REPORT

on Disclosure of Komercijalna banka Group A.D. Beograd
Data and Information for 2011

Report number	01
Document code	KOMBANK RM – 02 - 11
Report date	23 May 2012

TAB LE OF CONTENTS

1. INTRODUCTION

- Komercijalna banka Bank Group (hereinafter: the Group) 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
Member of the Executive Board	**President of the Executive Board**

2. BANKING GROUP GENERAL DATA

- Komercijalna banka AD Beograd Group is composed of Komercijalna banka AD Beograd, as a parent bank and three subordinate legal entities:
  - 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.

3. RISK MANAGEMENT

3.1. Risk Management Strategy

- The Bank Group has established a comprehensive and reliable risk management system which allows managing all risks the Group is or may be exposed to under all business activities, which is proportionate to the nature, volume and complexity of the Group 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 Group.
- The risk management system at the Bank Group level is defined by the following official documents:
  - Risk Management Strategy and Capital Management Strategy, and Capital Management Plan,
  - Risk management policies,
  - Risk management procedures;
  - Individual risk management methodologies,
  - Other official documents.
- Risk Management Strategy regulates, in a uniform and consistent manner, management of the risk that the Group 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 parent Bank and organizational parts which implement and participate in the risk management system, as are also the bodies and organizational parts of the Group members:

The Meeting

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

The Board of Directors

  - is responsible for establishment of a single risk management system in the parent Bank and the Group, 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 internal control system;
  - defines the internal organization or organizational structure of the parent 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 parent 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;

Audit Committee

- analyzes and adopts draft risk management and internal control strategies and policies of the Group 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.

Assets-Liability Committee (ALCO)

- follows up the 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 risks management. Each Group member has the Assets-Liability Committee.

Credit Committee

- decides on credit requirements within the frameworks defined by the parent Bank acts, analyzes the exposure of the parent 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 parent Bank. Each Group member has the Credit Committee which decides within its own competences and limits.

Risk Management Function

- an independent business function responsible for risk management at the level of the parent Bank and the Group, which:
  - 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 Group is exposed in its operation;
  - informs the competent Group bodies about the risk management on consolidated basis (the Bank's Board of Directors, Audit Committee, Executive Board, Assets-Liability Committee...)

Operational Compliance Control Department

- is responsible for:
  - identification, monitoring and managing the risk of the parent Bank's operational compliance;
  - identifies and assesses at least once a year the main risks of the parent 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 Group level, and makes regular assessment of the internal control system adequacy, reliability and efficiency.

- The Bank Group members have organizational parts for risk management, assets management and internal audit.
- The Group has by its Risk Management Strategy comprised the following:
  - an overview and definitions of all risks the Group is or may be exposed to;
  - the long-term goals determined by the Group 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 Group.
- The Group 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 Group due to non-fulfillment of debtors' obligations to the Group. 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 Group is exposed to.
  - **Risk of Receivables' Decreased Value** – the risk of possible occurrence of negative effects on the financial result and capital of the Group 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 Group 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 Group 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 Group 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 debtors' financial standings.
- **Environmental risk** – the risk of occurrence of negative effects on the financial result, capital and reputation of the Group 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 Group'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 Group'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 Group is exposed to, or the risk of possible occurrence of negative effects on the financial result and capital of the Group because of the impossibility for the Group 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 Group 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 Group 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 Group, 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 Group based on court and out-of-court proceedings in connection with the Group 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 Group because of the inability for the Group 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 Group 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 Group 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 Group 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 Group 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 Group 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 Group based on losses due to options' price fluctuations on the market.

  The Group 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 Group due to the Group 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 Group due to the loss of confidence on the side of the public or the negative view of the public concerning the Group 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 Group 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 Group operates or the absence of the Group 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 and 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 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 Group 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 Group's risk exposure profile, and further impact on profitability, liquidity and net value of the Group.

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 Group members and clear delineation of the staff responsibilities in all phases of that process;
  - mode of assessing the risk profile of the Group members, 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 Group, 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 Group;
  - 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 Group is carried out in conformance with law and by-law regulations of the National Bank of Serbia.
- Group members furnish monthly reports to the Risk Management Department of the parent Bank which monitors all risk types at the Group level.

