One Bank One UniCredit

2017

Annual Report

Banking that matters. UniCredit Bank

VISION:

Our vision is to be “One bank, one UniCredit”: pan-European commercial bank with a simple business model, which is fully plugged in Corporate & Investment Banking, delivering our unique Western, Central and Eastern European network to our extensive client franchise. Everything we do to implement our vision is based on our Five Fundamentals. Our top priority, every minute of the day, is to serve our customers the very best we can (Customers First). To do this, we rely on the quality and commitment of our people (People Development), and on our ability to cooperate and generate synergies as “One Bank, One UniCredit” (Cooperation & Synergies). We take the right kind of risk (Risk Management) whilst being very disciplined in executing our strategy (Execution & Discipline).

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We are a simple, successful Pan European Commercial Bank, with a fully plugged-in CIB, delivering a unique Western, Central and Eastern European network to our extensive franchise of 25 million clients.
Our strategy is long-term. We are transforming the Group through decisive actions to lay the groundwork for the future, changing the way we work to anticipate our clients' medium-term evolution. Everything we do is designed to make UniCredit a true Pan European Winner.

ADDRESSING OF CEO

Year 2017 was a period which marked significant growth in all important parameters. Thanks to improved processes, and placement of additional products as well as services, each designed according to needs of our clients, we managed to further strengthen our position as one of the market leaders in terms of profitability, efficiency and productivity. We have also kept 3rd position when market share in total assets is concerned.

The Bank's net profit reached 6.782 million dinars on consolidated basis. In line with our Group's strategy which is focused on developing strong roots in local markets, UniCredit continued to demonstrate strong commitment to Serbia, as evidenced by the increase of balance sheet assets by 10% year on year to over 370 billion dinars.

Relentless customer focus contributed to increase of UniCredit Bank Serbia's customer base by 11%, both in retail and corporate. Consequently, clients' deposits grew by 4,7% in comparison to the previous year, exceeding the amount of 185 billion dinars. Even though the local market was showing narrowed creditworthy demand, our bank managed to attract new clients, and continued to show its commitment to support future development of the country. The volume of net loans in 2017 reached almost 241 billion dinars, marking an increase of 15,5%. The fact that we increased the number of employees by 3,7% reaching to 1,286 by year end proves that we are constantly investing in this market.

In 2017 we engaged extraordinary efforts to position UniCredit Bank as one of the market leader when corporate social responsibility is concerned. We have continued to involve employees in different volunteering activities throughout Serbia. As a result almost half of the colleagues participated in mentoring programs, charity initiatives and arranging environment.

These excellent overall results were supported by one initiative which we started in September 2017. Namely, we decided to embark on an exciting journey to understand more about our customers, their feelings and behaviours. We in UniCredit Bank have realized that if we want to make a difference we need to walk in the shoes of our clients in order to understand what they really care about. With the aim to win over the hearts of people, we have started the UChange initiative. When we decided to change the way of doing banking, the only thing that was clear from very beginning was that we had to give the main role to the clients. We asked ourselves who could know better than them what we could do in order to improve their experience in a branch and that was a major milestone in our UChange initiative. Together with 50 existing, prospect and ex-customers we were reshaping the way they feel in our branches. The colleagues presented them with potential solutions, which they tested and suggested the modifications. We are continuing with this initiative also in 2018 and we strongly believe that it will lead us toward excellence in all business aspects because customers are in focus of everything we do.

In 2018 we plan to continue our commitment and determination to support expected development of the country, and meet customers' financial needs by expanding our product offer by bringing new, innovative high-value-added services to all our customers. Our Bank will continue to build a long-term partnership with its customers based on trustworthiness. Customer Satisfaction remains a crucial indicator of a successful partnership with our customers in the years to come. In line with increased focus of the entire UniCredit Group and leveraging on technological developments, we will continue with the process of digitalization of our core products and services putting the new technologies in hands of our clients.

At the end, I would like to thank all our employees for these excellent achievements which would not have been possible without their commitment and engagement. I would also like to thank our clients for their loyalty, trust and for firmly believing that UniCredit Bank is their bank of the first choice.

Čila Ihas
Predsednica Izvršnog odbora

ABOUT UNICREDIT GROUP

UniCredit Group is a simple successful Pan European Commercial Bank, with a fully plugged in CIB, delivering a unique Western, Central and Eastern European network to our extensive client franchise: 25 million clients. UniCredit offers local expertise as well as an international one reaching and supporting its clients globally, providing them with unparalleled access to leading banks in its 14 core markets as well as in other 18 countries worldwide. UniCredit European banking network includes Italy, Germany, Austria, Bosnia and Herzegovina, Bulgaria, Croatia, Czech Republic, Hungary, Romania, Russia, Serbia, Slovakia, Slovenia and Turkey.

MACROECONOMIC OVERVIEW

Serbia's GDP grew by 2,0% (estimated, year-on-year) in 2017 on the back of stronger exports and investments, coupled with improved macroeconomic fundamentals in the country and positive economic outlook abroad. The economy continues to strengthen despite the drought that adversely affected the agriculture production and fall in the production of electricity in the first quarter of 2017. The economic growth is led by construction, industry and trade sectors. It is well-diversified, the level of public investment is increasing and work on improving the business climate and regulatory changes have started producing positive results. Overall increase in net exports, industrial production and investment was supported by the strengthened confidence on country's economic outlook.

Macroeconomic indicators have additionally strengthened in 2017, which led to significant decrease of country risk premium (by 190 bases points from the beginning of the year) and the National Bank of Serbia's decision to continue with the policy of monetary easing. The IMF program has received good marks mainly due to successful and consistent implementation of fiscal consolidation while the progress of structural reforms has been limited. Restructuring of public utility companies and improving efficiency of the public sector demonstrated challenging in the election year. Despite efforts of the authorities to find a solution for 11 strategic companies for which bankruptcy protection was removed in 2016, most of these companies are still waiting for the solution. Fiscal risks from unresolved strategic companies and public enterprises remain high and pose risk to the debt sustainability.

Serbia has made solid progress in accession negotiations with the EU this year: six additional chapters were opened (culture and education, entrepreneurship and industrial policy, intellectual property, customs union, company law, foreign economic relations) and the progress in implementation of the agreement on judiciary was reached with Kosovo. EU is focusing on the judiciary, the rule of law, media freedom, fighting the corruption and progress in dialogue on Kosovo before further chapters are opened.

Serbia moved up four places on the World Bank "Doing Business" list, mainly due to improvement of procedure in granting the construction permits and simplifying the tax procedure for business start-ups, although results are still weak in some areas, such as getting an electricity connection to the network.

Fiscal consolidation measures introduced at the end of 2014 supported by the three year precautionary agreement with the IMF have produced results better than expected so far. The central state recorded surplus of 79,8 billion dinars (2,5% GDP) for the period January - October 2017, which is 50% better result compared to the same period last year and is in line with the projected fiscal deficit of 1,0% for 2017. This result was supported by reduced current expenditures as well as significant improvement in revenue collection. While the austerity measures have produced good result so far, good performance is required to continue in 2018 and beyond in order to keep a persistently high public debt (62,6% in November) on a downward path.

Current account deficit has increased in 2017 by 18% to estimated 4,8%, mainly due to higher imports of electricity and increase in private consumption. Strong inflows of foreign investment and dinar strengthening has reduced the external financing vulnerability, with the deficit fully funded by FDI in 2017. In 2017 FDI flows have increased and amounted to 2,2 billion euros. Foreign currency reserves represent 6 months of current external payments, providing a relatively good buffer against any external shocks.

Decreasing trend of Serbia's foreign trade deficit was interrupted in 2017. In January-October 2017 foreign trade exchange reached 28,4 billion euros which is 13,7% growth year–on-year. Foreign trade deficit is 15,4% higher year–on-year and has reached 3,3 billion euros. Imports grew faster than exports during 2017 (13,9% year–on-year vs. 13,5% year–on-year). Export-import ratio was reduced to 78,9% (79,2% for the same period in 2016). The major foreign trade partners in exports for period January - November 2017 were: Italy (1,8 billion euros), Germany (1,7 billion euros), Bosnia and Herzegovina (1,1 billion euros), Romania (0,7 billion euros) and the Russian Federation (0,9 billion euros).

Inflation has moved within the target tolerance range (3±1,5%) throughout 2017, partly due to lower target inflation and partly due to increase in oil and electricity prices assisted with the recovery of aggregate demand and inflation abroad. Average inflation for 2017 amounted to 3,1% while core inflation has been low and stable (average 1,7%).

Unemployment fell to 13,4% mainly due to the increase in inspection oversight and measures taken by the government to curb the grey economy. Average monthly net salary in 2017 was 392 euros recording nominal year-on-year increase of 3,6%, and real increase of 0,4%.

Implementation of reform laws adopted in 2016 and 2017 has started producing positive results: better tax collection, introduction of new electronic services for citizens and business and more efficient procedure for registering real estate. The authorities are also working on introducing e-building permits system nationwide, creating integrated inspection information system, introducing measures for curbing the grey economy, strengthening public investment management system and implementing e-government strategy. Public administration rightsizing target was met by strictly enforcing an employment attrition rule, business start-ups have received tax relief in the first two years of operating, while e-business is modernizing the way business is done in Serbia following adoption of legislation on e-business and e-government.

Strengthen and optimise capital.

Following a € 13 billion capital increase, we confirmed a 2019 fully loaded CET1 ratio target above 12.5 percent and an organic capital generation that will fully absorb the expected regulatory impacts: our capital position is stronger and in line with best in class G-SIFIs.

SERBIAN FINANCIAL SECTOR

BANKING SECTOR

After a period of turbulence caused by the world financial crisis, Serbian banking sector has slowly entered the recovery zone during the last two years, leaning on established macroeconomic stability, revival of economic growth, conducted structural reforms, increased public investments and domestic and foreign demand growth. A low inflation environment over a multiyear period has led to further monetary policy easing in 2017 by the Serbian National Bank via two 25 basis point rate cuts to a level of 3,5%, which in turn significantly reduced the local currency lending rates. At the same time the expansionary monetary policy of the European Central Bank has contributed to a further decline of euro-indexed interest rates.

During this period, increased market competition together with limited organic growth opportunities and harsher survival conditions has inevitably led to further bank consolidation on the market. Only in 2017, a total of five banks had changed their ownership, out of which four banks have been taken over by competitors already present on the Serbian banking sector. Acquisitions of banks by local buyers represent a sign of a stable banking sector which is capable of facing risks and which has favorable outlooks in terms of lending acceleration in the period ahead. Moreover, an improved macroeconomic environment coupled with a better business and investment climate and higher country rating of the Republic of Serbia have attracted new international banks to enter the Serbian financial market in form of green-field investments.

The banking sector finished the third quarter of 2017 with 30 commercial banks and total net assets of 3.293 billion dinars, posting a nominal growth rate of 3,8% compared to the same period last year. Net loans and receivables, the most dominant asset category, recorded a year-on-year expansion of 8,2%, mainly driven by a dynamic growth in the retail sector. In gross terms, total loans expanded 5,0% year-on-year despite the NBS Decision on accounting write-offs of bank balance sheet assets which led to significant NPL write-offs in September 2017. During that period retail lending has grown 11,4%, while corporate loans posted a 0,1% increase. The demand on the retail side was driven by cash and refinancing loans together with a recovery in mortgage lending. Although most housing loans relate to new lending, there is a visible trend of existing mortgage loan refinancing, which can be attributable to opportunities of loan repayment under favorable conditions in the period characterized by low interest rates and intensive market competition. Regarding the corporate sector, the growth was driven mainly by working capital loans and to a smaller extent investment loans.

Compared to the year-end 2016 level, the “dinarization” of loans has somewhat improved, given that the share of dinar loans in total corporate and retail lending in the first nine months of 2017 increased by 1,2 percentage points to 32,4%. Private individuals continued mainly to take out dinar loans, since 71% of new loans disbursed to private individuals were in local currency, which led to the fact that over half of total outstanding loans to private individuals is currently in dinars. The share of dinar loans to corporates decreased as of September 2017 to a level of 17,5% mainly due to the mentioned accounting write-offs in the same month. Bank deposits continued to grow in 2017, posting a nominal expansion of 4,3% and ending the third quarter at a level of 2.527 billion dinars. Deposits still represent the main source of funding of Serbian banks with a share of 69% in total liabilities.

At the end of the third quarter of 2017 the banking sector employed 23.342 people, which represents a reduction of 505 employees compared to the level at the end of 2016. The branch network consisted of 1.671 different organizational units, down by 48 units in comparison to the beginning of the year.

In order to harmonize the domestic regulation with the legislative framework of the European Union in the field of banking supervision, as of June 30th 2017 the National Bank of Serbia has introduced new regulations in line with provisions of the Basel III accord. The most significant changes included the reduction of the minimum capital adequacy ratio from 12% to 8% and the inclusion of additional capital buffers. At the end of the third quarter of 2017 the average capital adequacy ratio of the banking sector amounted to 22,5% which is significantly higher than the required minimum of 8% and 1,3 percentage points higher than the year before.

The year 2017 was crucial in the effort to reduce the problem of non-performing loans in the Serbian banking sector, for which both absolute and relative indicators have been significantly reduced in the first nine months, mostly owing to the Decision on the accounting write-off of bank balance sheet assets. Under this Decision, the banks were obliged to write-off all loans where the gross book value was fully covered with allowances for impairment, which resulted in write-offs in amount of 53,6 billion dinars in September 2017 alone, outpacing the NPL write-offs for the entire 2016 by 7,9 billion. Looking at the first nine months of 2017, the total gross NPLs were reduced by 94,4 billion dinars (27,3%), out of which 70% of the amount related to corporate clients and clients in bankruptcy proceedings. Based on those effects and the acceleration of lending activity, the NPL ratio was reduced to 12,2% at the end of September, which represents its lowest level since January 2009. The ratio is 4,8 percentage points lower compared to 2016 year-end level.

Given that the banking sector is oriented towards international standards and sound risk management principles, the banks continued to add provisioning levels in order to provide insulation against credit losses, covering the NPL’s with more than 62,2% with IFRS provisions, despite the high level of write-offs, and 127% with NBS provisions.

The profitability indicators of the Serbian banking sector continued to improve as of third quarter 2017. The aggregated profit of all thirty banks amounted to 53,5 billion dinars and recorded a 63% year-on-year increase. The improvement is mostly attributable to a decline in net credit losses due to lower expenses of indirect write-offs of on-balance sheet positions in comparison to third quarter 2016. At the same time the banking sector recorded lower net interest income, while net income from fees and commissions increased by 8,8%. The Return on assets (ROA) indicator reached 2,2% at the end of the third quarter of 2017 (third quarter 2016 1,4%), while in the same period the Return on equity (ROE) indicator amounted to 11,0% (third quarter 2016 6,9%).

The banking sector is expected to expand at modest but steady rates in the following years, facilitated by the effects of monetary policy easing, a rise in economic activity and low interest rates environment. Fixed investments in large infrastructure projects, growth of export and private consumption supported by growth of wages, will remain the key drivers of the lending activity. Positive effects can also be expected based on the intensive activities of banks relating to the reduction of NPLs, since their reduction frees up credit potential and gives incentives for a relief in credit standards, which will support the economic growth. Modest improvement in revenue generation is expected, while a strong pressure on NII margin deriving from intense market competition will continue to represent the main challenge in the period ahead. Profitability will be driven by lower Cost of risk, as NPL ratio will keep the downward trend. Additionally, it is almost certain that the consolidation trend of the banking sector will continue and that new players will enter the Serbian financial market.

LEASING SECTOR

The positive trend in financial leasing activity was recorded throughout 2017 due to increase in demand which was driven by the recovery in the economic activity, increase in earnings in the private sector and improved outlook of the economy.

At the end of 2017, according to the statistics of National Bank of Serbia, 16 financial leasing companies were operating at the Serbian market with total gross assets reaching 71,9 billion dinars. The receivables from finance lease make the largest share of total balance sheet assets (88,2%) at the end of third quarter 2017. These claims in absolute terms amounted to 63,5 billion dinars at the end of third quarter 2017, and were 11,6% higher compared to the end of 2016 (56,9 billion dinars).

The leasing sector recorded a profit before tax of 789,2 million dinars at the end of third quarter 2017, which is 18,7% lower than in 2016, due to lower interest income and higher net expense from foreign exchange differences as a result of local currency strengthening. Eleven financial leasing companies were profitable while five recorded a negative result. ROA decreased to 1,5% at the end of third quarter 2017, down from 2,1% at the end of third quarter 2016. Also, the rate of return on total equity (ROE) at the end of third quarter 2017 amounted to 11,80%, a decrease compared to the end of 2016 when this indicator stood at 15,59%. Number of employees in the financial leasing sector at the end of the quarter totaled 359, which is 6,3% lower than at the end of 2016.

Financial leasing institutions are still financing mainly freight vehicles, minibuses and buses (35,2%) and passenger vehicles (30,6%), while financing is mainly concentrated in the following sectors: transportation, storage, information and communications (29,0%). Significant participation at the end of third quarter 2017 had trade sector (17,6%), construction industry (14,1%) and manufacturing industry, mining and water supply (13,2%).

