaired by the percentage of impairment of the solvency group to which it belongs.
- Loan impairment that reduces the value of a loan is recorded in the provision account in the balance sheet, and recognized as an expense in the income statement.

Calculation of Provisions for Losses under Off-Balance Sheet Items

- Provisions of the Bank are calculated on individual and group basis. Contingent liabilities with a high degree of probability to entail an outflow of assets are assessed individually, while the rest of contingent liabilities are assessed on group level.
- Assessment of the provisions on the group level is performed 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 pertaining to balance sheet positions.
- 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	31.12.2012		31.12.2011	
	Exposure	Average value	Exposure	Average value
States and central banks	85.412.967	83.205.391	87.072.706	82.757.008
Territorial autonomies and local government units	1.622.784	1.695.241	1.649.888	1.623.984
International development banks	75.876	74.515	64.309	32.155
Banks	20.795.592	18.223.542	15.865.004	14.385.188
Companies	112.598.893	112.425.663	99.156.339	96.014.010
Private individuals	32.536.591	33.420.491	32.292.979	31.886.139
Exposures secured by mortgages on real property	31.104.830	27.006.143	25.330.272	23.147.687
Due outstanding receivables	12.238.634	6.807.784	4.650.660	2.866.247
Other exposures	39.772.297	32.285.674	26.210.901	25.959.928
Total	**336.158.465**	**315.144.444**	**292.293.058**	**278.672.346**

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

Sector Exposure Distribution per Classes of Assets RSD 000

Exposure to Credit Risk	31.12.2012.	31.12.2011.
	Value of exposure	Value of exposure
States and central banks	**91.590.446**	**90.939.250**
Finance and insurance sector	43.109.514	60.320.636
Public sector	48.480.858	30.618.460
Foreign entities sector	74	154
Territorial autonomies and local government units	**1.616.456**	**1.645.782**
Public sector	1.181.245	1.270.095
Foreign entities sector	435.211	375.687
International development banks	**75.876**	**64.309**
Finance and insurance sector	75.876	64.309
Banks	**21.031.030**	**16.038.021**
Finance and insurance sector	2.151.452	1.965.195
Foreign entities sector	18.879.544	14.072.826
Banks-other	34	-
Companies	**101.053.045**	**84.913.359**
Finance and insurance sector	4.668.677	4.773.145
Public companies sector	3.368.691	1.769.894
Company sector	91.721.257	76.940.347
Entrepreneurs sector	664.321	477.056
Public sector	4.210	2.060
Foreign entities sector	342.188	600.797
Other clients' sector	49.604	121.549
Household corporate firms with employees and farms	234.097	228.511
Private individuals	**31.480.795**	**30.153.110**
Finance and insurance sector	522	903
Public companies sector	9	1.999
Company sector	5.003.965	4.645.253
Entrepreneurs sector	1.260.990	26.645
Public sector	8.212	28.178
Retail sector	22.392.918	22.229.303
Foreign entities sector	124	713
Household corporate firms with employees and farms	2.780.156	3.151.021
Other clients' sector	33.899	69.094
Exposures secured by mortgages on real property	**30.687.494**	**24.647.481**
Finance and insurance sector	-	771
Company sector	3.947.658	3.591.413
Entrepreneurs sector	245.659	198.906
Retail sector	26.115.464	20.562.620
Foreign entities sector	3.079	-
Household corporate firms with employees and farms	344.966	256.738
Other clients' sector	30.668	37.032
Due outstanding receivables	**4.025.378**	**666.972**
Company sector	3.667.636	522.628
Entrepreneurs sector	7.885	12.962
Retail sector	195.275	93.163
Foreign entities sector	65.573	-
Household corporate firms with employees and farms	63.383	36.647
Other clients' sector	25.626	1.572
Other exposures	**38.786.563**	**25.542.630**
Finance and insurance sector	2.665.577	2.129.995
Public companies sector	1	-
Company sector	648.970	567.261
Entrepreneurs sector	4.091	1.414
Public sector	40.500	9.496
Foreign entities sector	337.962	388.946
Other clients' sector	55.186	72.577
Other	35.034.276	22.300.796
Total	**320.347.083**	**274.610.915**