3.2.1. 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 Group 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 central banks of the Group members;
  - the process of determining the internal rating system in conformance with the Group's internal methodology;
  - the process of managing risky lending;
  - 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 Group is determined by a more acceptable risk level for the Group and, in accordance with the Risk Management Strategy, also depends on the Group'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 Group, 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 according to the regulations of the central banks of the Group member banks and the client's internal rating according to the Group methodology), and control of the extent to which the limits at the Group level 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 central banks of the Group member banks, 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 Group's internal rating system.
- Within the lending approval process, exposure relative to regulatory and internally defined limits is reviewed.
- In order to maintain the risk at acceptable level, the Group members apply 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.
- Reporting on credit risk at the Group 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 on consolidated basis, exposure to credit risk according to the Internal rating system, due receivables, risky placements and credits, collaterals, provisions…
- External reporting at consolidated level 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 Group's internal acts.

3.2.2. Liquidity Risk

- Liquidity risk management is an important segment of the Group's conscientious and safe operation. The Group 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 Group and each individual member bank level.
- The Group 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 middle office function responsible for risk management at the Group level as well as by independent functions of individual members) and the liquidity risk management support process, and the process of liquidity risk taking.
- The function that independently manages the liquidity risk at the Group level carries out the following activities:
    - identifies,
    - measures,
    - monitors the compliance with the externally and internally defined limits,
    - proposes measures for risk minimization,
    - develops internal models and makes internal capital assessment for the liquidity risk, and
    - reports internally and externally on the liquidity risk management.
- At taking up the liquidity risk, the Group members and the parent bank analyze all risk indicators or identify the liquidity risk at the member and Group levels.
- Measurement of the exposure to liquidity risk is determined by the Group. It makes for this purpose the quantitative and qualitative assessment using the GAP and ratio analysis, as well as the stress test analysis of the liquidity risk, 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 all Group members in managing the liquidity risk 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.
- The parent bank has defined internal standards for managing the liquidity risk, which relate to the defined internal liquidity ratio limit, liquidity gap limits per maturity, identification and quantification of early elements of a liquidity crisis applied at the Group level and individually for each member.
- The system of external limits (prescribed by local regulators of the Group members' countries) and of internal limits (adopted by the competent Group committees) has been established for liquidity risk management. Regulatorily defined liquidity limits are observed by all members of the Group. They maintain the liquidity level above the defined minimum values by adjusting their operation with the limits defined at the Group level.
- The Group has established a process of liquidity risk monitoring and control. The process involves monitoring of the business activity compliance with the defined limit system so as to enable maintain the liquidity risk at the level accepted by the defined risk profile of the Group, as well as the monitoring of how the measures are implemented. The liquidity risk monitoring and control have been established and integrated in all business activities of the Group and at all levels of liquidity risk management, as has also been established an independent control of the adequacy, reliability and efficiency of the liquidity risk management system.
- The Group applies the following techniques in the risk mitigation process: reduction, diversification, transfer and avoidance.
- The Group has established system for liquidity risk reporting, which enables timely notification of the Group management and the competent bodies and organizational parts of its members. The reporting system also 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.

3.2.3. Interest Rate Risk in the Banking Book

- Primary objective of interest rate risk management of the Group is to preserve the economic value of the Group'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 Group has adopted the good practice as a recommendation of the Basel Committee in the interest rate management process.
- The Group 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 at the Group level performs:
  - identification,
  - measurement,
  - limit monitoring,
  - proposes measures for minimization,
  - develops models and makes internal capital assessment for interest rate risk, and
  - makes internal and external reporting on interest rate risk management.
- Measurement of the Group's 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 and stress-testing, which are carried out semi-annually as a minimum in regular circumstances for doing business. Measurement of the exposure to interest rate risk of individual Group members has been established to take place on a monthly level as minimum.
- Basic principles for interest rate risk management 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 in regular and extraordinary conditions for doing business, 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.
- In the interest rate management process the Group applies the system of external limits (defined by local regulations of the countries of the Group members) and internal limits (adopted by the competent Group bodies) defined individually for the members, as well as the global limit at the Group level. At defining the level of exposure to interest rate risk, the Group takes into account several interest rate risk aspects by limiting the negative effect on the financial result and economic value of the capital. At the Group level are defined the limits of interest-bearing items 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 Group, as well as the follow-up of implementation of the measures. The internal system of interest rate risk management is integrated in all Group activities, as is also the independent control of adequacy, reliability and efficiency of the interest rate management system.
- In conformance with the established system of reporting on the Group's interest rate risk, the Group Management and competent committees and organizational parts of the Group members are regularly kept informed thereon. The reporting system also 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.