Net interest margin was reduced compared to 2016 and amounted to 3,33% at the end third quarter 2017. The average active interest rate was reduced at the end of the third quarter 2017 and amounted to 4,64%, as well as the average passive interest rate, which at the end of the third quarter of 2017 stood at 1,31%.
In 2018, further growth in financial leasing market is expected, as the economy and domestic demand continues to recover. The growth is expected predominantly in vehicle product segment, construction industry and transportation and logistics industry. More favorable interest rates and simplified processes are likely to bring more interest for financing through leasing in coming period.

FINANCIAL PERFORMANCE OF UNICREDIT SERBIA GROUP IN 2017

UniCredit Serbia Group			
in thousands RSD	**2017**	**2016**	**Change**
Income statement			
Net interest income	12.636.571	12.325.461	0,3%
Net fees & commission income	3.006.788	2.731.200	10,1%
Other net non-interest income	2.089.001	1.761.127	18,6%
Operating expenses	-7.537.981	-7.212.318	-4,5%
Net impairment loss on financial assets	-2.626.765	-3.011.705	12,8%
Profit after tax	6.781.517	6.272.778	8,1%
Balance sheet			
Loans and receivables to banks	11.884.983	18.490.432	-35,7%
Loans and receivables to customers	240.608.342	208.339.473	15,5%
Deposits and other liabilities from banks	106.676.158	86.460.699	23,4%
Deposits and other liabilities from customers	186.658.833	178.232.370	4,7%
Equity	70.144.383	64.859.905	8,1%
Total balance sheet assets	370.780.331	337.402.324	9,9%
Capital adequacy**			
Total risk weightes assets	263.992.015	229.733.969	15,8%
Regulatory capital	49.266.229	39.507.991	23,0%
Capital adequacy ratio	18,7%	17,2%	+146 bp
Key performance indicators			
Cost/income ratio	43,2%	42,9%	+29 bp
ROA (Return on assets after tax)	1,9%	1,9%	-0 bp
ROE (Return on equity after tax)	10,0%	9,9%	+17 bp
Loans to Deposits ratio	129%	117%	+1.201 bp
Assets (avg)/Number of employees (avg)	280.247	269.712	3,9%
Cost of risk	1,2%	1,5%	-35 bp
Resources			
Number of employees	1.286	1.241	45
Number of branches	71	71	-

*** Data for 2017 only available for Unicredit Bank Srbija JSC on standalone basis**

UniCredit Bank has further strengthened its position in the banking sector during 2017, thanks to its orientation towards continuous growth and increase in market share. According to third quarter 2017 data, with total balance sheet of almost 360 billion dinars, bank kept 3rd position in the sector in terms of total assets, which present historically highest market share of 10,9%. Driven by strong year-on-year growth of loans of 13,6%, bank significantly increased market share in Net loans to customers, from 11,5% at third quarter 2016 to 12,0% as of third quarter 2017, considerably entrenching its second position in loan portfolio ranking on the market. Growth is driven by both excellent lending activity to private individuals and successful performance of corporate sector. Beside other achievements, the latter is confirmed also by the realization of the biggest ever single purchase of receivables transaction on the local market.

At the same time, Bank has continued with successful management of Non-performing receivables, which is evidenced by significant decrease of NPE ratio, dropping to 7,2% as of September 2017 from 14,0% at the end of September 2016, also being well below sector average of 12,2%. In this regard, significant positive effects on P&L are realized, due to prudent recognition of income from loans that are overdue more than 90 days

Strategic focus on quality of service and customers satisfaction enables Bank to constantly enlarge its clients' base, achieving 11% year-on-year growth as of end 2017. At the same time, excellent results are made in increasing number of active users of internet and mobile banking, thanks to successful implementation of digital banking models.

UniCredit Leasing continued with the expansion, increasing its market share in new business to 13% as of end of September 2017. Driven by growth of customer loans standing at the end of 2017 at 15% higher level compared to the end of 2016, UniCredit Leasing recorded year-on-year growth of total assets of 16%, steering its business mainly towards financing of large and medium enterprises with constant effort on increasing its market share in small business segment.

UniCredit Partner confirmed its successful performance at the end of 2017, by recording 12% higher operating income from agency in insurance, compared to the end of 2016.

FINANCIAL PERFORMANCE OF UNICREDIT SERBIA GROUP IN 2017 (continued)

UniCredit Serbia Group completed business year 2017 with excellent results, achieving historic high level of net profit after tax amounting to 6,78 billion dinars, with return on equity of 10%. Earning capability is confirmed by recording 3,8% year-on-year growth of total revenues, mainly driven by strong increase in net fees and commission income of 10% and double digit year-on-year growth of income from trading of financial instruments, keeping one of the leading position in that segment on the market. At the same time, UniCredit Serbia Group has also preserved high standards in terms of productivity and efficiency by increasing average assets per employee for almost 4% year-on-year and containing the cost to income ratio at previous year level of 43%. During the 2017 further improvement of asset quality was achieved, which resulted among other in decreasing of cost of risk for 35 bps by the end of 2017 compared to the end of previous year.

With total capital adequacy ratio of 18,7%, UniCredit Serbia Group holds solid capital base, almost fully comprised of high quality common equity tier 1 instruments and significantly exceeding regulatory requirements for maintaining of total combined capital buffers.

In spite of strong negative trend in the sector, UniCredit Serbia Group has increased number of employees confirming its orientation towards constant growth and positioning as an employer of choice on the market.

STRATEGY FOR PERIOD 2018-2020

Main strategic aim of the Bank for the next three years is further improvement of the one of the top market player position, relying on strong operating profitability, efficiency and sound risk management practices supported by excellent customer satisfaction, based on following key elements:

Customers – focus on existing clients and acquisition of the new ones, by offering high quality products and services;

Products – further improvement of products and services, with clear focusing on selected products, but also on the development of new and innovative ones based on the specific customer's needs;

Channels – further development of alternative sales channels, acceleration of digital transformation process together with synergy of Corporate, Retail Divisions and Leasing;

Operating model – major processes and system improvements leveraging on changing market environment and

Risk Management – maintain and improve portfolio quality along with strengthening of common risk culture among all Bank's employees.

UniCredit Bank Serbia, as member of UniCredit, participates in the Group "Transform 2019" Program, which assumes implementation of several strategic initiatives with the aim to further strengthen market position by driving forward the digital transformation, by acquiring new international CIB and Retail customers, by constant cost management as well as applying a strict risk discipline.

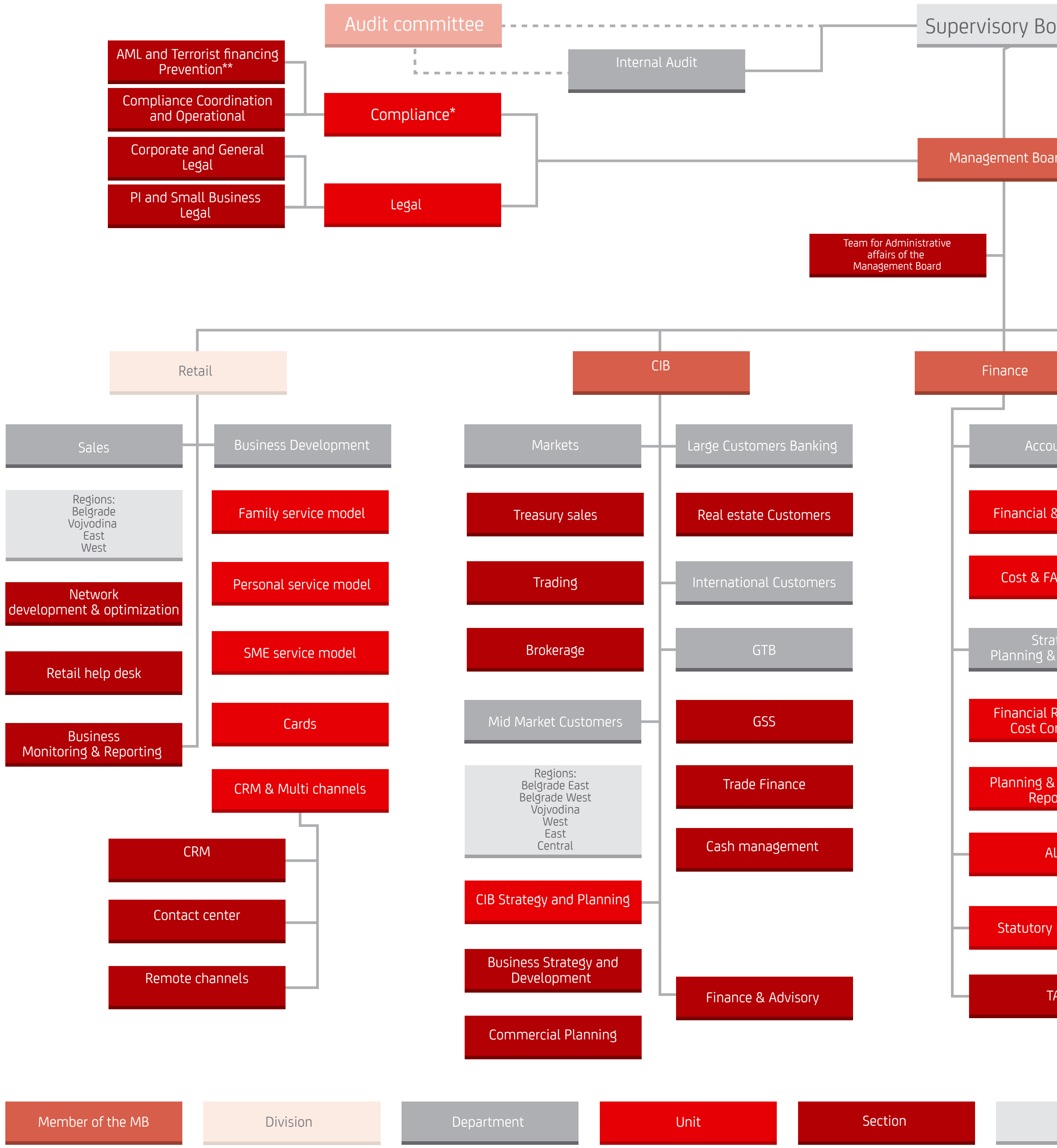
Multi-Year plan of the Bank assumes full application and alignment with all regulatory requests and set limits followed by balanced growth. Plan also assumes keeping strong track record of out-performance in terms of business growth, operating profitability and efficiency, with focus on process and system improvements, along with aim to improve portfolio quality together with enlargement of active client base, in order to enable sustainable growth.

Improve asset quality.

We addressed Italian legacy issues through the sale of a € 17 billion portfolio (FINO) and proactive bad loans management. A more disciplined risk management strategy and underwriting processes are driving significant improvements in all our asset quality metrics.

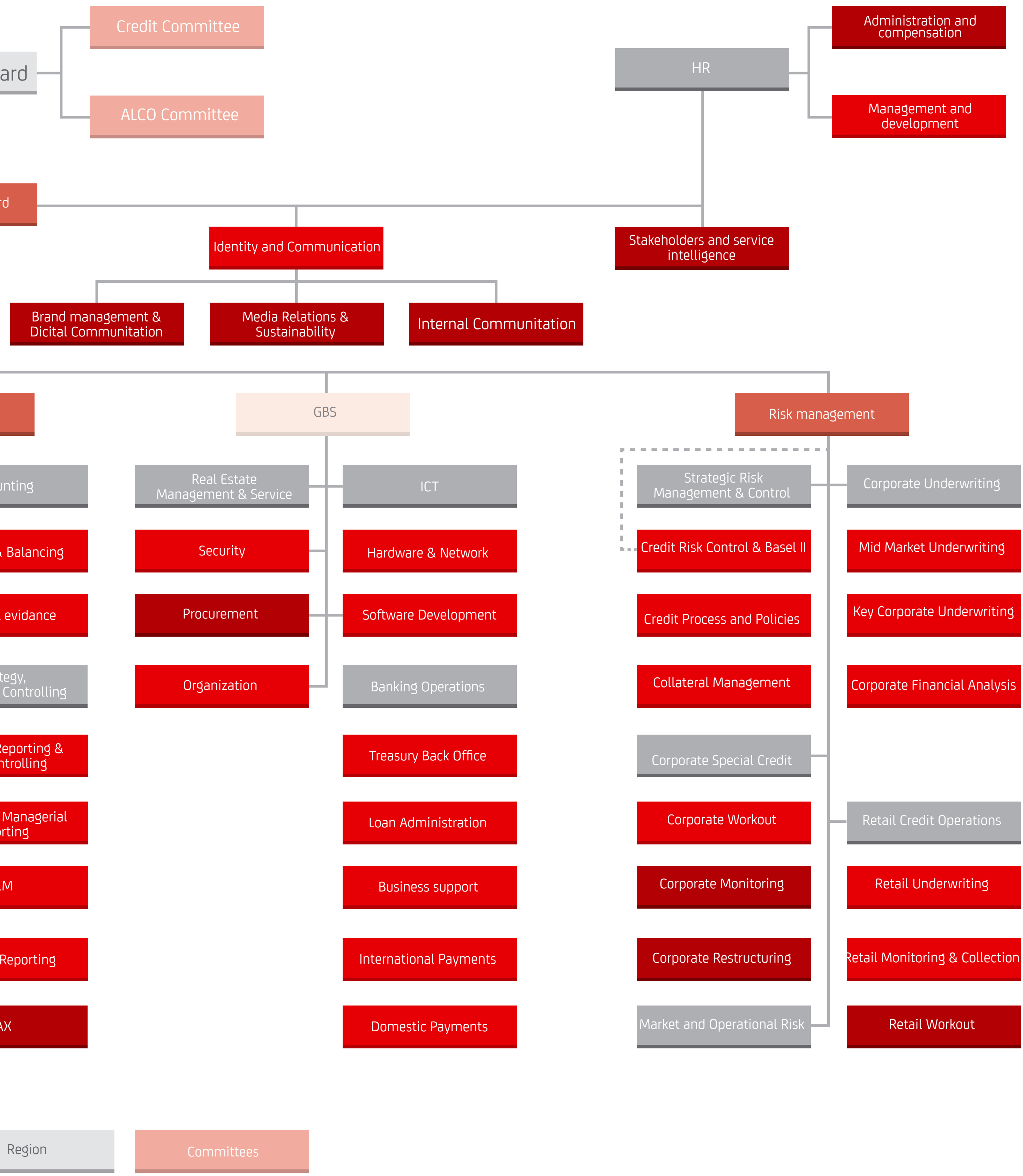
ORGANISATIONAL STRUCTURE OF UNICREDIT SERBIA GROUP

ORGANISATIONAL STRUCTURE



*Compliance section- Reporting to the Audit committee and Management Board and Supervisory Board if needed

**AML section- Reporting to the CEO



Credit Committee
ALCO Committee
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Administration and compensation
HR
Management and development
rd
Identity and Communication
Stakeholders and service intelligence
Brand management & Dicital Communitation
Media Relations & Sustainability
Internal Communitation
GBS
Risk management
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Real Estate Management & Service
ICT
Strategic Risk Management & Control
Corporate Underwriting
Balancing
Security
Hardware & Network
Credit Risk Control & Basel II
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Business support
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Retail Underwriting
Reporting
International Payments
Corporate Restructuring
Retail Monitoring & Collection
X
Domestic Payments
Market and Operational Risk
Retail Workout
Region
Committees

ORGANISATIONAL STRUCTURE

ORGANISATIONAL STRUCTURE

As of 2016, members of UniCredit Group Serbia besides UniCredit Bank Serbia JSC are UniCredit Leasing Srbija doo Beograd and UniCredit Partner doo za zastupanje u osiguranju Beograd. Following UniCredit Group entities were performing business also in Serbia in 2017: UniCredit Rent, UCTAM and Ambassador Parc Dedinje doo, which are representing parties related to the Bank.

UNICREDIT BANK SERBIA JSC. BEOGRAD

SUPERVISORY BOARD
Csilla Ihász, Chairperson
Spas Vidarkinsy, Member
Boris Begović, Member

MANAGEMENT BOARD
Ana Milić, Chairman
Ratko Petrović, Member
Vladimir Aljinović, Member

UNICREDIT PARTNER DOO
Zvonko Buden, Director
UniCredit Partner has no Supervisory or Management Board.

CORPORATE INVESTMENT BANKING (CIB)

Growth of the economic activity driven by exports and investments, stable macroeconomic environment and further easing of monetary policy stimulated the credit activity of the corporate sector in 2017, particularly in the second half of the year which recorded 0,1% annual growth despite significant write-offs of NPLs (6,5% growth once effect of non-performing loans write-off is excluded from the calculation). The growth is predominantly the result of the credit activity increase of private companies with 90,8% share in total assets of the corporate sector.

According to its purpose, corporate loans were mostly approved as working capital (46%), followed by investment loans (30%) in 2017. The break down by sector shows that the growth was led by enterprises from manufacturing, trade and construction sectors. The share of dinar loans to the economy declined by 2 pp to 17.5%, largely due to the write-off of dinar loans in 2017. Loans in euros and indexed in euros still account for the lion's share of loans to the corporate sector (80%), while the share of loans in the US dollar and Swiss francs is decreasing (1,3% and 0,6% in the loan portfolio respectively).