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

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

Exposure to credit risk	31.12.2012		31.12.2011	
	Gross exposure where allowance or provisioning was made	Allowance and provisions	Gross exposure where allowance or provisioning was made	Allowance and provisions
Territorial autonomies and local government units	**1.129.056**	**72**	**454.053**	**10.813**
Public sector	1.129.056	72	454.053	10.813
Banks	**259.124**	**230.687**	**215.579**	**215.554**
Finance and insurance sector	21.038	2.713	1.652	1.627
Foreign entities sector	238.086	227.974	213.927	213.927
Companies	**86.755.588**	**2.540.750**	**96.251.913**	**2.634.626**
Finance and insurance sector	5.076.231	7.859	4.830.314	31.380
Public companies sector	3.626.137	792	640.464	148
Company sector	76.757.195	2.528.014	84.729.964	2.542.279
Entrepreneurs sector	666.954	2.550	518.308	2.358
Public sector	3.213	17	1.088	4
Foreign entities sector	346.836	4	5.150.143	51.501
Other clients' sector	44.411	1.503	123.646	1.708
Household corporate firms with employees and farms	234.611	11	257.986	5.248
Private individuals	**29.235.867**	**439.726**	**24.592.922**	**505.681**
Finance and insurance sector	199	135	1.051	17
Public companies sector	9	-	2.326	37
Company sector	5.091.941	196.881	2.567.341	90.705
Entrepreneurs sector	1.262.168	26.834	1.099.569	32.342
Public sector r	7.695	151	32.787	526
Retail sector	20.032.521	163.996	20.484.794	309.424
Foreign entities sector	23	-	830	13
Household corporate firms with employees and farms	2.798.847	41.588	323.828	71.326
Other clients' sector	42.464	10.141	80.396	1.291
Exposures secured by mortgages on real property	**32.115.237**	**23.265**	**26.308.763**	**17.866**
Finance and insurance sector	-	-	823	1
Company sector	5.203.571	10.896	4.649.134	10.315
Public companies sector	250.606	2.665	-	-
Entrepreneurs sector	26.272.987	9.428	202.852	899
Retail sector	3.079	-	21.150.102	6.130
Household corporate firms with employees and farms	354.231	276	266.256	519
Other clients' sector	30.763	-	39.596	2
Due outstanding receivables	**25.822.679**	**13.871.860**	**16.974.497**	**12.343.361**
Finance and insurance sector	142.959	142.959	150.207	150.207
Public companies sector	153	153	125	126
Company sector	16.512.752	8.220.699	11.769.862	7.706.984
Entrepreneurs sector	277.944	234.285	240.692	207.689
Public sector	30.018	30.018	30.018	30.018
Retail sector	2.021.526	1.521.018	1.925.230	1.559.672
Foreign entities sector	2.480.576	166.074	70.591	70.591
Household corporate firms with employees and farms	360.747	244.797	327.946	232.589
Other clients' sector	3.996.004	3.311.857	2.459.826	2.385.485
Other exposures	**16.128.174**	**3.824.442**	**13.022.108**	**3.307.080**
Finance and insurance sector	2.646.141	261	1	-
Public companies sector	3	1	-	-
Company sector	553.938	6.905	682.966	30.791
Entrepreneurs sector	3.887	56	1.133	58
Public sector	1.193	-	1.870	27
Foreign entities sector	328.566	33	-	-
Other clients' sector	59.496	3.462	62.771	4.022
Other	12.534.950	3.813.724	12.273.367	3.272.182
Total	**191.445.725**	**20.930.802**	**177.819.835**	**19.034.981**