3.2.4. Market Risk

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

Foreign Exchange Risk Management

- The purpose of managing the exchange rate risk is to ensure safe operation of the Group through minimization of the negative effects of the exchange rate on the Group's financial result and capital, for the positions maintained in the Banking Book and the Trading Book.
- The Group 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, at the level of the Group and individual member banks.

- Foreign exchange risk measurement represents a quantitative and qualitative assessment of the Group's exposure to foreign exchange risk. For this purpose are used the gap and ratio analyses that are made on a monthly basis, stress testing that is carried out semiannually as a minimum in regular conditions for doing business, and more frequently in extraordinary conditions. The parent Bank performs monthly measurement of foreign exchange risk by using the Value at Risk methodology. Back testing is done semiannually at the Group level.
- The basic principles for foreign exchange risk management of the group encompass:
  - maintenance of FX risk level within the externally and internally defined limits at which is minimized the negative impact of inter-currency changes on the market. The Group 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 in regular and extraordinary conditions for doing business, 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 Group applies the system of external (regulatorily prescribed) and internal limits (adopted by the Group's competent bodies), established on the basis of FX risk ratio at the Group level and the level of each member bank. 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 Group's financial result and capital.
- The Group 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.
- A system for monitoring and controlling the limit and for implementation of the measures for minimizing FX risk has been established at the level of the Group and its members.
- The Group has established a process of monitoring and reporting on the effects of implementation of the measures and techniques applied to mitigate the risk through regular reporting to the competent committees and bodies, a clear division of responsibilities, and has defined the rules with respect to the frequency of reporting on implementation of the measures adopted for reduction of foreign exchange risk.
- The Group 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 Group management, as well as the competent committees and organizational parts of the Group member banks are furnished with regular repots. 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 Group has established an adequate organizational structure, business activities, lines of decision-making and responsibilities by making a clear delineation between the front office process at the level of member banks and the Group and the middle- and back-office process, guided by the principles of risk management system organization of the Trading Book.
- Basic principles for the Group'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 Group tends to the upper limit of the accepted risk profile of the risk exposure.
- The Group has in place the system of internal limits adopted by the competent Group bodies, both at the Group level and the level of individual members. At the Group level have been defined: the exposure limits for all positions of the Trading Book as well as the limits of the Trading Book share in total operations of the Group.
- The price risk of the Group is mitigated on a continued basis by maintaining the risk at the level acceptable for the risk profile, as well as by establishing and applying adequate measures and techniques. Definition and application of adequate measures of protection and prevention, definition of exposure limits and application of price risk mitigating measures characterize the phase of price risk mitigation.
- The system of price risk internal control is integrated in all business activities of the Group, 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 Group's price risk, external and internal reporting is performed by which the National Bank of Serbia, the Group's management and competent committees and organizational parts are timely and regularly informed.

3.2.1. Operational Risks

- Operational risk management represents an important segment of conscientious and safe operation of the Group. The Group 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 and control, and report on operational risk events in accordance with the requirements and deadlines set by the regulations.
- The Group 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 Group 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 Group 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 Group are: operation in accordance with good operational risk management practices; timely identification and continuous monitoring of the operational risk event, minimization of operational risk occurrence by implementation of the measures; and provision of adequate controls for operational risk management.
- The Group 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 Group 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 catastrophes. Through the efficiently established system the Group 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 Group 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 Group, 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 Group 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 Group 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 Group has in place a system for operational risk reporting, which includes timely reporting on the 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 Group to third parties.