Downward trend in interest rates continued in 2017 due to the easing of the monetary policy of the NBS, reduction of the country's risk premium, increase in banks' competition on the credit market and reduction of interest rates on the international money market in case of interest rates on euro-denominated loans. The interest rates on newly approved dinar loans at the end of 2017 amounted to an average of 5,9%, while the interest rate stood at 3,0% on the Euro and Euro-indexed loans.

Non-performing loan (NPL) rate for corporate sector was substantially reduced to 13,2% (18,7% in 2016) as banks off-loaded a portion of bad loans through sale, restructuring, write-off and recovery. Additionally, NBS Decision on accounting write-off of the balance sheet provided additional stimulus to banks to continue working on the reduction of non-performing loans. Proportion of NPLs is still high and NPL resolution strategy is yet to be implemented fully.

The new credit demand was mainly driven by the need to finance working capital and restructure debt and makes up almost 50% of total new corporate loans. However positive trend in investment loans market indicates better overall conditions on the credit market and the economy. Nevertheless, operating in the environment of low interest rates and compressed spreads presented the Serbian corporate banking sector with a unique set of challenges.

Despite these challenges, UniCredit Bank Corporate and Investment Banking was focused on opportunities and remained committed to the strategy of portfolio consolidation with emphasis on de-concentration of credit risk and selective approach with focus on SME clients. As a result, the loan portfolio amounted to around 145 billion dinars with a 7% year on year increase and 4.554 client base.

Deposit position was strengthened through various commercial activities that produced a significant increase of volumes in transaction banking. This resulted in an 8% year–on-year growth in deposits, reaching the amount of 122 billion dinars and significant growth in the number of recorded transactions.

Markets Department solidified its leading position in the local market. National Bank of Serbia's official data for 2017 indicate that UniCredit Bank's Markets Department is the first in providing F/X services to residents and non-residents with 17,7% and 37,8% market share, respectively. Furthermore, UniCredit Bank ranked second in transaction volumes in interbank exchange in euros with a 12,9% market share. Overall revenues of Markets Department posted a year-on-year growth, continuing the positive trend established in previous years.

During the 2017 the Bank continued its effort to promote hedging products, as a way to shield businesses from interest rate and FX fluctuations by offering interactive workshop for both large enterprises and medium-sized companies. The Bank continues to be ahead of the competitors with its innovative approach, and affirmed its leadership in the designing and marketing of these products. UniCredit Bank remained market leader in trading with financial instruments on both primary and secondary markets with a market share of 21% and 24%, respectively.

In 2017 UniCredit Bank supported small and medium sized business with special SME credit lines, and in doing so contributing to Government-led initiative for strengthening SME sector. The focus on SMEs will continue in 2017, as we implement InnovFin and COSME Program funded by the EU and EIB and Women in Business Program in cooperation with EBRD. We will also support Energy Efficiency projects through the joint initiative with Green for Growth Fund.

In 2018, CIB will continue with the strategy of selective portfolio growth and creation of economic value for Bank by increasing the return on risk-weighted assets through increased cross selling. Division will seek to increase market share in segments with lower penetration rate and foster long-term partnership with existing customers based on reciprocity and trustworthiness. Furthermore, CIB remains committed to continuous improvement of internal efficiencies through the process of evaluation and optimization. The Bank's business activities will be focused on stimulating the development and supporting the recovery of local economy by expanding our innovative value-added products proposition and advisory services to clients. Furthermore, the Bank will also continue close cooperation with regulators including National Bank and Ministry of Finance, thus actively supporting the improvement of domestic business environment, as well as all development initiatives.

Client centricity will continue to drive our focus and ambition of bringing economic value to our clients in aim to produce higher

CORPORATE INVESTMENT BANKING (CIB) (continued)

economic activity in our country. We will further support private and public sector including local communities, by fully exploiting our deep knowledge of the Serbian market, our Group global reach and expertise in financial products and solutions.

UniCredit Leasing, with total portfolio in the amount of RSD 7,8 billion as of third quarter 2017, holds forth place on the local market. Successful performance of UniCredit Leasing in 2017 is confirmed by recorded 49% year on year growth of gross operating profit.

Based on ALCS report on new business, financial leasing market increased by 25% compared to the previous year, with financed volume EUR 261 million at the end of the third quarter of 2017 (EUR 209 million in 2016). In the same period UniCredit Leasing realized EUR 34 million (EUR 18 million in 2016) raising its market share from 9% to 13%.

During 2017 UniCredit Leasing focused on further strengthening of SME segment, developing regional presence as well as enhancing cooperation with Vendors which led to better performance, higher market share and creation of solid base for next steps. Looking forward, we remain committed to financing vehicles in all categories, but also strengthening financing of agriculture equipment and mechanics, construction equipment and IT equipment and infrastructure.

Considering the economic environment and further development, perspectives of the leasing market in Serbia, UniCredit Leasing will seek to increase new business, maintain a good quality portfolio, improve cross-sales with UniCredit Bank in all segments, improve existing products and innovate new ones, as well as strengthen cooperation with clients and partners, by applying highly professional business standards.

RETAIL BANKING

Activities of Retail Division in 2017 were very dynamic. The growing trend was maintained during 2017, recording a growth of 13% in revenues compared to the previous year. The volume of loans and deposits have increased significantly, 15% and 7%, respectively, resulting with the increase in market share.

The Bank has been very active in the segment of Private individual and Small business clients, with the aim of strengthening and expanding cooperation with existing customers and the acquisition of new clients. Significant acquisitions led to an increase in number of clients by 11%, and is the result of a focus on customer needs and continuous cooperation with the companies.

Clients showed that they trust in Bank's product offer, service quality and reliability. Led by interest of clients, transparency remains the main pillar of Bank's daily business.

Key credit products in 2017:

- Cash loans with the insurance coverage in case of unemployment
- Housing loans with a fixed interest rate
- COSME program for Small business clients
- "Women in business" program, initiated by EBRD

Bank has introduced the pre-approval process in its housing loans offer in order to enable clients to easier and faster buy their living space. Based on the amount of income and credit obligations, the amount of funds that customers can calculate when buying an apartment is guaranteed for a period of six months.

The process of pre-approval for small enterprises and entrepreneurs continued, including all credit products from the Bank's offer.

In 2017, cooperation with the Ministry of Education, Science and Technological Development was continued through a new agreement on the payment of student loans and scholarships.

UniCredit Bank is paying significant attention to savings products, despite the current low interest rate trend. The Bank is recognized as one of the most stable and reliable banks in the local market, which is reflected in the constant increase in new deposits.

Enhancing customer satisfaction is promoted within the UChange program, which implies two-way communication with existing and potential bank clients, all in order to adapt the experience to the expectations and needs of clients, as a result of the company culture that puts the client in the focus.

In 2017, one of the most important priorities was improving digital business through the development and promotion of the digital banking platforms (mBanking, eBanking, website, contact centre). Within mBanking application, new functionality mCash was introduced, which allows customers to withdraw cash from ATMs using mobile phone.

UniCredit Bank has continued to invest in electronic channels through the installation of the latest generation of ATMs, which include services such as Exchange Office, Cash-in and Bill Payment.

In the upcoming period, the main goal is to continue with the increase of market share based on the good relationship with customers and through the offer which is exclusively created in accordance with their needs. The Bank will continue to support lending in local currency, offering particularly favourable conditions for products that do not carry currency risk. The focus will be on cash and housing loans, as well as on specially created credit offers to small businesses in order to support their further growth. Digitalization, as a concept of modernizing business, will continue to be one of the main priorities.

RISK MANAGEMENT

Within its organizational structure, the Bank has a separate Risk Division with comprehensive and very important function of maintaining and developing a stable and profitable loan and other placements portfolio. This Division covers the management of credit, market, operational, liquidity risk and other risks through the work of five departments: Strategic Risk Management and Control Department, Corporate Underwriting Department, Retail Credit Operations Department, Corporate Special Credit Department, Financial and Operational Risk Department. They all report to the Member of Management Board in charge of Risk Management, which provides increased control over all loan process phases, as well as a global overview and assessment of the risks to which the bank is exposed.

In order to define a consistent policy of lending activity and the overall framework of the risk management, the Bank defines a Retail and Corporate credit risk strategy, for each business year. In this way, the bank provides the proper realization of the adopted business policy within framework that will result in an acceptable level of credit risk when it comes to individual placements and adequate diversification and general quality of the loan portfolio. The Bank also takes into account the analysis of the risk of money laundering and financing of terrorism in deciding on taking credit risk.

During 2017 further improvement of risk management system was focused on internal organization enhancement, business processes and risk management policies in accordance with the best practices of UniCredit Group and requirements arising from the implementation of Basel standards and regulator requests.

Identification, measurement, control and risk management on the portfolio level is based on reporting system which provides information about the condition, quality and evolution of the loan portfolio. During 2017 there is a continuity of reporting process improvement through increased automation of calculation and report generation.

In the area of Basel standards the focus of activities was placed on the confirmation of predictive power of internally developed rating models and appropriate setting of credit risk parameters for the business segments: corporates, private individuals and entrepreneurs and small business clients. During 2017, the process of monitoring of PD models performance has been established as regular quarterly activity. In the beginning of 2017, calibration of PD models for entrepreneurs and small business segment was performed, in accordance with the recommendations of internal validation. A regular ongoing validations were performed for PD and EAD models.

During 2017, new credit risk models have been developed for the purpose of calculation of loan loss provisions according to IFRS 9 standard. Mentioned models have been developed according to methodologies of UniCredit Group, and they represent a new set of credit risk models. During the year, the newly developed model parameters have been used to assess the impact of IFRS 9 adoption, and they have been amended according to the instructions and methodologies received from the Group. A new tool for LLP calculation has been introduced and adjusted according to requirements of UniCredit Bank Serbia (LIC tool, provided by external vendor Ernst&Young).

Improvement of Forbearance methodological concept is carried out in order to implement the regulations of the National Bank of Serbia on this issue and to improve the regulatory monitoring and records of rescheduled/restructured loans and placements for which there are financial difficulties in repayment. During 2017 the Bank implemented Basel III standards for reporting to the National Bank of Serbia, while reporting in accordance to the Basel III was implemented in UniCredit Group since 2014.

During 2017 Corporate Special Credit has continued with active approach in decreasing of NPL stock. Besides continuing with using the sale of a single receivables as a valid NPL strategy, the Bank has also continued with the implementation of the so called accounting write-offs (write-offs without debt release). Along with an adequate regular collection activates, sale of single receivables and accounting write-offs had an additional influence on significant decrease of corporate NPL stock.

In the Retail segment, for private individuals and small business clients and entrepreneurs, the focus in 2017 was on increasing the efficiency of all of the processes, improvement of the process of monitoring and collection with the aim to increase the efficiency of the process as well as to improve collection. Credit process in small business segment is enhanced and decreased NPL stock in Retail segment through better collection and implementation of Decision of NBS of accounting write-off.

During 2017 Collateral Statistical Monitoring was successfully completed as well as further improvement of cooperation with external valuation companies, court appointed experts, insurance companies and lender supervisors. Aside from that, general improvements of collateral management processes and practice were also implemented through more agile acquisition of valuations, insurance policies, more detailed tracking of mortgage inscriptions, etc. The Bank was successfully delivering to NBS regular monthly reports regarding real estate valuations which are used for loan processing purposes. During 2017, the bank has initiated the process of licensing internal appraiser in line with Law on real estate appraiser, which will lead to further enhancement of control of collaterals which are used for credit risk mitigation purposes.

Relevant market, interest rate and liquidity risk taxonomies are defined for identifying and reporting risk exposures. Accurate and reliable risk data are generated to meet normal and stress/crisis reporting accuracy requirements. Data are aggregated on a largely automated basis, to minimize the probability of errors. Liquidity early warning indicators are defined for monitoring financial markets development and assessing its impact on the bank's liquidity position. The goal is to keep overall liquidity management at an efficient level of liquidity to allow the Bank to honor its payment obligations. Further improvement relating to accuracy, integrity, completeness and adaptability of reporting processes will continue during 2018.

Governance structure of the control system of operational risk management involves all relevant organizational levels and thus contributes to raising awareness about the importance of operational risk. Quantitative elements of operational risk measurement system (internal loss data, risk indicators and scenario analysis) are classified and collected by guaranteeing the data completeness, reliability and timely updates. Permanent working group continue its activities with the aim of identifying potential risk and defining measure for mitigating the risk. The system of identification, assessment and control of operational risk adequately reflects the risk profile and allows timely communication with management in order mitigate the identified risk.

Based on the foregoing, it can be concluded that during 2017 the Bank further enhanced risk management system, along with its capital adequacy and profitability levels, guarantees adequate management and coverage of the risks to which the Bank is exposed.

In previous years integration of risk management functions has been successfully implemented within which in accordance with the Law on financial leasing, UniCredit Leasing entrusted the tasks of identifying, measuring, assessing and managing risks to the risk management function of the Bank. In 2017 risk management function for Leasing was dedicated to improvement of organization and economies of scale in credit business, support in commercial actions and credit process optimization, better portfolio management due to centralized client assessment and single view on customer. Besides that, further enhancement and alignment of the risk management methodologies and internal regulation, as well as in managing the risk profile and monitoring exposures on consolidated level for interest rate, liquidity and operational risk exposures were implemented which resulted in maintaining and developing a stable and profitable leasing portfolio.

CRO Division will continue with the efforts and actions aimed at improving the system of management of all risks to which the Bank is exposed in its operations. Special focus is planned towards further enhancement of the credit process in order to improve efficiency, as well as on creating a comparative advantage in the market through process optimization on one hand, and through improvement of the tools for identifying and mitigation of credit risk, on the other hand. In that way adequate support to all organizational parts will be secured. And in 2018 one of the main goals is to maintain and improve portfolio quality and enabling base for sustainable growth with focus on further portfolio diversification, but always using proactive approach toward risk management enabling new client acquisition.

GLOBAL BANKING SERVICE (GBS)

During 2017, beside continued optimization and automation of the banking operation processes and further development of electronic channels, the main focus was on the improvement of projects portfolio management.

Technological developments, as well as requirements both from internal and external customers, were initiating optimal usage of resources for realization of projects. In accordance with that Global Banking Services Division has adjusted its operational model and organizational structure in order to create preconditions for better initiation, monitoring and realization of different initiatives. Organizational changes were made in order to form separate structures such as Team for portfolio management, Business analysis Unit and Production support unit. All mentioned above, led to better execution of projects, both Group and local, which resulted in maximal utilization of investment budget.

Informational technologies Department and Security Unit have continued to improve security infrastructure of the Bank. Together with the implementation of database firewall, new log management system and antimalware solution, general security level of the bank has been raised which secures smooth usage of banking services for banks customers. Also, the initiative to improve quality level of secondary Data center by moving whole equipment to specialized modular room, improving disaster recovery process is also under implementation phase.

Within analysis of the process effectiveness, Bank was applying new methodologies such as Lean and Six Sigma concepts, while within project management agile methodology was tested.

Bank continued to improve internal control system by changing the process and setting up new methodology. Once again, in 2017, as indicator of good functioning of internal control system Bank has received positive mark of conformity level provided within the annual report referring to the implementation and management of the internal control system of the bank.

Banking operations Department has continued with the further process optimization, automation and centralization of back office activities with the aim to provide full support to the business needs. Thanks to the efficiency, flexibility and expertize, Banking operations Department has contributed significantly to the success of the bank in 2017.

With adequate cost control and level of performed investments with constant monitoring of costs of depreciation and achievements of planned revenues, cost-income ratio did not significantly change and was kept on very ambitious level in comparison with other banks on domestic market. In that respect, it can certainly be said that UniCredit Bank is one of the most efficient banks on the local market.

In 2018, goals of Global Banking Services Division will be directed towards successful realization of the bank's strategic projects, process optimization which will lead to better business efficiency, as well as further improvement of cost management activities.

HUMAN RESOURCES HR

By continuing to provide strategic support to the realisation of the planned business activities, HR Department was focused in 2017 on:

- Empowering of the organisation towards innovation, agility and focus on the Clients,
- Development of employees and upgrading their technical and social skills;
- Greater affiliation of employees and positioning of the Bank as the most preferred employer in the market.

Special emphasis during the past year has been placed on agile culture, innovation and focus on clients. A number of trainings and workshops were organized with the aim of introducing to the members of the management team, as well as to the first and second lines in the hierarchy, the new methods of work, the ways in which organizations and individuals can innovate, as well as the awareness of the importance of digital transformation for business in general. HR Department participated in the organization, development and implementation of the “U Change” initiative, which aims to develop the aforementioned methods and values.

Employees were provided with a large number of internal and external trainings, „rotation at work“ programs, either in our country or in the Group, were planned and held, through which employees had the opportunity to gain a wider perception, learn technical skills they need, or to gain international experience. Bank was also working on strengthening team spirit, co-operation and collaboration, and cooperation with universities through practice programs, study visits and scholarships for the best students were continued.

During the last year, HR Department continued to work on strengthening of the employees belonging and positioning the bank as the most preferred employer in the market. In this regard, there were several initiatives and projects with this goal (day for birthday, family day, healthy Wednesday, share joy, thanksgiving cards, Talenton). One of the initiatives was that the employees themselves participate in the formulation of action plans in order to solve problems highlighted in the employee satisfaction survey. The HR department has managed to implement the action plan, and one of the best results is a new benefit- private health care insurance for all employees.