**Note: presented is the gross exposure of items where allowance and provisions for off-balance sheet items was made*

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

Exposure to credit risk	31.12.2012	31.12.2011
	Exposure value	Exposure value
States and central banks	**91.590.446**	**90.939.250**
Republic of Serbia	91.590.372	90.939.096
Other	74	154
Territorial autonomies and local government units	**1.616.456**	**1.645.782**
Republic of Serbia	1.616.456	1.645.782
International development banks	**75.876**	**64.309**
Other	75.876	64.309
Banks	**21.031.030**	**16.038.021**
Republic of Serbia	2.151.486	1.965.195
Germany	10.476.870	10.043.821
Switzerland	3.813.877	1.493.147
United States of America	1.217.101	786.203
Great Britain	2.152.347	619.211
Bosnia and Herzegovina	526.501	–
Other	692.848	1.130.443
Companies	**101.053.045**	**84.913.359**
Republic of Serbia	100.710.857	84.312.562
Other	342.188	600.797
Private individuals	**31.480.795**	**30.153.110**
Republic of Serbia	31.466.270	30.135.620
Other	14.525	17.490
Exposures secured by mortgages on real property	**30.687.494**	**24.647.481**
Republic of Serbia	30.684.415	24.638.960
Other	3.079	8.521
Due outstanding receivables	**4.025.378**	**666.972**
Republic of Serbia	3.959.805	666.969
Other	65.573	3
Other exposures	**38.786.563**	**25.542.630**
Republic of Serbia	38.448.600	25.153.778
Other	337.963	388.852
Total	**320.347.083**	**274.610.915**

**Note: gross exposure reduced by allowance, provisions for estimated losses and required reserves and adjusted for conversion factors for off-balance sheet items upon application of mitigation techniques*

Maturity distribution of all exposures per classes of assets RSD 000

Exposure to credit risk	31.12.2012. Exposure value	31.12.2011. Exposure value
States and central banks	**91.590.446**	**90.939.250**
Up to three months	63.563.652	63.314.362
From three months to 6 months	5.669.181	18.500
From 6 months to 1 year	2.871.033	11.964.896
Over 1 year	19.486.580	15.641.492
Territorial autonomies and local government units	**1.616.456**	**1.645.782**
Up to three months	493.807	379.722
From three months to 6 months	1.836	-
From 6 months to 1 year	-	9.955
Over 1 year	1.120.813	1.256.104
International development banks	**75.876**	**64.309**
Up to three months	75.876	64.309
From three months to 6 months	-	-
From 6 months to 1 year	-	-
Over 1 year	-	-
Banks	**21.031.030**	**16.038.021**
Up to three months	16.500.290	15.359.413
From three months to 6 months	1.059.194	–
From 6 months to 1 year	227.196	174.313
Over 1 year	3.244.350	504.295
Companies	**101.053.045**	**84.913.359**
Up to three months	9.757.797	8.779.985
From three months to 6 months	8.388.825	13.456.390
From 6 months to 1 year	17.180.137	12.391.294
Over 1 year	65.726.286	50.285.690
Private individuals	**31.480.796**	**30.153.109**
Up to three months	5.181.434	4.819.828
From three months to 6 months	2.083.914	1.717.873
From 6 months to 1 year	3.479.544	4.660.888
Over 1 year	20.735.904	18.954.521
Exposures secured by mortgages on real property	**30.687.494**	**24.647.481**
Up to three months	144.936	100.700
From three months to 6 months	136.077	152.293
From 6 months to 1 year	201.089	245.638
Over 1 year	30.205.392	24.148.851
Due outstanding receivables	**4.025.378**	**666.972**
Up to three months	569.980	174.654
From three months to 6 months	132.510	65.999
From 6 months to 1 year	75.657	24.726
Over 1 year	3.247.231	401.594
Other exposures	**38.786.562**	**25.542.630**
Up to three months	27.221.250	14.068.467
From three months to 6 months	120.888	38.410
From 6 months to 1 year	168.652	262.636
Over 1 year	11.275.772	11.173.117
Total	**320.347.083**	**274.610.915**