3.2.2. Country Risk

- Country risk management policy represents an official document which defines more specifically the system for managing the country risk to which the Group is or may be exposed in its operation, as a part of the risk management system.
- The Group 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 Group'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 Group defines the procedure for country risk monitoring and control as monitoring of the limit on consolidated level, and of the measures adopted for mitigating the country risk, as well as the control process.
- The Group has in place a system for country risk reporting on consolidated level by which the Risk Management Division timely informs the management and competent committees of the parent Bank.

3.2.3. Investment Risk

- The Group 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 Group's risk profile is determined by the acceptable risk level for the Group. The acceptable level of exposure to investment risk is in accordance with the defined Risk Management Strategy and depends on the level of the Group'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 capital investment plans;
  - correct recording of information through information systems of the Group;
  - 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 Group defines the procedure for investment risk monitoring and control as monitoring of the limit on consolidated level, and of the measures adopted for mitigating the country risk, as well as the control process.
- The Group has in place the internal and external system for reporting on investment risk on consolidated basis.

4. BANK GROUP CAPITAL

- The Group's Capital Strategy and Plan concretely stipulate and specify the implementation of the strategic objectives and guidelines for capital planning, and set the time period 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 Group 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.
- In conformance with the defined targeted values, the Group members take 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.)**	**43.190.509**
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	12.261.613
1.4.	Profit of current year	2.500.000
1.5.	Deductable items from initial capital	897.204
1.5.1.	Intangible investments	603.744
1.5.2.	Amount of bank shares taken in pledge, except preference cumulative shares	229.520
1.5.3.	Non-realized losses based on securities available for sale	63.940
1.6.	Minority stakes in subordinate companies	56
1.7.	Other positive consolidated reserves	863.491
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**	**16.004.691**
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	188.902
3.2.	Required reserve from the profit for estimated losses under balance sheet assets and off-balance sheet items of the bank	15.815.789
4.	**REGULATORY CAPITAL**	**33.038.521**

- The Group 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	**19.791.944**
Exposures to states and central banks	924.296
Exposures to territorial autonomies and local self-government units	159.905
Exposures to international development banks	–
Exposures to banks	426.976
Exposures to corporate entities	11.334.808
Exposures to natural persons	2.949.225
Exposures secured by mortgages on real property	2.256.486
Due outstanding receivables	151.384
Other exposures	1.588.864
Market Risks	**52.335**
Capital requirement for price risk based on debt securities	–
Capital requirement for price risk based on equity securities	–
Capital requirement for foreign exchange risk	52.335
Capital requirement for commodity risk	–
Operational Risks	**1.860.784**
Exposure to operational risk	1.860.784
Total capital requirements	**21.705.063**
Capital adequacy ratio (minimum 12%)	**18,27%**

- The Group 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 Group to appropriate special capital requirements for market risks.

4.1. Internal Capital Adequacy Assessment Process – ICAAP

- The Bank Group 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 Group and is regularly revised and adjusted, particularly when it is exposed to new risks or major changes.
- The Group 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 Group:
    - 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 Group is or may be exposed to in its operation;
    - ensures adequate internal capital in accordance with the Group's risk profile;
    - is incorporated in the Group's management system and decision-making in the Group;
    - 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 Group is exposed to.
- By determining the potential for risk coverage, the Group 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 Group 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 Group level to be as efficient as possible.
- The basic principles of the internal capital adequacy assessment process of the Group are:
    - establishment of the internal capital adequacy assessment process of the Group 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 Group in accordance with the volume, type and complexity of the Group operation;
    - ensuring the internal capital in accordance with the risk profile of the Group.

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 Group deals with, as well as the specificities of the markets on which it operates. In assessing the risk materiality, the Group 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 Group manages them through the established risk management system.
- The amount of the necessary internal capital is calculated for individual risks – the Group uses the methods prescribed for calculation of minimum capital requirements, as well as the internal approaches to measurement. The Group performs the stress testing for all materially significant risks and internal capital, which include the risk factors specific for the environment in which the Group 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 Group for risk inclusion in ICAAP if assessed as materially significant:

- **Credit risk, counterparty risk and settlement/delivery risk** – The Group 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 Group members use two parallel approaches:**
  - Regulatory approach – classification of the receivables according to the regulations of the central banks of the countries of the Group members 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.
  - 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 Group 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 Group has the clearly defined criteria for credit and receivable assessment and recognition, and the criteria for assessing and recognizing the provisions for contingent liabilities, 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 Group operation in the period when the loss is definitely confirmed 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 of 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 Group.
- The main elements in assessing the impairment of a 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 by 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 Group members identify 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 Group.
- 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, 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