In 2018, HR Department will continue to provide full support to business in achieving business results through the improvement of organisational culture (innovation, agility, giving feedback), developing leaders and talents in leadership skills, motivating and retaining employees with high achievements who possess high potential, as well as through the increase in the number of internal, cross divisional shifts and filling of open positions, and continue to cooperate with universities through practice programs, study visits and scholarships for the best students.

During 2018, HR Department will continue to empower organizations and employees in the direction of digital transformation, to improve employee’s development opportunities, as well as career advancement. HR Department will also provide support for developing critical positions and developing programs that support new employees. Special attention will also be devoted to programs focusing on the well-being of employees, as well as care about health and good living habits.

IDENTITY AND COMMUNICATION

In 2017 Identity and Communication Unit continuously worked on additional promotion of the brand while providing support to business in creating innovative products and services which enabled bank to maintain the competitiveness and one of the leading positions on the market.

During 2017 several successful campaigns have been conducted, but the most important are for Dinar Cash Loan and Housing Loan. Not only that these commercials attracted the attention with theirs originality, but they also significantly contributed to the fact that the bank further increased market share when these two products are concerned. Two awards which the Association for Market Communications (UEPS) delivered to the bank speak about the creativity of the campaigns. In the category for Integrated Campaign within the financial sector and services, the advertisements for Housing Loan won the Silver Award, while for the Cash Loan campaign bank received the international Effie award.

Taking into consideration the increasing importance of social media, in 2017 Bank presented new topics and formats within Facebook and Instagram. These changes enabled it not only to increase the number of followers, but also built a better interaction with the clients. Bank is especially proud that it was the first bank on the Serbian market to introduce Viber stickers. In period of only three months, summer stickers were shared 3 million times in Viber communication.

Through numerous national and local initiatives in 2017 UniCredit Bank managed to increase the presence in media and thus further contribute to the recognition of the bank. The bank managed to increase the number of media reports in comparison with previous year and take over the leading position when media coverage on CSR topic is concerned. One of the reasons is the fact that Bank continuously improve the existing relations with the media, but also creating new ones.

Internal communication had an important role in 2017 since it significantly contributed to building better interpersonal relations and feeling of belonging to the bank and the Group. Various activities have been conducted in cooperation with HR Department with aim to create the best place to work, out of which “Thank you cards” with which we promoted a “thanksgiving culture” should be mentioned. Internal communication was also essential for promotion of volunteerism within the bank. The fact that almost a half of the employees participated in the numerous initiatives confirms that the way of communication is crucial for people engagement.

In 2018 Identity and Communication Unit will further focus on business improvement and increase of client base thanks to carefully designed integrated campaigns. Bank will continue to improve the image of competent interlocutor in media which we previously built, while taking care of the reputation.

CORPORATE SOCIAL RESPONSABILITY

With aim to contribute to economic and social development of local communities in which it operates and to support young people, vulnerable categories of people and the youngest in sports, continues also in 2017 UniCredit Bank supported numerous CSR activities and implemented large number of initiatives in which involved its employees.

With the aim to provide society with an added value that can be used in the long run – knowledge and expertise of its employees, UniCredit Bank continued to implement its CSR which implies broader involvement of employees in all activities. Bank continued to support the activities implemented by the organization called Junior Achievements in Serbia. Namely, within national competition "Business Challenge" six colleagues from UniCredit Bank played a role of mentors for 5 groups of high school students, and members of Jury, and helped them to develop their business ideas through creation of business plans, while one employee was a member of Grand Jury. Within Regional competition for 2017 30 experts of UniCredit Bank in four cities supported colleagues to make excellent business out of innovative ideas.

Over 180 employees and members of their families joined the humanitarian Run of Joy organised by BelHospice during Belgrade Marathon. Besides that, 250 participated in volunteering activities of arrangement of schoolyards in primary schools in Pirot, Novi Pazar and Zrenjanin, as well as arrangement of Gerontological centre Karaburma in Belgrade. Within the "Old doll for a new smile" initiative, employees prepared 100 gift packages for children from Foster home Kolevka in Subotica, together with 100 kilograms of clothes and shoes.

In 2017 3rd edition of Idea for better tomorrow has been implemented which aims to contribute to development of social entrepreneurship, as well as finding ideas for products and services which can improve image of Serbia in the region and abroad. In period from June 6th till July 18th 2017, over 130 ideas were registered. During the second phase the commission selected 15 finalists which suggested best ideas and with whom the experts worked on development of business plans. After the creation and evaluation of business plans, expert commission, based on innovation of ideas and sustainability of projects, selected the winning ones. Seven best finalists were chosen for grants in overall amount of 40,000 euros, but also consultant support of employees. Namely, based on individual assessment of each enterprise, the areas that should been improved has been identified in order to enable sustainability and 7 employees were identified which will in the next 4 months share their experience, knowledge and skill about financial market with the beneficiaries.

In 2017 UniCredit Bank decided to donate money to those who need help the most instead of purchase of New Year's gifts for our clients. In that way, Bank was able to support University Children's Hospital Tirsova, BelHospice and Serbia National Association of Parents of Children with Cancer – NURDOR with total amount of 16.500 euros. In addition, as a small sign of appreciation for this year Bank gave to the clients, two products that were ones of the winning products of the competition Idea for Better Tomorrow, which UniCredit Bank has been organizing since 2012 with the aim to support development of social entrepreneurship in Serbia. Until now, we have supported the development of 23 ideas with the grants in the total amount of 140,000 euros.

As in previous years, bank continued to support traditional manifestation with cultural character and significant importance for local communities, such as Days of Bora Stankovic, Days of Zoran Radmilovic and Days of Mokranjac.

Bank is very proud of the fact that almost half of the employees was involved in the numerous initiatives during 2017. In 2018 the bank will continue to implement different activities in order to contribute the improvement of living conditions in the local communities, while at the same time it will work on the additional engagement of the employees in the projects of broader social significance.

CONSOLIDATED STATEMENT OF FINANCIAL POSITION
As of December 31, 2017

(Thousands of RSD)

	Note	31.12.2017.	31.12.2016.
Cash and cash funds held with the central bank	3.k, 20	29.661.017	28.085.266
Financial assets at fair value through profit and loss, held for trading	3.j, 3.o, 21	2.281.049	2.315.317
Financial assets available for sale	3.j, 3.p, 22	82.171.636	76.320.664
Financial assets held to maturity	3.j, 3.n, 23	77.886	42.957
Loans and receivables due from banks and other financial institutions	3.j, 3.m, 24	11.885.064	18.490.432
Loans and receivables due from customers	3.j, 3.m, 25	240.608.342	208.339.473
Fair value adjustments of risk hedged items	3.l, 26	192.251	222.845
Receivables per financial derivatives designated as risk hedging instruments	3.l, 27	9.195	375
Intangible assets	3.r, 3.s, 28	1.165.916	921.336
Property, plant and equipment	3.q, 3.s, 29	1.554.223	1.581.197
Investment property	30	1.364	1.397
Deferred tax assets	3.i, 31	172.085	165.498
Other assets	32	1.000.303	915.567
Total assets		**370.780.331**	**337.402.324**
Financial liabilities carried at fair value through profit and loss, held for trading	3.j, 33	207.003	234.232
Liabilities per financial derivatives designated as risk hedging instruments	3.l, 34	448.794	540.097
Deposits and other liabilities due to banks, other financial institutions and the central bank	3.j, 3.t, 35	106.676.158	86.460.699
Deposits and other liabilities due to customers	3.j, 3.t, 36	186.658.833	178.232.370
Fair value adjustments of risk hedged items	3.l, 37	-	103
Subordinated liabilities	3.j, 3.t, 38	2.718.490	3.082.125
Provisions	3.u, 3.x, 39	1.076.838	961.581
Current tax liabilities	3.i, 19.4	205.253	31.749
Other liabilities	40	2.644.579	2.999.463
Total liabilities		**300.635.948**	**272.542.419**
Issued (share) capital	42.1	24.169.776	24.169.776
Profit	42.1	7.437.207	6.882.290
Reserves	42.1	38.537.400	33.807.839
Total equity		**70.144.383**	**64.859.905**
Total liabilities and equity		**370.780.331**	**337.402.324**

CONSOLIDATED INCOME STATEMENT
Year Ended December 31, 2017

(Thousands of RSD)

	Note	2017.	2016.
Interest income	3.d, 7	15.145.641	15.739.371
Interest expenses	3.d, 7	(2.782.070)	(3.413.910)
Net interest income		**12.363.571**	**12.325.461**
Fee and commission income	3.e, 8	4.362.623	3.885.975
Fee and commission expenses	3.e, 8	(1.355.835)	(1.154.775)
Net fee and commission income		**3.006.788**	**2.731.200**
Net gains on the financial assets held for trading	3.f, 9	248.467	30.989
Net losses on the hedges against risks	3.g, 10	(33.865)	(3.744)
Net gains on the financial assets available for sale	3.p, 11	261.172	166.256
Net foreign exchange gains and positive currency clause effects	3.c, 12	1.357.787	1.424.041
Net investment income	13	120.379	-
Other operating income	14	135.061	143.585
Net losses from impairment of financial assets and credit risk-weighted off-balance sheet assets	3.j, 15	(2.626.765)	(3.011.705)
Staff costs	16	(2.894.755)	(2.752.772)
Depreciation and amortization charge	3.q, 3.r, 17	(538.903)	(602.403)
Other expenses	18	(4.104.322)	(3.857.143)
Profit before taxes		**7.294.615**	**6.593.765**
Income tax	3.i, 19	(513.098)	(320.987)
Profit after taxes		**6.781.517**	**6.272.778**

CONSOLIDATED STATEMENT OF OTHER COMPREHENSIVE INCOME
Year Ended December 31, 2017

(Thousands of RSD)

	Note	2017.	2016.
PROFIT FOR THE YEAR		6.781.517	6.272.778
Components of other comprehensive income that cannot be reclassified to profit or loss			
- Actuarial gains/(losses)		9.856	(2.533)
Components of other comprehensive income that can be reclassified to profit or loss			
- Net fair value adjustments of financial assets available for sale		(255.417)	(834.514)
(Losses)/gains from taxes on the other comprehensive income for the year	31.2	(1.478)	380
Total negative other comprehensive income for the year	42.2	(247.039)	(836.667)
TOTAL POSITIVE INCOME FOR THE YEAR		**6.534.478**	**5.436.111**

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
Year Ended December 31, 2017

(Thousands of RSD)

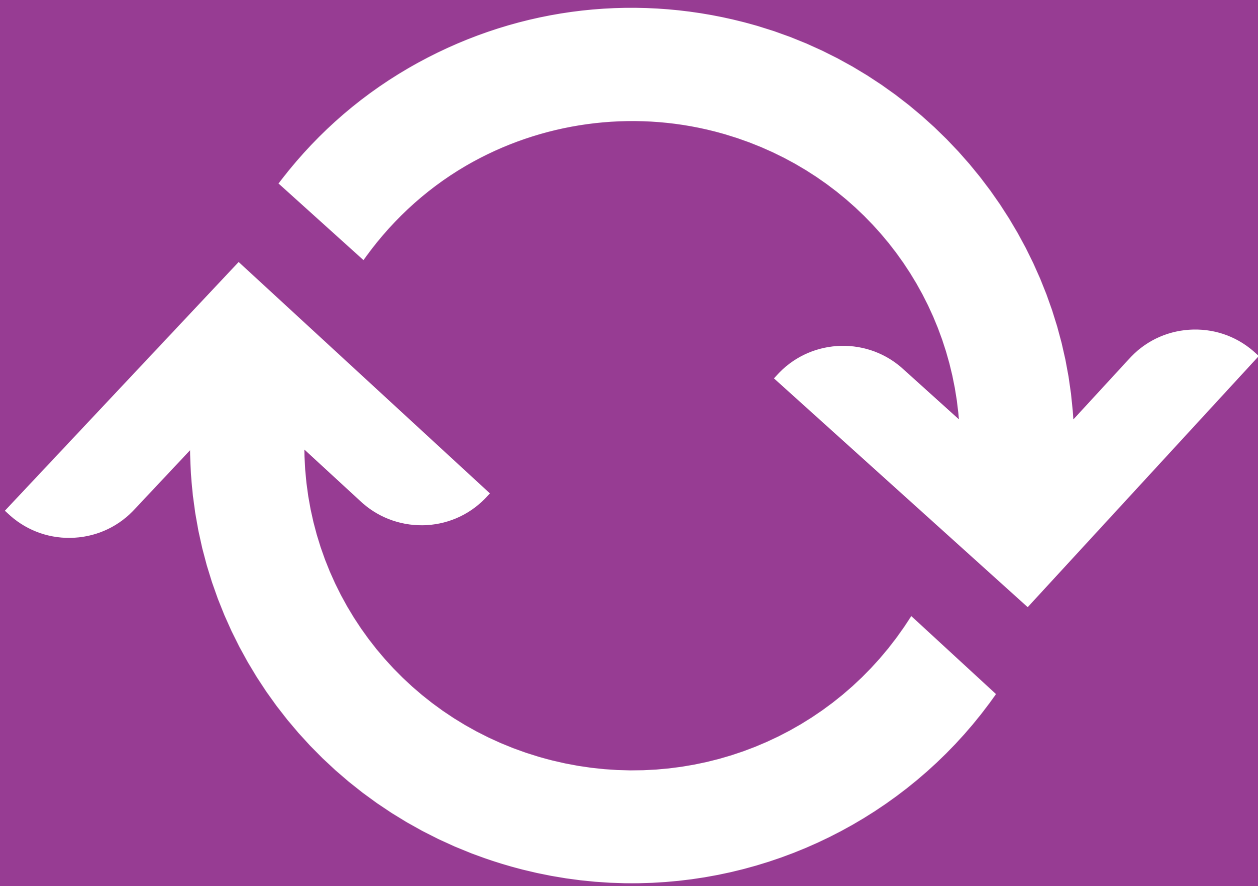
	Note	2017.	2016.
ISSUED CAPITAL			
Balance, beginning of year		23,607,620	-
Opening balance of the parent entity		-	23,607,620
Balance, end of year	42.1	23,607,620	23,607,620
SHARE PREMIUM			
Balance, beginning of year		562,156	-
Opening balance of the parent entity		-	562,156
Balance, end of year	42.1	562,156	562,156
OTHER RESERVES FROM PROFIT			
Balance, beginning of year		32,020,480	-
Opening balance of the parent entity		-	28,254,097
Prior year's retained earnings distribution		4,976,600	3,766,383
Balance, end of year	42.1	36,997,080	32,020,480
REVALUATION RESERVES			
Balance, beginning of year		1,799,182	-
Opening balance of the parent entity		-	2,807,920
Effect of the market value adjustment of securities available for sale		(253,446)	(1,008,738)
Balance, end of year	42.1	1,545,736	1,799,182
UNREALIZED LOSSES ON SECURITIES AVAILABLE FOR SALE			
Balance, beginning of year		-	-
Opening balance of the parent entity		-	(174,224)
Effect of the market value adjustment of securities available for sale		(1,971)	174,224
Balance, end of year	42.1	(1,971)	-
ACTUARIAL LOSSES PER DEFINED BENEFIT PLANS			
Balance, beginning of year		(11,823)	-
Opening balance of the parent entity		-	(9,670)
Movements during the year		8,378	(2,153)
Balance, end of year	42.1	**(3,445)**	**(11,823)**
RETAINED EARNINGS			
Balance, beginning of year		**6,882,290**	**-**
Opening balance of the parent entity		**-**	**6,366,383**
Effects of acquisition through business combination		**-**	**609,512**
		6,882,290	**6,975,895**
Prior year's profit distribution – allocation to dividend		**(1,250,000)**	**(2,600,000)**
Prior year's profit distribution – allocation to reserves		**(4,976,600)**	**(3,766,383)**
Profit for the year		**6,781,517**	**6,272,778**
Balance, end of year	42.1	**7,437,207**	**6,882,290**
TOTAL EQUITY		**70,144,383**	**64,859,905**

CONSOLIDATED STATEMENT OF CASH FLOWS
Year Ended December 31, 2017

(Thousands of RSD)

	Note	2017.	2016.
Cash inflows from operating activities		**25.607.166**	**21.716.323**
Interest receipts		12.230.574	11.770.459
Fee and commission receipts		4.512.673	3.876.176
Receipts of other operating income		8.863.799	6.069.346
Dividend receipts and profit sharing		120	342
Cash outflows from operating activities		**(19.191.780)**	**(15.178.479)**
Interest payments		(2.631.134)	(3.552.691)
Fee and commission payments		(1.356.084)	(1.147.232)
Payments to, and on behalf of employees		(3.052.140)	(2.646.646)
Taxes, contributions and other duties paid		(588.413)	(520.336)
Payments for other operating expenses		(11.564.009)	(7.311.574)
Net cash inflows from operating activities prior to changes in loans and deposits		**6.415.386**	**6.537.844**
Decrease in loans and increase in deposits received and other liabilities		**42.353.214**	**49.863.258**
Decrease in financial assets initially recognized at fair value through profit and loss, financial assets held for trading and other securities not intended for investments		-	547.925
Increase in deposits and other liabilities due to banks, other financial institutions, the central bank and customers		42.353.214	49.315.333
Increase in loans and decrease in deposits received and other liabilities		**(30.726.233)**	**(18.728.920)**
Increase in loans and receivables due from banks, other financial institutions, the central bank and customers		(30.726.233)	(18.728.920)
Net cash generated by operating activities before income taxes		**18.042.367**	**37.672.182**
Income taxes paid		(342.432)	(418.767)
Dividends paid		(1.250.000)	(5.100.000)
Net cash generated by operating activities		**16.449.935**	**32.153.415**
Cash inflows from investing activities		**120.379**	**-**
Other proceeds from investing activities		120.379	
Cash outflows from investing activities		(3.836.879)	(3.566.634)
Outflows per investments in investment securities		(3.066.018)	(2.490.290)
Equity investments in subsidiaries, associates and joint ventures			(112.644)
Purchases of intangible assets, property, plant and equipment		(770.861)	(963.700)
Net cash used in investing activities		(3.716.500)	(3.566.634)
Cash outflows from financing activities		**(6.666.518)**	**(32.140.094)**
Net cash used in repayment of borrowings		(6.666.518)	(32.140.094)
Net cash used in financing activities		**(6.666.518)**	**(32.140.094)**
Total cash inflows		**68.080.759**	**71.579.581**
Total cash outflows		**(62.013.842)**	**(75.132.894)**
Net cash increase/(decrease)		6.066.917	(3.553.313)
Cash and cash equivalents, beginning of year	3.k, 43	**16.817.106**	**20.407.612**
Foreign exchange losses		(78.125)	(37.193)
CASH AND CASH EQUIVALENTS, END OF YEAR	3.k, 43	**22.805.898**	**16.817.106**

Transform operating model.