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

Changes in allowances and provisions RSD 000

	Loans and deposits	Interest and fee receivables	Securities	Stake in capital	Other investments	Other assets	Off-balance sheet exposure	Total
Balance as of 01.01.2012	10.690.247	1.639.898	4.611	370.189	2.793.946	163.789	502.017	16.164.697
Increase	5.989.128	298.306	6.909	76.783	347.589	190.055	522.524	7.431.294
Decrease	(5.357.273)	(234.856)	(7.073)	-	(101.127)	(54.537)	(526.910)	(6.281.776)
Exchange differentials	445.736	27.930	224	-	171.285	10.266	-	655.441
Write-offs	(63.412)	(29.280)	-	-	(31.516)	(438)	-	(124.646)
Other changes	2.002	(138.483)	-	(18)	(2.322)	(3.893)	1	(142.713)
Balance 31.12.2012	**11.706.428**	**1.563.515**	**4.671**	**446.954**	**3.177.855**	**305.242**	**497.632**	**17.702.297**

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

Exposure according to risk categories and client type as of 31.12.2012 RSD 000

Classification	Corporate clients	Banks	Retail clients	Total
A	68.910.052	20.662.808	57.804.981	147.377.841
B	46.658.557	228.546	5.546.935	52.434.038
V	17.323.851	28.556	1.465.898	18.818.305
G	3.277.498	-	1.299.556	4.577.054
D	20.274.328	1.739.000	3.357.627	25.370.955
Total	**156.444.286**	**22.658.910**	**69.474.997**	**248.578.193**

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

Overview of credit loss reserves and required reserves by client type as of 31.12.2012 RSD 000

Type of Client	Credit Loss Reserves	Required Reserves
Corporate clients	24.550.285	12.153.062
Banks	1.747.855	8.709
Retail clients	4.019.396	1.295.369
Total	**30.317.536**	**13.457.140**

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 nor their specific issues due to their non-existence. For financial instruments issued by the Republic of Serbia, the Bank applies the preferential risk weight, or 0%.

Credit rating assignment to credit risk levels

State risk classification in accordance with the 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 RSD 000

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 e	
		31.12.2012	31.12.2011	31.12.2012	31.12.2011
States and central banks		85.412.967	87.072.706	91.590.446	90.939.250
0	0%	87.072.706	91.590.446	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 documents 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 loan.
- The Bank pays attention to regular assessment/valuation of the collaterals, which is necessarily conducted prior to the conclusion of the loan agreement and during the agreement validity. Securities are assessed on monthly basis.
- The acceptable loan amount and collateral value ratio is based on the assessed collateral value, which is adjusted by application of defined percentage depending on type of collateral, thereby establishing the liquidation value of the collateral that the Bank can collect.

Description of basic types of credit protection instruments

- The Bank uses 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 collateral;
  - Securities, which include 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 sureties, 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,
  - territorial autonomies,
  - other.
- 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 the applicable mitigation techniques

- The Bank follows up and manages the credit and market risk concentration in the segment of large exposures by also considering the issuers of eligible security instruments. Also, the Bank reports to the management on monthly basis on large exposures
- In order to manage the concentration risk in the framework of used credit risk mitigation techniques:
  - Analysis is made of indirect exposure to the credit protection provider, within the credit process;
  - The exposure limit system is established.
- The major part of eligible non-material credit protection instruments account for the guarantees of the Government of the Republic of Serbia

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	
	31.12.2012.	31.12.2011.	31.12.2012.	31.12.2011.
States and central banks	–	–	–	–
Territorial autonomies and local government units	–	–	–	–
International development banks	–	–	–	–
Banks	–	–	–	–
Companies	1.368.171	1.348.559	6.430.734,	4.121.058
Private individuals	780.971	1.367.998	939	23