- Provisions of the Group members 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 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
States and central banks	93,341,623
Territorial autonomies and local self-government units	2,350,821
International development banks	64,309
Banks	16,377,785
Companies	109,052,013
Natural persons	34,825,045
Exposures secured by mortgages on real property	27,284,958
Due outstanding receivables	5,467,578
Other exposures	28,125,597
Total	**316,889,730**

**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	**97,199,110**
Finance and insurance sector	64,309,577
Public sector	32,889,379
Foreign persons sector	154
Territorial autonomies and local self-government units	**2,322,423**
Public sector	1,946,736
Foreign persons sector	375,687
International development banks	**64,309**
Finance and insurance sector	64,309
Banks	**16,567,823**
Finance and insurance sector	1,553,780
Foreign persons sector	15,014,043
Companies	**94,445,408**
Finance and insurance sector	4,773,145
Public enterprises sector	1,907,105
Company sector	85,038,121
Entrepreneurs sector	477,056
Public sector	1,299,113
Foreign persons sector	600,807
Other clients' sector	121,549
Households corporate firms with employees and agricultural households	228,511
Natural persons	**32,673,879**
Finance and insurance sector	903
Public enterprises sector	1,999
Company sector	5,209,063

Entrepreneurs sector	55,667
Public sector	30,994
Households sector	24,132,385
Foreign persons sector	5,359
Households corporate firms with employees and agricultural households	3,151,021
Other clients sector	86,488
Exposure secured by mortgages on real property	**26,595,467**
Finance and insurance sector	771
Company sector	3,631,897
Entrepreneurs sector	200,670
Households sector	22,468,359
Households corporate firms with employees and agricultural households	256,738
Other clients sector	37,032
Due outstanding receivables	**1,139,080**
Company sector	828,162
Entrepreneurs sector	20,149
Households sector	252,278
Households corporate firms with employees and agricultural households	36,647
Foreign persons sector	271
Other clients sector	1,572
Other exposures	**27,346,102**
Finance and insurance sector	2,130,263
Company sector	580,393
Entrepreneurs sector	833
Public sector	9,495
Foreign persons sector	388,937
Other clients sector	72,188
Other	24,163,995
Total	**298,353,601**

**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	**1,138,395**	**12,433**
Public sector	1,138,395	12,433
Banks	**226,316**	**215,602**
Finance and insurance sector	12,389	1,675
Foreign persons sector	213,927	213,927
Companies	**102,900,329**	**2,979,049**
Finance and insurance sector	4,830,314	31,380
Public enterprises sector	745,595	1,597
Company sector	90,508,729	2,884,089
Entrepreneurs sector	518,308	2,358
Public sector	765,608	1,168
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	**26,003,301**	**771,368**
Finance and insurance sector	1,051	17
Public enterprises sector	3,946	199
Company sector	3,049,077	183,005
Entrepreneurs sector	1,125,318	41,449
Public sector	32,787	154,424
Households sector	21,354,954	309,424
Foreign persons sector	3,784	320
Households corporate firms with employees and agricultural households	323,828	71,326
Other clients sector	108,555	11,204
Exposures secured by mortgages on real property	**26,673,259**	**30,591**
Finance and insurance sector	823	1
Company sector	4,847,022	15,041
Entrepreneurs sector	205,125	1,383
Households sector	21,313,478	13,644
Households corporate firms with employees and agricultural households	266,256	519
Other clients sector	40,555	4

Due outstanding receivables	**18,093,543**	**12,696,885**
Finance and insurance sector	151,166	150,207
Public enterprises sector	125	126
Company sector	12,438,844	7,884,059
Entrepreneurs sector	256,722	214,202
Public sector	30,018	30,018
Households sector	2,356,830	1,728,498
Foreign persons sector	71,826	71,461
Households corporate firms with employees and agricultural households	327,946	232,589
Other clients sector	2,460,066	2,385,725
Other exposures	**13,323,998**	**3,495,602**
Finance and insurance sector	1	1
Company sector	696,947	30,875
Entrepreneurs sector	282,138	187,946
Public sector	3,169	27
Other clients sector	68,376	4,572
Other	12,273,367	3,272,182
Total	**188,359,141**	**20,201,530**