The transformation of our operating model is fully on track, including cost discipline and efficiency measures to reduce the cost income ratio. Our FTE and branch reductions are ahead of schedule – as we further improve on customer focus, services and products. The digital and IT transformation is fully on track, investments supporting the business transformation with digitalization as a key enabler.

1) ESTABLISHMENT AND ACTIVITY OF THE BANKING GROUP

The Banking Group (hereinafter: the "Group") is comprised of the parent entity UniCredit Bank Srbija a.d. Beograd (hereinafter: the "Parent Entity" or the "Bank") and its subsidiaries UniCredit Leasing Srbija d.o.o. Beograd and UniCredit Partner d.o.o. Beograd. In January 2016 the Bank became the sole (100%) owner of each of the aforesaid subsidiaries.

(a) Establishment and Activity of the Bank

UniCredit Bank Srbija a.d. Beograd (the: "Bank") was originally established as HVB Banka Jugoslavija ("HVB") in 2001 after obtaining an operating license from the National Bank of Yugoslavia on July 2, 2001. On October 1, 2005, a status change of merger and acquisition of entities HVB Banka Srbija i Crna Gora A.D. Beograd, as the Acquirer and Eksport-Import banka Eksimbank A.D. Beograd, as the Acquiree was registered. The Bank changed its name to UniCredit Bank Srbija a.d. Beograd on March 30, 2007.

The Bank is a member of UniCredit Group. In accordance with the reorganization of the Banking Group's activities in Central and Eastern European countries, under the Demerger and Takeover Agreement executed by and between UniCredit Bank Austria AG and UCG Beteillingsverwaltung GmbH on August 31, 2016 and Merger and Acquisition Agreement executed by and between UCG Beteillingsverwaltung GmbH and UniCredit SpA on September 30, 2016, UniCredit Bank Austria AG transferred its sole (100%) ownership of the Bank to the Austrian holding company UCG Beteillingsverwaltung GmbH. Through merger of UCG Beteillingsverwaltung GmbH with UniCredit SpA, UniCredit SpA became the sole shareholder of UniCredit Bank Srbija a.d., Beograd.

The Bank is registered in the Republic of Serbia to provide banking services associated with payment transfers, lending and depositary activities in the country and abroad.

As of December 31, 2017, the Bank was comprised of the Head Office in Belgrade and 71 branch offices located in towns throughout the Republic of Serbia (December 31, 2016: 71 branch offices).

As of December 31, 2017, the Bank had 1,254 employees (December 31, 2015: 1,205 employees).

(b) Establishment and Activity of the Subsidiary UniCredit Leasing Srbija d.o.o. Beograd

The Subsidiary UniCredit Leasing Srbija d.o.o. Beograd (hereinafter: "Leasing") was established under Decision of the Commercial Court in Belgrade registry card no. 1-92733-00 dated May 18, 2004 under the name of HVB Leasing d.o.o. Beograd. The founder of Leasing was Bank Austria Creditanstalt Leasing GmbH, Vienna. On April 11, 2007, Leasing changed its name into UniCredit Leasing d.o.o. Beograd. Change of founder was registered with of the Serbian Business Registers Agency under no. 4109/2009 dated February 10, 2009 with UniCredit Global Leasing S.p.A, Milan as the new founder. In January 2016, in accordance with the Agreement on Sale and Purchase of Equity Interest and upon obtaining the National Bank of Serbia's approval, the Bank became the sole (100%) owner of Leasing. Change in ownership was registered with the Serbian Business Registers Agency on January 26, 2016.

The Leasing Company is principally involved in finance lease activities.

As of December 31, 2017 Leasing had 30 employees (December 31, 2016: 32 employees).

(c) Establishment and Activity of the Subsidiary UniCredit Partner d.o.o. Beograd

The Subsidiary UniCredit Partner d.o.o. Beograd (hereinafter: "Partner") was founded on May 3, 2006 under the name of HVB Partner d.o.o. za zastupanje u osiguranju Beograd. Partner's founder was BA-CA Leasing Versicherungs Service GmbH, Vienna, Austria. Change of the founder to a new founder Allegro Leasing Gesellschaft m.b.H. was registered under Decision of the Serbian Business Registers Agency no. BDŽU 30358/2013/01-01 dated April 9, 2013. The Company's foundation was registered with the Serbian Business Registers Agency under Decision no. BD 3370/2007 on March 13, 2007. On June 2008, Partner changed its name to UniCredit Partner d.o.o. za zastupanje u osiguranju.

In January 2016, in accordance with the Agreement on Sale and Purchase of Equity Interest and upon obtaining the National Bank of Serbia's approval, the Bank became the sole (100%) owner of Partner. Change in ownership was registered with the Serbian Business Registers Agency on January 12, 2016.

Partner is registered to perform the activities of an agent and intermediary in insurance. On April 16, 2007 Partner executed the Agency Agreement with the Wiener Staedtische osiguranje a.d. Beograd, (headquartered at no. 1, Trešnjinog Cveta St., Belgrade) as the main insurer. Based on the written approval obtained from the main insurer and other insurance companies, Partner acts as an agent of the following insurers: Generali oisguranje a.d. Beograd, DDOR Novi Sad a.d., Novi Sad, Dunav osiguranje a.d., Beograd, AS osiguranje a.d., Beograd, AMS osiguranje a.d., Beograd, Triglav osiguranje a.d., Beograd, UNIQA osiguranje a.d., Beograd and AXA osiguranje a.d., Beograd.

As of December 31, 2017 Partner had 2 employees (December 31, 2016: 4 employees).

Notes to the consolidated financial statements (CONTINUED)

2) BASIS OF PREPARATION AND PRESENTATION OF THE CONSOLIDATED FINANCIAL STATEMENTS AND ACCOUNTING CONVENTION

(a) Basis of Preparation and Presentation of the Consolidated Financial Statements

Legal entities and entrepreneurs incorporated in Serbia are required to maintain their books of account, to recognize and value assets and liabilities, income and expenses, and to present, submit and disclose financial statements in conformity the Law on Accounting (hereinafter referred to as: the "Law", Official Gazette of the Republic of Serbia no. 62/2013). The Group is required to apply International Financial Reporting Standards ("IFRS"), which as per the aforementioned law comprise the following: the Framework for the Preparation and Presentation of Financial Statements (the "Framework"), International Accounting Standards ("IAS"), International Financial Reporting Standards ("IFRS"), as well as the related interpretations issued by the International Financial Reporting Interpretations Committee ("IFRIC") and additional related interpretations issued by the International Accounting Standards Board ("IASB"), the translations of which to the Serbian language were approved and issued by the competent Ministry of Finance. In addition, in accordance with the Amendments and Supplements to the Law on Banks (Official Gazette of the Republic of Serbia no. 14/2015), upon preparation of the annual financial statements, banking groups in the Republic of Serbia are obligated to apply the International Financial Reporting Standards, subsequent revisions and amendments thereto and related interpretations as from their issue date by the competent authorities.

The accompanying consolidated financial statements are presented in the format prescribed under the Decision on the Forms and Contents of the Items in the Forms of the Financial Statements of Banks (Official Gazette of RS nos. 71/2014 and 135/2014).

These consolidated financial statements were prepared at historical cost principle, except for the measurement of the following significant balance sheet items:
- financial assets available for sale stated at fair value;
- derivative financial instruments stated at fair value; and
- financial assets and liabilities held for trading stated at fair value.

Historical cost is generally based on the fair value of consideration paid in exchange for goods and services. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between the market participants at the measurement date under current market conditions regardless of whether that price is directly observable or estimated using another valuation technique. Upon estimating the fair value of assets or liabilities, the Bank takes into account characteristics of assets or liabilities that other market participants would also consider upon determining the price of assets or liabilities at the measurement date. Fair value for measurement and/or disclosure purposes in the accompanying financial statements was determined in the aforesaid manner, except for share-based payment transactions, which are in the scope of IFRS 2, leasing transactions, which are in the scope of IAS 17, and measurements that have some similarities to fair value but are not fair value, such as the net realizable value in IAS 2 or value in use in IAS 36.

In addition, for financial reporting purposes, fair value measurements are categorized into Level 1, 2 or 3 based on the degree to which the inputs to the fair value measurements are observable and the significance of the inputs to the fair value measurement in its entirety, which are described as follows:

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date;
- Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly; and
- Level 3 inputs are unobservable inputs for the asset or liability.

In the preparation of the accompanying consolidated financial statements, the Group adhered to the accounting policies described in Note 3.

The Group's consolidated financial statements are stated in thounsands of dinars (RSD).Dinar is the offical reporting currency in Republic of Serbia.

Standards and interpretations issued that came into effect in the current period are disclosed in Note 2(b). Standards and interpretations in issue but not yet in effect are disclosed in Note 2(c).

(b) Initial application of amendments to the existing standards effective for the current reporting period

The following amendments to the existing standards issued by the International Accounting Standards Board (IASB) have been effective over the current reporting period:
- Amendments to IAS 7 "Statement of Cash Flows" – Disclosure Initiative (effective for annual periods beginning on or after January 1, 2017);
- Amendments to IAS 12 "Income Taxes" - Recognition of Deferred Tax Assets for Unrealized Losses (effective for annual periods beginning on or after January 1, 2017); and
- Amendments to IFRS 12 due to "Improvements to IFRSs (cycle 2014-2016)" resulting from the annual improvement project of IFRS (IFRS 1, IFRS 12 and IAS 28) primarily with a view to removing inconsistencies and clarifying wording (amendments to IFRS 12 are to be applied for annual periods beginning on or after January 1, 2017).

2) BASIS OF PREPARATION AND PRESENTATION OF THE CONSOLIDATED FINANCIAL STATEMENTS AND ACCOUNTING CONVENTION (CONTINUED)

Adoption of these amendments to the existing Standards has not led to any material changes in the Bank's financial statements.

(c) New standards and amendments to the existing standards in issue not yet adopted

At the date of authorization of these financial statements the following new standards, amendments to the existing Standards and new interpretations were in issue but not yet effective:

- IFRS 9 "Financial Instruments" (effective for annual periods beginning on or after January 1, 2018);
- IFRS 15 "Revenue from Contracts with Customers" and further amendments (effective for annual periods beginning on or after January 1, 2018);
- IFRS 16 "Leases" (effective for annual periods beginning on or after January 1, 2019);
- IFRS 17 "Insurance Contracts" (effective for annual periods beginning on or after January 1, 2021);
- Amendments to IFRS 2 "Share-based Payment" - Classification and Measurement of Share-based Payment Transactions (effective for annual periods beginning on or after January 1, 2018);
- Amendments to IFRS 4 "Insurance Contracts" - Applying IFRS 9 "Financial Instruments" with IFRS 4 "Insurance Contracts" (effective for annual periods beginning on or after January 1, 2018 or when IFRS 9 "Financial Instruments" is applied first time);
- Amendments to IFRS 9 "Financial Instruments" - Prepayment Features with Negative Compensation (effective for annual periods beginning on or after January 1, 2019);
- Amendments to IFRS 10 "Consolidated Financial Statements" and IAS 28 "Investments in Associates and Joint Ventures" - Sale or Contribution of Assets between an Investor and its Associate or Joint Venture and further amendments (effective date deferred indefinitely until the research project on the equity method has been concluded);
- Amendments to IAS 19 "Employee Benefits" - Plan Amendment, Curtailment or Settlement (effective for annual periods beginning on or after January 1, 2019);
- Amendments to IAS 28 "Investments in Associates and Joint Ventures" - Long-term Interests in Associates and Joint Ventures (effective for annual periods beginning on or after January 1, 2019);
- Amendments to IAS 40 "Investment Property" - Transfers of Investment Property (effective for annual periods beginning on or after January 1, 2018);
- Amendments to IFRS 1 and IAS 28 due to "Improvements to IFRSs (cycle 2014-2016)" resulting from the annual improvement project of IFRS (IFRS 1, IFRS 12 and IAS 28) primarily with a view to removing inconsistencies and clarifying wording (amendments to IFRS 1 and IAS 28 are to be applied for annual periods beginning on or after January 1, 2018);
- Amendments to various standards due to "Improvements to IFRSs (cycle 2015-2017)" resulting from the annual improvement project of IFRS (IFRS 3, IFRS 11, IAS 12 and IAS 23) primarily with a view to removing inconsistencies and clarifying wording (effective for annual periods beginning on or after January 1, 2019);
- IFRIC 22 "Foreign Currency Transactions and Advance Consideration" (effective for annual periods beginning on or after January 1, 2018); and
- IFRIC 23 "Uncertainty over Income Tax Treatments" (effective for annual periods beginning on or after January 1, 2019).

The Bank's management has elected not to adopt these new Standards, amendments to existing Standards and new interpretations in advance of their effective dates. The management anticipates that the adoption of these Standards, amendments to existing Standards and new interpretations will have no material impact on the financial statements of the Bank in the period of initial application.

(d) Comparative Information

Comparative information in the accompanying consolidated financial statements represents the data from the Bank's newly consolidated financial statements for 2016.

(e) Use of Estimates

Preparation of the consolidated financial statements in accordance with IFRS requires the management to make the best possible estimates and reasonable assumptions that affect the application of the accounting policies and the reported amounts of assets and liabilities, as well as income and expenses. Actual amounts of assets and liabilities may vary from these estimates.

These estimations and underlying assumptions are subject to regular review. The revised accounting estimates are presented for the period in which they are revised as well as for the following periods.

(f) Statement of Compliance

The Group's consolidated financial statements have been prepared in accordance with the International Financial Reporting Standards ("IFRS) issued by the International Accounting Standards Board ("IASB").

(g) First-Time Adoption of IFRS 9

In accordance with IFRS 9, effective as of January 1, 2018, the Group has changed its accounting policies on recognition, classification and measurement of its financial assets and labilities as well as those on impairment of the financial assets.

Notes to the consolidated financial statements (CONTINUED)

2) BASIS OF PREPARATION AND PRESENTATION OF THE CONSOLIDATED FINANCIAL STATEMENTS AND ACCOUNTING CONVENTION (CONTINUED)

The Group did not apply provision of IFRS 9 to the earlier financial reporting periods. Effects of adjustments of the financial assets and liabilities' carrying values as of the standard's first-time adoption date were recognized within retained earnings as the 2018 opening balance adjustment. The Bank will continue to apply provisions of IAS 39 relating to the risk hedging accounting.

i. Classification and Measurement of Financial Assets and Liabilities

In accordance with IFRS 9 classification and measurement of financial assets depend on the following two main criteria:
a) Business model based on which the Bank manages a financial asset and
b) Characteristics of the contractual cash flows of a financial assets (the so-called SPPI criterion).

The business model reflects the manner in which the Group manages its financial assets in order to collect the cash flows therefrom. The Group performed detailed analysis of its business models taking into account historical experience in sales of the financial assets as well as future expectations in this respect. Upon analysis, the Group considered other objective and relevant information such as risks affecting the business model performance and the manner of such risk management, the way business model performance is evaluated, how the financial assets within the model are measured, how the Group's management is reported to, etc. Accordingly, the Group has defined the following business models:
a) Hold to collect cash flows,
b) Hold to collect cash flows and to sell and
c) Other business models (e.g. hold for sales).

If there a change occurs to the model underlying a financial asset management, the financial assets is reclassified. Reclassification is made prospectively, i.e., as of the first day of the following reporting period. The Group does not expect frequent changes of its business models.

In instances of business models "Hold to collect" or "Hold to collect and sell" it is assessed whether the cash flows represent solely payments of principal and interest (the so-called SPPI test). In accordance with the basic loan arrangement, interest includes the time value of money, the accepted level of counterparty credit risk and other basic lending risks and adequate profit margin. If the contractual terms include risk exposures that are not in line with the basic loan arrangement, such a financial asset is classified and measured at fair value through profit or loss irrespective of the business model it belongs to.