Exposures secured by mortgages on real property	61.157	6.818	–	–
Due outstanding receivables	164.963	13.604	–	–
Other exposures	58.464	2.938	–	–
Total	**2.433.727**	**2.739.917**	**6.431.673**	**4.121.080**

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

5.2. Counterparty Risk

Counterparty Risk

- Bank performs transactions in the trading book and banking book which fall under the counterparty risk, and in part of operations 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 protection instrument since the collateral issuer and the counterparty is one and the same.

Exposure to counterparty risk RSD 000

Type of risk	Exposure value
Exposures to counterparty risk	4.000.000

5.3. Liquidity Risk

- The Bank may be exposed to the risk of inability to settle matured obligations (default risk), as well as to 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 share of adequate sources of funding in Bank's liabilities (funding sources risk), while external factors relate to exposure to non-marketability of assets in the case of need to acquire the sources of funding.
- The Bank manages in short-term the liquidity risk by monitoring/following up and controlling the positions in all major currencies in order to timely perceive the needs for additional sources of financing in case of maturity of the corresponding positions, and/or in long-term it plans the structure of its sources and loans so as to provide the enough stable sources and sufficient liquidity reserves.
- On short-term basis, the Bank manages the liquidity ratio which it limited to 1 on daily basis, and also the more specific liquidity ratio which it complies with the regulatory defined limits. On long-term basis, the Bank has defined the financial leverage to equal maximum 90%.
- On monthly basis the bodies of the Bank monitor the liquidity crisis indicators and the structure of liquidity reserves.
- The Bank tests the Plan for managing liquidity in crisis situations, by which it identifies the possible crisis, tests the survival period and solvency of the Bank in presumed crisis conditions, and also perceives and analyzes the accessibility of sources for covering potential obligations, and/or assesses the accompanying organizational support (public relations and the Plan for the case of occurrence of unforeseen events).
- The Bank has developed its own internal approach for the needs of determining the capital required for covering the liquidity risk.

5.4. Managing Interest Rate Risk 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 redetermination (for positions with variable interest rate);
  - Yield curve risk
  - Basis risk due to changes of different reference interest rates in case of interest rate sensitive positions with similar characteristics in terms of maturity or re-pricing,

  - Options risk, to which it may be exposed due to contractual provisions in connection with interest rate sensitive positions, as well as built-in minimum and maximum interest rates options.

  - The Bank measures the exposure to interest rate risk by Gap and ratio analysis, interest rate shock and duration on monthly basis and by stress tests and simulations minimum on semiannually basis.
- For the needs of preparation of interest rate GAP, the mentioned positions are categorized in the following manner:
  - positions with agreed fixed interest rate are categorized according to maturity period,
  - positions with agreed market variable interest rate are categorized according to the repricing period provided such period is shorter than the maturity period,
  - positions with agreed variable interest rate in accordance with the Bank's business policy are categorized according to maturity period, assets and liabilities not having a defined maturity or having the maturity other than the agreed one 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 prepayments of loans are particularly taken into consideration, which are analyzed by the bank on the basis of historical trends and expert assessment. The Bank assessed the movement of transaction deposits, demand deposits and retail savings deposits by applying the relevant statistical models in the field of time series analysis.
- The Bank has limited to 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 that are recorded in the trading book (price risk).
- In the structure of currency exposure, dominant is the exposure to currency EURO, then to CHF, and also exposure to currency USD. Internal factors of exposure to foreign exchange risk originate from currency structure of loans and deposits: loans are primarily agreed in RSD with currency clause (EUR and CHF), whereas deposits are mostly in currency EUR. Exposure to foreign exchange risk remained during 2012 within internally and externally defined limits and average FX risk ratio was about 1, 92%.
- In the structure of price risk exposure dominant are trading bonds, whereas equity instruments participate slightly.
- 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 the customized internal approach for the purpose of establishing the required internal capital for covering the foreign exchange risk, for whose application it has not requested the permission of the National Bank of Serbia. The Bank calculates the minimum capital requirements for these risks by using the standardized approach.