**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	**97,199,109**
Republic of Serbia	91,873,717
Bosnia and Herzegovina	4,754,456
Other	570,936
Territorial autonomies and local self-government units	**2,322,423**
Republic of Serbia	1,645,782
Other	676,641
International development banks	**64,309**
Other	64,309
Exposure to banks	**16,567,823**
Republic of Serbia	1,965,195
Germany	10,967,933
Switzerland	1,493,147
United States of America	786,203
Great Britain	619,211
Other	736,134
Companies	**94,445,408**
Republic of Serbia	84,312,562
Bosnia and Herzegovina	5,678,306
Montenegro	3,853,743
Other	600,797
Natural persons	**32,673,879**
Republic of Serbia	30,138,817
Bosnia and Herzegovina	1,455,787
Montenegro	1,043,116
Other	36,159
Exposures secured by mortgages on real property	**26,595,467**
Republic of Serbia	24,640,173
Bosnia and Herzegovina	1,047,161
Montenegro	899,612
Other	8,521
Due outstanding receivables	**1,139,080**
Republic of Serbia	666,969
Other	472,111
Other exposures	27,346,102
Republic of Serbia	**25,154,064**

Montenegro	1,346,332
Other	845,705
Total	**298,353,601**

**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	**97,199,110**
up to three months	67,568,982
from three months to 6 months	18,500
from 6 months to 1 year	11,964,896
over 1 year	17,646,731
Territorial autonomies and local self-government units	**2,322,423**
up to three months	379,730
from three months to 6 months	-
from 6 months to 1 year	9,955
over 1 year	1,932,738
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	**16,567,823**
up to three months	16,297,196
from three months to 6 months	-
from 6 months to 1 year	184,897
over 1 year	85,731
Companies	**94,445,408**
up to three months	9,357,003
from three months to 6 months	13,843,307
from 6 months to 1 year	13,008,322
over 1 year	58,236,776
Natural persons	**32,673,879**
up to three months	5,081,085
from three months to 6 months	1,869,628
from 6 months to 1 year	4,940,579
over 1 year	20,782,587
Exposures secured by mortgages on real property	**26,595,467**
up to three months	115,534
from three months to 6 months	164,684
from 6 months to 1 year	218,412
over 1 year	26,096,836
Due outstanding receivables	**1,139,080**
up to three months	234,332
from three months to 6 months	92,554
from 6 months to 1 year	54,365
over 1 year	757,829
Other exposures	**27,346,102**
up to three months	15,259,948
from three months to 6 months	108,897
from 6 months to 1 year	264,709
over 1 year	11,712,548
Total	**298,353,601**

**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	11,150,444	1,789,589	262	371,757	2,858,037	151,936	414,031	16,736,056
Increase	6,864,409	749,325	7,554	-	252,399	72,174	497,160	8,443,021
Decrease	(6,602,922)	(657,785)	(3,254)	(1,568)	(255,988)	(47,545)	(392,108)	(7,991,170)
Exchange differentials	203,683	13,148	49	-	(9,570)	(314)	170	207,166
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	**11,380,294**	**1,741,465**	**4,611**	**370,189**	**2,800,087**	**166,909**	**519,253**	**16,982,808**

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

Exposure according to internal category rating system and client type as at 31.12.2011 000 RSD

Risk category	Corporate clients	Banks	Retail clients	Total
1	22,535,967	14,662,531	52,376,655	89,575,153
2	68,322,642	1,796,782	4,652,441	74,771,865
3	34,706,628	40	3,813,243	38,519,911
4	1,744,669	1,175	376,812	2,122,657
5	18,006,994	1,512,006	5,389,029	24,908,029
Total	**145,316,900**	**17,972,534**	**66,608,181**	**229,897,615**

**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*

Use of credit ratings

- For the class of exposure to states and central banks the Group 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 Group 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 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

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		**93,332,566**	**97,199,110**
0	0%	91,873,871	91,873,871
6	100%	570,782	570,782
7	150%	4,754,456	4,754,456

Credit Risk Mitigation Techniques

Valuation of credit protection instruments and their managing

- The Group 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 Group member and the applicant, and their procuring after the conclusion of the agreement and prior to realization of the placement.
- The Group members regularly assess/value the collaterals prior to the conclusion of the loan agreement and during the agreement validity.
- 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 Group member can collect.