Based on the performed analysis of the business models and characteristics of the contractual cash flows, as from January 1, 2018 the Group will classify all is financial assets into the following categories:
1) Financial assets at amortized cost;
2) Financial assets at fair value through other comprehensive income (FVTOCI); and
3) Financial assets through profit or loss (FVTPL).

The Group has had no changes in the manner of classification and measurement of financial liabilities under IFRS 9 against classification and measurement under IAS 39.

With regard to the classification and measurement of the financial assets, the Group recognized the effect of IFRS 9 first-time adoption arising from the measurement of equity investments in other entities against impairment previously recognized. In fact, equity investments in other entities, according to IFRS 9, are measured at fair value through other comprehensive income (FVTOCI). Since the Group assesses that the cost method provides the best fair value approximation, these investments are measured at cost, i.e., at the net present value, which amounted to zero as of December 31, 2017. However, value adjustment of the investments in other entities was made in the same amount against retained earnings, offsetting the said increase, so that there was no cumulative effect.

ii. Impairment of Financial Assets under IFRS 9

In accordance with IFRS 9, upon impairment of the financial instruments existence of objective evidence of impairment is not necessary for recognition of credit losses. Expected credit losses are also recognized for unimpaired financial assets. In other words, the Bank calculates provisions for all credit exposures except for those already measured at fair value through profit or loss (FVTPL) (including both performing and non-performing financial assets).

Expected credit losses are recalculated at each reporting date in order to reflect changes occurred in the credit risk since the initial recognition of the financial instrument. Such an approach results in earlier identification of credit losses as it is necessary to recalculate expected losses over a 12-month period for all credit risk exposures. It is necessary to recalculate lifetime expected credit losses for all exposures exhibiting significant deterioration.

Upon calculating expected credit losses, the Bank uses forward-looking information and macroeconomic inputs, i.e., the Bank considers not only historical information adjusted so as to reflect the effects of the present conditions and information providing objective evidence of the financial assets being impaired for actual losses incurred, but reasonable and supportable information as well, which includes projections of the future economic conditions upon calculation of expected credit losses, both at individual and at collective levels. The amount of provisions for credit losses will increase with deterioration of the projected economic conditions and

2) BASIS OF PREPARATION AND PRESENTATION OF THE CONSOLIDATED FINANCIAL STATEMENTS AND ACCOUNTING CONVENTION (CONTINUED)

decrease with their improvement.

The Group's basic principles and rules upon calculation of provisions under IFRS 9 are as follows:

The Group calculates 12-month expected credit loss or a lifetime expected credit loss of a financial instruments depending on the significance of the change in its credit risk occurred since the instrument's initial recognition. For these purposes, the Group uses the following three stages of impairment:

- Stage 1 includes all new financial assets at initial recognition and instruments without significant credit quality deterioration since their initial recognition or instruments within the low credit risk category;
- Stage 2 includes financial instruments with significant credit quality deterioration since their initial recognition yet with no objective evidence of impairment based on credit losses;
- Stage 3 includes financial instruments where objective evidence of impairment exists at the reporting date.

Stages 1 and 2 include only performing financial assets.
Stage 3 includes only non-performing financial assets
For Stage 1 financial instruments, 12-month expected credit losses are calculated.
For Stage 2 financial instruments, lifetime expected credit losses are calculated.
For Stage 3 financial instruments, lifetime expected credit losses are calculated and interest income is calculated on the net exposures.

Financial assets are transferred from Stage 1 to Stage 2 when the credit risk has increased significantly since the instruments' initial recognition. The transfer logic is based on quantitative and qualitative criteria and must be applied to all the financial instruments. Deterioration of probabilities of default (PD) is the key parameter underlying the quantitative criterion of the transfer logic. The additional three qualitative criteria applied after the said quantitative parameter are:

- Classification to forbearance performing status results in automatic classification to Stage 2 for the following 9 months (from that status classification date). Following the said period, unless there are other significant credit risk deterioration triggers, such transactions may be reclassified back to Stage 1.
- 30 days past due – if a transaction reaches 30 days past due, it should be classified as Stage 2.
- Classification to restructuring performing status – all performing exposures transferred to the Special Credit Unit are automatically classified as Stage 2.

In the impairment process, the Group applies a special treatment to the purchases of already impaired assets, the so-called NPL portfolios and to the approval of new loans to the borrowers with already impaired loans within its portfolio, i.e. those already in NPL status. In accordance with the Standard, such assets are defined as POCI (purchased and originated impaired credit assets) and are separately measured through cumulative changes in lifetime expected credit losses of the instruments after their initial recognition.

Positive changes in the lifetime expected credit losses of the instrument are recognized as gains on the impairment of instruments if the expected credit loss in lower than the amount of expected credit losses included in the estimated cash flows upon initial recognition. Given the business model at hand, the Group currently possesses no identified assets in its portfolio that could be regarded as POCI assets, i.e., the Group has no purchased NPL portfolio or additional financing of borrowers with already existing NPLs in its portfolio.

Adjustments to the carrying value of the financial instruments due to transition to IFRS 9, which will be recognized within retained earnings as 2018 opening balance adjustment, will not affect CET 1 ratio given the fact that retained earnings are not included in the calculation of the capital adequacy ratio and common equity Tier 1 capital ratio (CET 1 ratio). In the event that the Group has no retained earnings, i.e., that the profits equal zero, the effect on the common equity Tier 1 capital ratio (CET 1) would equal -0,18% or -0,73% if the effect would not include the impact of the macroeconomic variables. This effect has been arrived at without calculating the effects of the first-time adoption of IFRS 9 on the calculation of the required reserves and on the calculation of the credit risk weighted assets.

Notes to the consolidated financial statements (CONTINUED)

3) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting policies presented hereinafter have been consistently applied for all years presented in the accompanying consolidated financial statements.

(a) Consolidation

The Group's consolidated financial statements include the consolidated statement of financial position as of December 31, 2017 and the related consolidated income statement, statement of other comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

The Group's consolidated financial statements as of and for the year ended December 31, 2017 include the financial statements of the Parent Entity (the Bank) and the financial statements of the following entities:

	Equity Interest %	
Subsidiary:	**2017**	**2016**
UniCredit Leasing d.o.o, Beograd	100%	100%
UniCredit Partner d.o.o, Beograd	100%	100%

The Bank is the sole owner of the above listed subsidiaries.

All the material transaction amounts and balances arising from the intragroup business relations were eliminated upon consolidation.

(b) Going Concern

These consolidated financial statements have been prepared under going concern assumption, which entails that the Group will continue its operations for an indefinite period in the foreseeable future.

(c) Foreign Exchange Translation

Transactions denominated in foreign currencies are translated into dinars at official exchange rates effective at the date of each transaction.

Monetary assets and liabilities denominated in foreign currencies, as well as those indexed to a currency clause, are translated into dinars by applying the official exchange rates prevailing at the reporting date.

Foreign exchange positive or negative effects arising upon the translation of transactions during the year, and translation of the assets and liabilities denominated in foreign currencies at the reporting date, are credited or charged to the Group's income statement as net foreign exchange gains or losses and positive/negative currency clause effects.

The official middle exchange rates determined by the National Bank of Serbia and applied in the translation of the consolidated statement of financial position components into dinars for the following major currencies were as follows:

in RSD	December 31, 2017	December 31, 2016
USD	99,1155	117,1353
EUR	118,4727	123,4723
CHF	101,2847	114,8473

(d) Interest Income and Expenses

Interest income and expenses are recognized in profit and loss and are calculated using the effective interest method. The effective interest rate is the rate that precisely discounts the estimated future cash flows through the expected duration of the financial instrument (or, where appropriate, a shorter period) on the net carrying value of financial assets or financial liabilities. When calculating the effective interest rate, the Group performs an assessment of cash flows, taking into consideration all conditions of the agreement related to the financial instrument, but not considering future credit losses.

The calculation of the effective interest rate includes all fees and commissions paid and received and transaction costs, which are part of the effective interest rate. Transaction costs are costs directly attributable to the acquisition or issue of a financial asset or liability.

Interest income and expenses recognized in profit or loss include:

- interest on financial assets and financial liabilities that are measured at amortized cost calculated using the effective interest rate method;
- interest on securities available for sale calculated using the effective interest rate method; and
- interest on coupon securities held for trading.

Interest income and expenses from all trading assets and liabilities (other than interest on coupon securities) are deemed secondary to the trading activities of the Group and are presented together with all other changes in the fair value of trading assets and liabilities within net gains on financial assets held for trading.

Regular interest income from impaired loans and receivables due from customers is calculated based on the net amounts of loans using the effective interest method in accordance with IAS/IFRS. Calculation of penalty interest income from impaired loans is suspended from the assignment of the default status to the client and recorded therefrom within off-balance sheet items, except for a portion of the legally prescribed penalty interest on written off loans without debt acquittal, where the Group has decided to cease further calculation and recording of interest within the off-balance sheet items as from the moment of write-off of loans without debt acquittal.

3) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Impaired loans and receivables are those due from customers with default (non-performing) status (internal ratings 8-, 9 and 10), which is explained in more detail in the Rulebook on Calculating Provisions under IAS/IFRS and the Methodology for Default Status Identification under Basel Standards.

(e) Fee and Commission Income and Expenses

Fee and commission income and expenses that are integral parts of the effective interest rate of a financial asset or liability are included in the calculation of the effective interest rate and therefore stated within interest income and expenses.

Other fee and commission income is recorded upon service rendering. It mainly comprises fees for services rendered in the domestic and foreign payment transfers, issue of guarantees and letters of credit and other banking services.

Other fee and commission expenses mostly relate to fees for transactions and services provided and are recorded upon receipt of services.

(f) Net Gains/Losses on the Financial Assets Held for Trading

Net gains/losses on the financial assets held for trading comprise net gains/losses arising from trade in assets and liabilities, including all realized and unrealized changes in the fair values thereof.

(g) Net Gains on the Hedges against Risks

Net gains on the hedges against risks include net gains on changes in fair values of derivatives designated as risk hedging instruments and changes in fair values of loans, receivables and securities as hedged items, arising from the risks against which the items are hedged.

(h) Operating and Finance Leases

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the Group. Leases are classified as operating leases when the terms of the lease do not transfer substantially all the risks and rewards of ownership to the Group.

i. Operating Lease

Payments made during the year under operating leases are charged to the income statement on a straight-line basis over the period of the lease. Lease incentives received are recognized as an integral part of the total lease expense, over the term of the lease.

ii. Finance Lease – Group as the Lessee

Leases where the Group takes over substantially all the risks and rewards of ownership are classified as finance leases. An asset acquired under a finance lease is initially measured at the lower of its fair value and present value of the minimum lease payments. Subsequent to initial recognition, the asset is accounted for in accordance with the accounting policy applicable to that asset.

Minimum lease payments made under finance leases are apportioned between the finance expense and the reduction of the outstanding liability. The finance expense is allocated to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability.

Assets held under other types of lease are classified as operating leases and are not recognized in the Group's statement of financial position.

iii. Finance Lease – Group as the Lessor

The Group recognizes financial assets leased in its statement of financial position in the amount equal to the net investment in the lease. The Group transfers the risks associated with ownership to the lessees so that the lease receivables are regarded as repayment of principal and portion of the related finance income.

Recognition of the finance income is based on the pattern reflecting the constant periodic rate of interest on the finance lease net investment outstanding. Lease payments related to the current period, net of service fees, are charged to the gross investment in the lease as the reduction in the principal and finance income unearned.

(i) Income Tax Expenses

Tax expense comprises current taxes and deferred taxes. Current taxes and deferred taxes are recognized in profit or loss except to the extent that they relate to items recognized directly in equity or in other comprehensive income.

i. Current Income Tax

Current tax is expected tax payable or receivable on the taxable income for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to the tax payable in respect of previous years. Current income tax represents an amount calculated in accordance with the Republic of Serbia Corporate Income Tax Law. The prescribed tax rate for 2017 equals 15%. The taxable base is the profit before taxes shown in the statutory statement of income and adjusted for differences that are specifically defined under statutory tax rules of the Republic of

3) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Serbia.

The Republic of Serbia Corporate Income Tax Law was amended at the end of 2017 with the amendments effective as from the preparation of the tax statement for 2018, i.e., tax period ending in 2018, except for the provisions relating to the recognition of the expenses arising from the write-off and impairment of receivables (applicable to determination, calculation and payment of the tax liabilities for 2017). Accordingly, the tax statement for 2017 will be prepared according to the general rules that were used under the amendments to the Law from the end of 2016, with partial application of the amendments from the end of 2017.

ii. Deferred Income Taxes

Deferred income tax is recognized in respect of temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Deferred taxes are measured at the tax rates that are expected to be applied to the temporary differences when they reverse, based on the laws that have been enacted by the reporting date.

A deferred tax asset is recognized for unused tax losses, tax credits and deductible temporary differences to the extent that it is probable that the future taxable profits will be available against which they can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

iii. Other Taxes and Contributions

According to the relevant legislation in the Republic of Serbia, the Bank pays various taxes, contributions, and duties, such as property tax, payroll contributions charged to the employer and other public duties. These are included under other expenses within the income statement.

(j) Financial Assets and Liabilities

i. Recognition and Initial Measurement

The Group initially recognizes financial assets and liabilities at the settlement date.

A financial asset or liability is measured initially at fair value plus transaction costs that are directly attributable to its acquisition or issue, except for financial assets and liabilities held for trading, whose measurement does not include these costs.

ii. Classification

The Group classifies its financial assets and liabilities into the following categories:

- loans and receivables;
- held-to-maturity investments;
- financial assets and liabilities at fair value through profit and loss and
- financial assets available for sale.

Please refer to accounting policies 3(m), 3(n), 3(o) and 3(p).

The Group classifies its financial liabilities as measured at amortized cost or liabilities at fair value through profit or loss. Please refer to accounting policy 3(t).

iii. Derecognition

Financial Assets

The Group derecognizes a financial asset when the contractual rights to the cash flows from the financial asset expire, or when it transfers the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred or in which the Group neither transfers nor retains substantially all the risk and rewards of ownership and it does not retain control of the financial asset.

On derecognition of a financial asset, the difference between the carrying amount of the asset (or the carrying amount allocated to the portion of the asset transferred), and the sum of the consideration received (including any new asset obtained less any new liability assumed) and any cumulative gain or loss that had been recognized in other comprehensive income is recognized in profit or loss.

The Group enters in transactions whereby it transfers assets recognized on its statement of financial position, but retains either all or substantially all of the risks and rewards of the transferred assets or a portion of them. If all or substantially all risks and rewards are retained, then the transferred assets are not derecognized. Transfers of assets with retention of all or substantially all risks and rewards include, for example, repurchase transactions.

When assets are sold to a third party with a concurrent total rate of return swap on the transferred assets, the transaction is accounted for as a secured financing transaction similar to repurchase transactions as the Group retains all or substantially all the risks and rewards of ownership of such assets.

In transactions in which the Group neither retains nor transfers substantially all the risk and rewards of ownership of a financial asset and it retains control over the asset, the Group continues to recognize the asset to the extent of its continuing involvement, determined by the extent to which it is exposed to changes in the value of transferred asset.

3) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Financial Liabilities

The Group derecognizes a financial liability when its contractual obligations are discharged or cancelled or have expired.

iv. Offsetting

Financial assets and liabilities are offset and the net amount presented in the statement of financial position when, and only when, the Group has a legal right to set off the recognized amounts and it intends either to settle on a net basis or to realize the asset and settle the liability simultaneously.

Income and expenses are presented on net basis only when permitted under IFRS, or for gains and losses arising from a group of similar transactions such as in the Group's trading activity.

v. Amortized Cost Measurement

The amortized cost of a financial asset or liability is the amount at which the financial asset or liability is measured at initial recognition, minus principal repayments, plus or minus the cumulative amortization using the effective interest method of any difference between the initial amount recognized and the maturity amount, less any impairment.

vi. Fair Value Measurement

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction in the principal (or most advantageous) market at the measurement date under current market conditions regardless of whether that price is directly observable or estimated using another valuation technique.

When available, the Group measures the fair value of an instrument using quoted prices in an active market for that instrument. A market is regarded as active if quoted prices are readily and regularly available and represent actual and regularly occurring market transactions on an arm's length basis.

If a market for a financial instrument is not active, the Group establishes fair value using a valuation technique. Valuation techniques include using recent arm's length transactions between knowledgeable, willing parties (if available), reference to the current fair value of other instruments that are substantially the same, discounted cash flow analyses and other optional models. The chosen valuation technique makes maximum use of market inputs, relies as little as possible on estimates specific to the Group, incorporates all factors that market participants would consider significant in setting a price, and is consistent with accepted economic methodologies for pricing financial instruments.

Inputs to valuation techniques reasonably represent market expectations and measures of the risk-return factors inherent in the financial instrument. The Group calibrates valuation techniques and tests them for validity using prices from observable current market transactions for the same instrument, based on other available observable market data.