5.6. Exposures Arising from Equity Investments in the Banking Book

- 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 subsidiaries, the Bank also holds minority equity investments in companies, which enable it to perform certain types of financial services.
- Equity stakes are initially assessed at purchase price and at the balance sheet date at market value, if the same is known. The changes in market value are stated within the capital, credited or charged to revaluation reserves until the disposal of the funds when the revaluation reserves are transferred to income or expenses.
- In case when equity stakes record a fall in fair value, with the objective evidence of impairment of assets (long and continuous decline in value over a period longer than twelve months, as well as decline in value above 30% of assets purchase price), accumulated loss is recognized as an impairment charge, although the recognition of a financial asset has not stopped, (IAS 39.59, IAS 39.67 and IAS 39.68).
- 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 capital for which there is no active market are valued at purchase price.

Exposure per investment purpose as of 31.12.2012 RSD 000

Equity investments in banking book	Carrying value	Allowances	Fair value	Realized gain/loss	Unrealized gain	Unrealized loss
Subsidiary legal entities in the country	140.000	-	140.000	-	-	-
Subsidiary banks abroad	5.340.888	-	5.340.888	-	-	-
Banks and financial organizations	136.236	25.266	110.970	19.472	-	-
Companies and other legal entities	451.430	421.688	29.742	57.312	762	-
Foreign entities abroad	295.433	-	295.433	-	295.433	-
Total	**6.363.987**	**446.954**	**5.917.033**	**76.784**	**296.195**	**-**

Exposure value as of 31.12.2012 RSD 000

Exposure type	Carrying value	Fair value
Holdings and investments in capital	**6.363.987**	**5.917.033**
quoted on stock exchange	432.058	355.275
not quoted on stock exchange	451.041	80.870
Subsidiary legal entities	5.480.888	5.480.888
Total	**6.363.987**	**5.917.033**

- In 2012, the Bank did not achieve realized gain / loss which arise from sale or from closing the positions based on equity investments.
- Long and continuous decline in value of individual equity investments amounting to RSD 76,8 million is recognized as an impairment charge in Income Statement.
- Total unrealized gain/loss originating from equity investments is shown in the table, while the amount of unrealized gains which is included in calculation of supplementary capital is reduced by 10%. Unrealized losses are not reduced when included in supplementary capital.

5.7. Banking Group

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

Members of the Banking Group

  - Komercijalna banka AD Budva (100% owned by the Bank),
  - Komercijalna banka AD Banja Luka (99,99% owned by the Bank),
  - Investment Fund Management Company Kombank INVEST AD Beograd (100% owned by the Bank)

- The parent bank does not have related entities to whose financial statements the method of proportional consolidation and equity method would be applied or which would be excluded from consolidation because of a Group member's participation that represents a deductible item from the Group capital.

5.7.1. Overview of Differences between Consolidated Financial Statements

		Consolidation for supervision		Consolidation pursuant to IFRS	
Company type	Company name	Consolidation method		Consolidation method	
		Full	Equity method	Full	Equity method
Bank	Komercijalna banka AD Beograd	X		X	
	Komercijalna banka AD Budva	X		X	
	Komercijalna banka AD Banja Luka	X		X	
Investment Fund Management Company	KomBank INVEST AD Beograd		X	X	

5.7.2. Legal or Other Impediments for the Transfer of Capital

- There were no legal or other impediments in the previous period for a timely transfer of capital and settlement of obligations between the parent bank and subsidiary companies within the Banking Group business operations.
- In the forthcoming period, the parent bank does not expect any difficulties in the cash flows between the Banking Group members or any legal and other impediments in business operations.