Description of basic types of credit protection instruments

- The Group is using the following credit protection instruments:
  - material credit protection;
  - non-material credit protection;
- Among the instruments of material credit protection, the Group 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 Group uses as appropriate instruments of protection:
  - cash and cash equivalents deposited with the Group members, 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 Group 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 Group 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 Group 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 Group informs the management semiannually about large exposures on consolidated basis.
- In order to manage the risk concentrations 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.
- The guarantees of the Republic of Serbia Government make up the bulk of eligible non-material credit protection instruments.

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	1,398,969	4,137,688
Natural persons	1,379,463	23
Exposures secured by mortgages on real property	6,818	–
Due outstanding receivables	13,604	–
Other exposures	2,938	–
Total	**2,801,792**	**4,137,710**

**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 Group 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 parent Bank performs transactions in the Trading Book and Banking Book in connection with:
  - financial derivatives;
  - repo and reverse repo transactions
- The Bank Group members do not perform transactions that are subject to counterparty risk.

- For the needs of calculating the exposure of the positions that are subject to calculation of the capital requirements for the counterparty risk, the Group 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 Group 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 Group 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 Group'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 Group manages the liquidity risk on a daily basis by following up and controlling its assets and due obligations, controlling the positions in all major currencies in order to have a timely idea about the needs for additional sources of financing. In the long-run, the members plan the structure of their sources and lending so as to provide enough stable sources and sufficient liquidity reserves.
- The parent Bank measures the exposure to the liquidity risk of the Group by analyzing the Group's exposure relative to the defined limits.
- The Group tests the Liquidity Management Plan in crisis situations 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 assesses the accompanying organizational support (public relations and the Plan for the case of occurrence of unforeseen events).
- The Group 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 Group 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 posiitons 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 Group measures semiannually, as a minimum, the exposure to interest rate risk by GAP and ratio analysis, interest rate shock and duration, stress tests and simulations, while GAP, ratio analysis, duration and interest rate shock are performed monthly at the level of member banks.
- For the needs of preparation of interest rate GAP, interest-bearing 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 Group 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 Group'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 Group 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 Group 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 and to the BAM, domicile currencies of the Group members.
- The Group is insignificantly exposed to the price risk, which is also demonstrated by the share of the Trading Book in total operations of the Group, which is below 1% and which is exclusively the exposure of the parent bank. The Group members do not take positions in the Trading Book.
- The Group 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 Group 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 Group is to offer a broad spectrum of financial services to clients, which also requires – apart from the products and services of the Group members – 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 parent 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 parent Bank and the member in Budva also hold minority equity investments in companies, which enables them 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 books of the parent Bank, 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 assessed 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 Group 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 Group or when delivered by the Group.

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
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	189,938	-	189,938	-	189,878	-
Total	**713,023**	**370,189**	**342,834**	-	**190,640**	**63,940**

Exposure value as at 31.12.2011 000 RSD

Exposure type	Bookkeeping value	Fair value
Holdings and investments in capital	**712,944**	**342,755**
quoted on stock exchange	261,825	261,824
not quoted on stock exchange	451,119	80,931
Securities available for sale	**79**	**79**
quoted on stock exchange	79	79
not quoted on stock exchange	-	-
Total	**713,023**	**342,834**

- In 2011, the Group 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. Consolidated Reports and Group Operation

- Financial reports of all Banking Group members are consolidated by full consolidation method in accordance with relevant IAS/IFRS.
- The parent bank does not have related persons to whose financial reports the method of proportional consolidation and stake method would be applied or which would be excluded from consolidation because of a Group member's participation that represents a deductible item of the Group 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 Group operation.
- In the forthcoming period, difficulties are not expected in the cash flows between the Banking Group members or any legal and other obstacles in operation.