Assets and long positions are measured at a bid price and liabilities and short positions are measured at an asking price. When the Group has position with offsetting risks, mid-market prices are used to measure the offsetting risk positions and a bid or asking price adjustment is applied only to the net open position as appropriate. Fair values reflect the credit risk of the instrument and include adjustments for the credit risk of the Group and counterparty where appropriate. Fair value estimates obtained from models are adjusted for any other factors, such as liquidity risk or model uncertainties to the extent that the Group believes a third-party market participant would take them into account in pricing a transaction.

The best evidence of the fair value of a financial instrument at initial recognition is the transaction price, i.e. the fair value of the consideration given or received. However, in some cases, the fair value of that instrument is evidenced by comparison with other observable current market transactions for the same instrument (i.e., without modification or repackaging) or based on a valuation technique whose variables include only data from observable markets, then the difference is recognized in profit or loss on initial recognition of the instrument. In other cases the difference is not recognized in profit or loss immediately but is recognized over the life of the instrument on an appropriate basis or when the instrument is redeemed, transferred or sold, or the fair value becomes observable.

vii. Impairment Identification and Measurement

At each reporting date the Group assesses whether there is objective evidence that financial assets not carried at fair value through profit or loss are impaired. A financial asset or a group of financial assets are impaired when objective evidence demonstrates that a loss event has occurred after the initial recognition of the asset, and that the loss event has an impact on the future cash flows on the asset that can be estimated reliably.

Objective evidence that financial assets (including equity securities) are impaired can include significant financial difficulty of the borrower or issuer, default or delinquency by a borrower, restructuring of a loan or a receivable by the Group on terms that the Group would not otherwise consider, indications that a borrower or issuer will enter bankruptcy, the disappearance of an active market for a security, or other observable data relating to a group of assets such as adverse changes in the payment status of borrowers or issuers in the group, or economic conditions that correlate with

3) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

defaults in the group. In addition, for an investment in an equity security, a significant or prolonged decline in its fair value below its cost is objective evidence of impairment.

The Group considers evidence of impairment for loans and receivables and held-to-maturity investment securities at both a specific asset and collective level. All individually significant loans and receivables and held-to-maturity investment securities are assessed for specific impairment. All individually significant loans and receivables and held-to-maturity investment securities found not to be specifically impaired are then collectively assessed for any impairment that has been incurred but not yet identified. Loans and receivables and held-to-maturity investment securities that are not individually significant are collectively assessed for impairment by grouping together loans and receivables and held-to-maturity investment securities with similar characteristics.

In assessing collective impairment the Group uses statistical modelling of historical trends of the probability of default, timing of recoveries and the amount of loss incurred, adjusted for management's judgment as to whether current economic and credit conditions are such that the actual losses are likely to be greater or less than suggested by historical modelling. Default rates, loss rates and the expected timing of future recoveries are regularly benchmarked against actual outcomes to ensure that they remain appropriate.

Impairment losses on assets carried at amortized cost are measured as the difference between the carrying amount of the financial asset and the present value of estimated future cash flows discounted at the asset's original effective interest rate. Impairment losses are recognized in profit or loss and reflected in an allowance account against loans and receivables. When a subsequent event causes the amount of impairment loss to decrease, the decrease in impairment loss is reversed through profit or loss.

Impairment losses on available-for-sale investment securities are recognized by transferring the cumulative loss that has been recognized in other comprehensive income to profit or loss as a reclassification adjustment. The cumulative loss that is reclassified from other comprehensive income to profit or loss is the difference between the acquisition costs, net of any principal repayment and amortization, and the current fair value, less any impairment loss previously recognized in profit or loss. Changes in impairment provisions attributable to time value are reflected as a component of interest income.

When certain loans and receivables, as well as investments in securities, are determined to be irrecoverable, these are written off. Write-off of loans and receivables represents derecognition of such assets within the statement of financial position, where write-off of loans without debt acquittal is distinguished from write-off with debt acquittal. Loans are written off without debt acquittal in instances where the Group has estimated that loans will not be collected, but does not waive its contractual and legal rights in respect of the loan except for a portion of the legally prescribed penalty interest to the accrual of which the Group would still be entitled even after the conducted write-off without debt acquittal, where the Group has decided to cease further calculation and recording of interest as from the moment of such write-off. In such cases, the Group ceases to recognize loans and receivables within the statement of financial position (balance sheet) and commences recording those within the off-balance sheet items. The Group writes off loans and receivables with debt acquittal when these are estimated as irrecoverable and that it is not economically justifiable to take further actions toward their collections. In such instances, the written-off loans and receivables are derecognized from the statement of financial position without any further recording whatsoever.

(k) Cash and Cash Funds Held with the Central Bank

Cash and cash funds held with the central bank include cash on hand, balances held on the gyro accounts, other cash funds and the obligatory foreign currency reserve held with the central bank. Cash and cash funds held with the central bank are stated at amortized cost within the statement of financial position.

For the purposes of cash flow statement preparation cash and cash funds include funds held on the accounts with foreign banks, while the obligatory foreign currency reserve held with the central bank is not included in the cash flow statement.

(l) Derivatives Held for Hedges against Risks and Hedge Accounting

Derivatives held for risk management purposes include all derivative assets and liabilities that are not classified as trading assets or liabilities. Derivatives held for risk management purposes are measured at fair value in the statement of financial position.

The Group designates certain derivatives held for risk management as hedging instruments in qualifying hedging relationships. On initial designation of the hedge, the Group formally documents the relationship between the hedging instrument and hedged item, including the risk management objective and strategy in undertaking the hedge, together with the method that will be used to assess the effectiveness of the hedging relationship. The Group makes as assessment, both at the inception of the hedge relationship as well as on an ongoing basis, as to whether the hedging instrument is expected to be highly effective in offsetting the changes in the fair value or cash flows of the respective hedged item during the period for which the hedge is designated, and whether the actual results of each hedge are within a range from 80% to 125%.

3) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

When a derivative is designated as the hedging instrument in a hedge of the change in fair value of a recognized asset or liability that could affect profit or loss, changes in the fair value of the derivative are recognized immediately in profit or loss together with changes in the fair value of the hedged item that are attributable to the hedged risk.

If only certain risks attributable to hedged items are subject to hedging, the recognized changes in fair value of the hedged items that are not associated with the risk subject to hedging are recognized in accordance with the Group's policy on financial instrument measurement depending on the instrument classification.

(m) Loans and Receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and that the Group does not intend to sell immediately or in the near term. They arise when the Group provides money or services directly to a debtor with no intention of trading the receivable. Loans and receivables comprise loans and receivables to banks and customers.

Loans and receivables are initially measured at fair value plus direct transaction costs, and subsequently measured at their amortized cost using the effective interest method. Amortized cost is calculated by taking into account any issue costs and any discount or premium on settlement.

Loans and receivables are presented net of specific and collective allowances for impairment. Specific and collective allowances are made against the carrying amount of loans and receivables that are identified as being impaired in order to reduce their value to recoverable amount. If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized (such as an improvement in the debtor's credit rating), the previously recognized impairment loss is reversed by adjusting the allowance account. The amount of the reversal is recognized in the income statement within the line item "net losses from impairment of financial assets."

(n) Held-to-Maturity Financial Assets

Held to maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturity that the Group has the positive intention and the ability to hold them to maturity, and which are not designated as at fair value through profit or loss or as available-for-sale.

Held-to-maturity investments are carried at amortized cost using the effective interest method. Any sale or reclassification of a more than insignificant amount of held-to-maturity investments would result in the reclassification of all held-to-maturity investments as available-for-sale, and prevent the Group from classifying investment securities as held-to-maturity for the current and the following two financial years. However, sales and reclassifications in any of the following circumstances would not trigger reclassification:

- • sales or reclassifications that are so close to maturity that changes in the market rate of interest would not have a significant effect on the financial asset's fair value,
- • sales or reclassifications after the Group has collected substantially all of the asset's original principal, and
- • sales or reclassifications attributable to non-recurring isolated events beyond the Group's control that could not have been reasonably anticipated.

(o) Financial Assets at Fair Value through Profit and Loss

Financial assets at fair value through profit or loss are financial assets that are classified as held for trading or upon initial recognition are designated by the Group as at fair value through profit or loss. Financial assets at fair value through profit or loss held for trading are those that the Group acquired or incurred principally for the purpose of selling or repurchasing it in the near term, part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking or derivatives.

Financial assets at fair value through profit or loss are measured at fair value. Changes in the fair value are presented within the income statement.

(p) Financial Assets Available for Sale

Available for sale financial assets are those non-derivative financial assets that are designated as available for sale or are not classified as another category of financial asset. Available-for-sale investments are those intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, exchange rates or market prices. Unquoted equity securities whose fair value cannot be reliably measured are as exception carried at cost net of impairment allowances. Impairment allowance is charged to the income statement as the difference between the carrying value of a financial asset and the present value of its estimated future cash flows. All other available-for-sale investments are carried at fair value.

Interest income from debt instruments classified as assets available for sale is recognized in profit or loss using the effective interest method. Dividend income from debt instruments classified as assets available for sale is recognized in profit or loss when the Group

3) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

becomes entitled to the dividend. Foreign exchange gains or losses on available-for-sale debt security investments are recognized in profit or loss. Impairment losses are recognized in profit or loss.

Other fair value changes are recognized in other comprehensive income until the investment is sold or impaired, where upon the cumulative gains and losses previously recognized in other comprehensive income are reclassified to profit or loss under net gains/losses on financial assets available for sale.

A non-derivative financial asset may be reclassified from the available-for-sale category to the loans and receivables category if it otherwise would have met the definition of loans and receivables and if the Group has the intention and ability to hold that financial assets for the foreseeable future or until maturity.

(q) Property, Plant and Equipment

i. Recognition and Measurement

Items of property and equipment are measured at cost less accumulated depreciation and any accumulated impairment losses. Cost includes expenditures that are directly attributable to the acquisition of the asset.

Purchased software that is integral to the functionality of the related equipment is capitalized as part of that equipment. When parts of an item of property or equipment have different useful lives, they are accounted for as separate items (major components) of property and equipment. Any gain or loss on disposal of an item of property and equipment is determined by comparing the proceeds from disposal with the carrying amount of the item or property and equipment, and is recognized net within other income/expenses in profit or loss.

ii. Subsequent Expenditure

Subsequent expenditure is capitalized only when it is probable that the future economic benefits of expenditure will flow to the Group.

The cost of replacing part of an item of property or equipment is recognized in the carrying amount of the item if it is probable that the future economic benefits embodied within the part will flow to the Group and its cost can be measured reliably. The costs of the day-to-day servicing of property and equipment are recognized in profit or loss as incurred.

iii. Depreciation

Items of property and equipment are depreciated from the following month when they are available for use. Depreciation is recognized in profit or loss on a straight-line basis over the estimated useful lives of each part of an item of property and equipment since this most closely reflects the expected pattern of consumption of the future economic benefits embodied in the asset. Leased assets are depreciated over the shorter of the lease term and their useful lives.

The depreciation rates used for the current and comparative periods are as follows.

Assets	Estimated Useful Life (Years)	Minimum Annual Rate %
Buildings	Maximum 50	2%
Furniture	Maximum 25	4%
IT equipment and electronic systems	Maximum 15	6,67%
Other	Maximum 10	10%

Depreciation methods, useful lives and residual values are reassessed at each financial year-end and adjusted as appropriate.

(r) Intangible Assets

Intangible assets comprise software, licenses and other intangible assets.

Intangible assets purchased by the Group are stated at cost less accumulated amortization and any accumulated impairment losses.

Subsequent expenditure on intangible assets is capitalized only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure is expensed as incurred.

Amortization is recognized in profit or loss on a straight-line basis over the estimated useful life of an intangible asset, from the date that it is available for use. The estimated useful life of intangible assets is five years and amortization rate used equals 20%, except for the assets whose usage periods are contractually defined, when these assets are amortized over the contractually defined periods.

Amortization methods, useful lives and residual values are reassessed at each financial year-end and adjusted as appropriate.

(s) Impairment of Non-Financial Assets

The carrying amounts of the Group's non-financial assets, other than investment property and deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated. Indefinite-lived intangible assets are tested annually for impairment. An impairment loss is recognized if the carrying amount of an asset or a cash-generating unit exceeds its recoverable amount.

The recoverable amount of an asset or a cash-generating unit is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are

3) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset or a cash-generating unit.

An impairment loss is recognized if the carrying amount of an asset exceeds its recoverable amount (as the difference between the two). Impairment losses are recognized in profit or loss.

Impairment losses recognized in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortization, if no impairment loss had been recognized.

(t) Deposits, Borrowings and Subordinated Liabilities

Deposits, borrowings from banks and customers and subordinated liabilities are the Group's source of debt funding.

The Group classifies equity instruments as financial liabilities or equity instruments in accordance with the substance of the contractual terms of the instruments.

Deposits, borrowings and subordinated liabilities are initially measured at fair value increased by directly attributable transaction costs and are subsequently measured at their amortized cost using the effective interest method.

(u) Provisions

A provision is recognized if, as a result of a past event, the Group has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability. The Group does not perform discounting of the future cash flows expected to arise in the near term.

(v) Financial Guarantees

Financial guarantee represent contracts whereby the Group is obligated to make the designated payment to the guarantee holder for the loss incurred due to the designated debtor's failure to make the relevant payment in timely manner in accordance with the debt instrument terms.

Financial guarantee liabilities are initially recognized at their fair value, and the initial fair value is amortized over the life of the financial guarantee. The guarantee liability is subsequently carried at the higher of this amortized amount and the present value of any expected payment (when a payment under the guarantee has become probable). Financial guarantees are included within contingent liabilities.

(x) Employee Benefits

In accordance with regulatory requirements of the Republic of Serbia, the Group is obligated to pay contributions to tax authorities and to various state social security funds, which guarantee social security insurance benefits to employees. These obligations involve the payment of contributions by the employer, in amounts computed by applying the specific, legally-prescribed rates. The Group is also legally obligated to withhold contributions from gross salaries to employees, and on behalf of its employees, to transfer the withheld portions directly to government funds. These taxes and contributions payable on behalf of the employee and employer are charged to staff costs in the period in which they arise.

Pursuant to the Labor Law, the Group has an obligation to disburse an employment retirement benefit to a retiree. Long-term provisions for retirement benefits payable upon fulfillment of the prescribed conditions stated at December 31, 2017 represent the present value of the expected future payments to employees determined by actuarial assessment using assumptions such as mortality rate tables, employee turnover and disability rates, projected annual salary growth rate of 2.5%, annual discount rate 5% with expected inflation rate of 2%, as well as well as margins on annuities to a vanishing point as prepared by the actuary. In addition, in 2017 the Group accrued expenses for unused annual leaves (vacations).

Notes to the consolidated financial statements (CONTINUED)

4) FINANCIAL RISK MANAGEMENT

(a) Introduction and Overview

In its operations the Group is particularly exposed to the following risks:
- Credit risk, including the residual risk, dilution risk, settlement/delivery risk, and counterparty risk;
- Concentration risk, which includes risks of exposure to a single entity or a group of related entities;
- Liquidity risk;
- Market risks (interest rate risk, currency risk and other market risks);
- Operational risk;
- Investment risk;
- Strategic risk;
- Compliance risk; and
- Money laundering and terrorist financing risks.

Credit risk is the risk of possible negative effects on financial result and equity of the Group caused by the borrower default on its obligations to the Group. Credit risk includes risks which represent the likelihood of occurrence of adverse effects on the Group's financial result and equity due to:
- Residual risk – the fact that credit risk mitigation techniques are less efficient than anticipated or their implementation does not have sufficient influence on reduction of risks to which the Group is exposed.
- Dilution risk – reduced value of purchased receivables as a result of cash or non-cash liabilities of the former creditor to the debtor
- Settlement/delivery risk – unsettled transactions or counterparty's failure to fulfil his part of the deal in a transaction or settlement of monetary liabilities under that transaction
- Counterparty risk – consequence of failure of counterparty to fulfil it's part of the deal in a transaction before final settlement of cash flows of the transaction or settlement of monetary liabilities under that transaction.

Liquidity risk is the possibility of occurrence of negative effects on financial result and equity of the Bank caused by the Bank's inability to fulfil its due obligations as a result of withdrawal of existing sources of financing and/or impossibility of securing new sources of financing, or difficulties in converting assets into liquid funds due to market disturbances.

Market risks include interest rate risk, foreign exchange risk and other market risks. Interest rate risk is a risk of negative effects on financial result and equity of the Group caused by changes in the level of interest rate. Foreign exchange risk is the risk of negative effects on financial result and equity of the Group caused by changes in the exchange rate. Other market risks include price risk on equity securities, price risk on debt securities, settlement/delivery risk and counterparty risk.

Operational risk is the risk of negative effects on the financial result and equity of the Group caused by human error, inadequate internal procedures and processes, inadequate management of the information system and other systems in the Group, as well as by unpredictable external events.

Risk Management Framework

The most important role in the risk management as part of the internal control system is assigned to the Supervisory Board, which is responsible for risk management system establishment and monitoring. The Supervisory Board defines strategies and policies for managing key risk types that the Bank and its subsidiaries are exposed to in their operations. In addition, the Supervisory Board is in charge of prior approval of large exposures to a single entity or a group of related entities exceeding 10% of the Bank's own equity as well as of increase of such exposures to above 20% of the Bank's own equity. Relationship between parent and subsidiaries is strictly defined in accordance with regulatory provisions covering related party transactions and taking into account legal credit limits prescribed by National Bank of Serbia. The Bank's Audit Committee assists the Supervisory Board in performance of its function by considering the Bank's most important internal acts before these are adopted by the Supervisory Board. The Management Board of the Bank is in charge of implementation of the approved risk management strategies and policies, and implementation of the procedures for risk identification, measurement and assessment.

Important role in loan approval process is assigned to the Credit Committee, which is in charge of making decisions about credit applications within its competence level, or giving recommendation for higher credit approval competence level.

Internal organization of the Group ensures functional and organizational separation of risk management and other regular business activities. The Bank has a separate Risk Management Division in its organizational structure. We underline that the risk management function is integrated, where UniCredit Leasing d.o.o. entrusted the Bank's risk management function with the tasks or risk identification, measurement, assessment and management in accordance with the Law on Financial Leasing.

The Risk Management Division covers risk management through the activities of five departments: Strategic Risk Management and Control, Retail Credit Operations, Corporate Underwriting, Corporate Special Credit, and Financial and Operational Risk Department. All departments report directly to the member of the Management Board in charge of risk management, thereby ensuring avoidance of conflicts of interest and separation of the risk management and regular operating activities.

Internal Audit Department

The Internal Audit Department conducts its activities based on the annual operating plan and strategic five-year internal audit plan approved by the Supervisory Board. Regularity of internal audit (frequency or length of an audit cycle) of a particular business area

4) FINANCIAL RISK MANAGEMENT (CONTINUED)

varies from one to five years and directly depends on the estimated risk level. The Internal Audit Department regularly monitors implementation of recommendations provided in its reports (action plans) and reports to the Management Board, Audit Committee and the Supervisory Board on all potential delays in the implementation of the measures.

(b) Credit Risk

Credit process in the Group is based on strict segregation of the competences and responsibilities in credit operations between risk assuming activities for which business function is in charge, and risk managing activities. Business function is comprised of divisions in charge of the client acquisition and client relationship management, while the risk management function encompasses departments within the Risk Management Division, which are in charge of loan underwriting, monitoring, restructuring and collection. According to the "four eye" principle, a decision on a loan application is proposed by the business function (first vote) and the final decision or recommendation for loan approval decision is given by the risk management function (second vote).Exceptions can be made for certain standardized products in the retail segment – individuals and SMEs, when, due to a large number of relatively small loan amounts and simplification of the procedure, the approval process can be completely realized within the business function, with mandatory application of the "four-eye" principle in accordance with predefined criteria and parameters approved by the risk management function.

For adequate and timely management of risks in the area of crediting, the Group applies its internal acts aligned with the Law on Banks, effective decisions of the National Bank of Serbia governing risk management and the regulations governing the business activities of the subsidiaries. The Group's goal is to protect itself against the risks and to optimize the level of the risks assumed by defining adequate procedures and individual responsibilities in the risk management process.

In order to define a consistent guidelines for the credit activity and a general framework for risk management, the Group makes credit risk management strategies for Retail and Corporate segments for each financial year. The strategies include general guidelines for the basic parameters of risk management, principles of analysis of the creditworthiness of each customer segment, and definition of the direction of development of individual products, as well as detailed strategy direction of portfolio development per certain industries. In this manner, the Group ensures that the approved business policies are implemented resulting in acceptable credit risk exposure at the level of individual loans, as well as adequate diversification and general quality of the loan portfolio.

The Group also considers analysis of the money laundering and terrorist financing risk in making decisions on the credit risk assumptions.

Competences, responsibilities and authorities of persons involved in risk management system are defined by the Rules on Competences for Crediting Business. In credit process decision making, the "four eye" principle has to be followed in order to ensure that the two sides involved in the credit process check each other – the one proposing and the other approving a loan.

Credit Risk Reporting

The Group manages credit risk, sets credit risk limits and controls it in all segments of its business and for all relevant types of corporate and retail loans. Timely identification, measuring, monitoring and managing of the credit risk on the Group's portfolio level is supported by the Risk Management Information System ("RMIS"). By reporting at the total portfolio level or at the individual client level, RMIS provides complete, accurate and timely information about the balance, quality and movements of the loan portfolio.

RMIS has to fulfil the four main functions:
1. Collect and process data and credit risk indicators
2. Analyze movements and changes in the entire loan portfolio and its structural characteristics
3. Continuously monitor credit risk and
4. Provide a basis for the process of decision making on the credit risk management.

The scope of monitoring, management and reporting on credit risk on portfolio level includes monitoring of loan loss provisions (impairment allowances of balance sheet assets and provisions for probable losses per off-balance sheet items), as well as special reserves for estimated losses calculated in accordance with the NBS Decision on Classification and relevant internal acts of the Group.

Credit Risk Parameters

Credit risk is quantified by measuring the expected loss. Main indicators that are used to monitor credit risk and to calculate expected loan losses are as follows:
- Exposure of the Group at default (EaD);
- Probability of default (PD); and
- Loss given default (LGD).

The Group uses internal credit rating models. Rating models define specific rating for clients with similar credit risk levels. Each rating grade is related to certain PD parameter based on the Master Rating Scale. Leasing PD are determined based on the master scale applicable to leasing companies within UniCredit Group. The Bank also internally estimates other credit risk parameters, while UniCredit Group defines parameters for Leasing.

Internal credit risk assessment models, credit risk parameters and collaterals are used for loan loss provisions calculation in line with the

4) FINANCIAL RISK MANAGEMENT (CONTINUED)

International Financial reporting Standards ("IFRS"), as defined by the Group's separate acts.

In order to fulfil above mentioned functions, RMIS uses IT systems of UniCredit Group and internally generated databases with information about the portfolio at the individual loan facility level. The Group's systems provide rating and past-due days data as important client's credit risk parameters for the Bank's clients (past-due days for Leasing's clients are obtained from the internal database) as critical credit risk parameters of clients.

Limits

The Group manages credit risk concentration of the portfolio by setting limits. Limits are defined by the Group's internal acts and/or NBS regulations and compliance with those is monitored and reported on an ongoing basis. Limits are explained in more detail in section on the exposure risks.

Reports

In monitoring of credit risk on portfolio level, the following reports are used.

Report	Organizational unit in charge	Dynamics	Credit Committee	Management Board	Audit Committee	Supervisory Board
CRO Report / SB presentation	CFO/Strategic Risk Management Department	Quarterly (or more often)	-	+*	+*	+
Credit Risk Dashboard	Credit Risk Control Unit	Monthly***	-	-	-	-
Credit Portfolio Overview	Risk Management Division	Quarterly	+**	+	-	-

*the report is presented for consideration and analysis before final presentation to the Supervisory Board
**the report is submitted to the Credit Committees after its presentation to the Management Board
***predefined report template is updated on a monthly basis according to the availability of the most recent accounting data and is submitted to the Head of the Risk Management Division and Heads of departments and units within CRO Function.

CRO Report to the Supervisory Board is prepared quarterly or more frequently if necessary depending on the schedule of the Supervisory Board's meetings. All organizational units within the Risk Management Division participate in preparation of the report while the Strategic Risk Management and Control Department is responsible for coordination and delivery of the report. The report is prepared in the form of a presentation and includes, among other things, the following:

- Status overview of the most relevant activities of the Risk Management Division;
- Information on the structure and movements of the loan portfolio;
- Information on the key indicators of the portfolio quality, balance and movements of non-performing loans (NPLs), provisions for credit losses, risk costs and coverage of NPLs with credit loss provisions;
- Basic information on the portfolio concentration and compliance with the set limits, including the list of 10 largest client groups and 10 largest non-performing clients within the overall exposure.

Credit Risk Dashboard Report is updated on a monthly basis by the Strategic Risk Management and Control Department and delivered to the Management Board member in charge of the Risk Management Division and Heads of all departments within this division. The information is presented at the sub-segment level (large corporate clients, middle-sized corporate clients, real estate financing, business clients and entrepreneurs and individuals) with comparative data for the previous month and previous year-end.

The report includes the following information:

- Loan Structure (type and currency);
- Portfolio structure per internal credit rating categories;
- Portfolio structure per (non)-default client status;
- Data on the asset quality at the sub-segment level (exposure, NPL volume and ratio, amount of credit loss provisions, NPLs coverage with credit loss provisions);
- PD and LGD per segment;
- Credit loss provisioning costs per sub-segment (charge and release/reversal as compared to the beginning of year and previous month)
- cost of risk per sub-segment.

Credit Portfolio Overview is prepared on a quarterly basis and is presented to the Bank's Management Board, and afterwards to Credit Committee. All organizational units dealing with the credit risk management within the Risk Management Division participate in preparation of the report. Among other things, the report includes the following information:

4) FINANCIAL RISK MANAGEMENT (CONTINUED)

- detailed information on the structure and movements of the loan portfolio, overall and per segment;
- data on the key portfolio quality indicators, balance and movements of NPLs, provisions for credit losses, costs of risk, NPLs coverage with credit loss provisions, portfolio distribution per rating, etc.;
- the list of 10 largest client groups and 10 largest non-performing clients within the overall exposure;
- portfolio status and overview of the key activities and results according to the internal portfolio classification (Standard, WL, Restructuring, Workout);
- information on the portfolio concentration and compliance with the set limits.

In addition to the standardized reports, there are many activities undertaken in order to provide accurate parameters used in credit risk monitoring: ad hoc analysis and reporting and other activities that contribute to the accuracy of credit risk parameters.

Ad hoc analysis and reporting are applied in case of higher risk exposure, especially if the credit risk level is changing drastically and abruptly and when timely reaction is expected – for example: deterioration of internally defined rating grades, significant need for additional provisions, signs of mismatching in organization, implemented system or procedures, change of any of the credit risk parameters or in calculation of provisions.

Other activities conducted by the Group include: quality verification of data used in monitoring, managing and reporting on the credit risk, improvement of the existing systems and procedures, annual process of budgeting and subsequent control and any adjustments of the budget parameters.

Credit Risk Exposure

The table below shows the Group's maximum credit risk exposure per financial instrument type:

Thousands of RSD

	Cash and cash funds held with the central bank (Note 20)		Held-to-maturity financial assets (Note 23)		Loans and receivables due from banks and other financial institutions (Note 24)		Loans and receivables due from customers (Note 25)		Financial assets at FVTPL held for trading (Note 21)		Available-for-sale financial assets (Note 22)		Other assets (Note 32)		Off-balance sheet items	
	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016
Individually impaired																
Corporate clients, rating 10	-	-	-	623	-	-	1.883.111	6.480.923	-	-	-	-	14.724	97.176	3.084	5.154
Corporate clients, rating 9	-	-	-	-	-	-	168.857	153.792	-	-	-	-	-	91	-	-
Corporate clients, restructured loans	-	-	-	-	7	6	10.592.819	14.566.424	-	-	-	-	30.170	195.576	213.576	369.075
Retail clients, > 90 days past due	-	-	-	-	-	-	1.400.737	4.064.755	-	-	-	-	3.076	92.780	724	1.209
Gross loans	-	-	-	623	7	6	14.045.524	25.265.894	-	-	-	-	47.970	385.623	217.384	375.438
Impairment allowance	-	-	-	623	7	3	8.218.862	15.120.903	-	-	-	-	31.869	343.254	126.577	99.508
Carrying value	-	-	-	-	-	3	5.826.662	10.144.991	-	-	-	-	16.101	42.369	90.807	275.930
Group-level impaired																
Corporate clients, rating 1 - 6	38.226	43.692	70.179	43.526	11.892.400	18.519.101	154.746.484	125.846.684	-	-	2.120.222	2.583.082	71.320	290.332	134.431.232	110.501.685
Corporate clients, rating 7	-	-	-	-	1.358	3.440	5.263.396	6.356.534	-	-	-	-	2.438	618	3.675.251	5.970.505
Corporate clients, rating 8	-	-	9.355	-	-	-	460.951	3.110.239	-	-	-	-	499	521	41.710	367.794
Retail clients, < 90 days past due	-	-	-	-	-	-	75.667.609	64.135.108	-	-	-	-	388	482	1.575.544	1.619.058
Gross loans	38.226	43.692	79.534	43.526	11.893.758	18.522.541	236.138.440	199.448.565	-	-	2.120.222	2.583.082	74.645	291.953	139.723.737	118.459.042
Impairment allowance	196	775	1.648	569	8.694	32.112	1.357.549	1.354.475	-	-	-	-	543	559	198.264	197.727
Carrying value	38.030	42.917	77.886	42.957	11.885.064	18.490.429	234.780.891	198.094.090	-	-	2.120.222	2.583.082	74.102	291.394	139.525.473	118.261.315
Carrying value of rated assets	38.030	42.917	77.886	42.957	11.885.064	18.490.432	240.607.553	208.239.081	-	-	2.120.222	2.583.082	90.203	333.763	139.616.280	118.537.245
Carrying value of non-rated assets	29.622.987	28.042.349	-	-	-	-	789	100.392	2.281.049	2.315.317	80.051.414	73.737.582	910.100	581.804	-	-
Total carrying value	**29.661.017**	**28.085.266**	**77.886**	**42.957**	**11.885.064**	**18.490.432**	**240.608.342**	**208.339.473**	**2.281.049**	**2.315.317**	**82.171.636**	**76.320.664**	**1.000.303**	**915.567**	**139.616.280**	**118.537.245**

* Category "corporate clients – restructured loans" includes corporate customers with internal rating 8-, whose impairment allowance was made on a group-level and not individually.

4) FINANCIAL RISK MANAGEMENT (CONTINUED)

Implementation of Basel Standards

In the area of Basel standards implementation the focus of activities was placed mainly on the monitoring and confirming of predictive capabilities of the internally developed rating models and their parameters for corporate, retail, entrepreneur and small entity segments. In 2017 the Bank performed internal validation of all internally developed rating models and credit risk parameters, which confirmed their predictive capabilities and calibration against the identified risk level in the current banking operations. According to the resulting internal validation recommendations, the Bank improved calibration of PD model for the segment of entrepreneurs and small businesses. In 2017 the Bank fully implemented Basel III Standards for reporting to the National Bank of Serbia, while it has been reporting to UniCredit Group under Basel III standards since 2014.

Internal Rating System (Rating Scale)

The ranking rules for customers are established at the level of the UniCredit Group and as such are uniform for each member of the UniCredit Group. The Group's rating system was developed and has been in use since 2004 at the Group level for clients classified in the corporate clients group. For retail clients and entrepreneurs, the rating system was internally developed and has been in use since 2010. The Group uses UniCredit Group's rating models for multinational companies, banks, insurance companies and exposures to states/governments. The Master Scale is used as a unique rating assignment method which ensures that customers with the same rating have the same credit characteristics and the same probability that they will not settle their obligations, in part or in full, within the period of 1 year.

The Master Scale is divided into 10 rating classes that are further broken down into a total of 26 rating subgroups.

The internal master scale is compliant with Basel standards, meaning that each rating subgroup has a PD parameter associated with it, with probability that a customer with particular characteristics will be unable to settle liabilities toward the Group and will be in default. For the first 23 subgroups the probability of default ranges between 0.02% and 20.00%, where those clients are rated between 1+ and 8. Their probability of default is based on statistical analysis based on historical data.

Ratings from 1+ to 6-: These rating notches are reserved for customers determined in an internal credit assessment to have a credit standing of very good to just acceptable. For customers with this rating periodic review of credit rating is performed annually.

Ratings 7+ to 7-: Cover three subgroups for transactions with low credit rating. Customers assigned these rating notches have substantially greater risk factors and must be constantly monitored.

Ratings 8+ and 8- cover those companies without individual provisioning which are subject to special workout or credit-reduction measures.

Rating 8- relates to customers in default according to the Basel standards criteria.

Rating 9 comprises customers with loan loss provision calculated on an individual basis or those where a portion of the receivable has been written off.

Rating 10 is assigned to the clients in the process of liquidation or bankruptcy.

Ratings 8-, 9 and 10 are by definition assigned to customers in default in accordance with Basel standards criteria, with specific credit loss provisioning calculation.

Impairment Allowance and Provisioning Methodology

The provisioning procedure is conducted in two steps in accordance with the relevant adopted acts for provision calculation in accordance with IAS/IFRS and Group's adopted rules:

- assessment of individual/specific provision (at group or individual level) for clients where impairment of value already occurred, and
- assessment of impairment on a portfolio level for loans where impairment in value does not exist or exists but it has not yet been identified.

Rules and Principles for Individual Impairment/Provision

A financial asset is impaired and impairment has occurred if there is objective evidence of impairment resulting from one or more events after initial recognition which impact future cash flows associated with such financial asset. The Group reviews at least once in three months whether there is objective evidence of impairment of a financial assets or group of assets. If there is such evidence, the Group is required to calculate the amount of impairment for the purpose of deciding whether to recognize an impairment loss. In other words, if there is any such evidence of impairment, the Group should estimate the recoverable amount for such assets or group of assets and recognize an impairment loss.

In determining the adequate amount of provision a distinction is made between the need for calculating a special provision on an individual basis and a special provision on a group basis for clients grouped in categories with similar risk characteristics, including segments to which the client belongs and total amount of exposure at client level. Total exposure of clients consists of the balance of receivable and off-balance balance of receivables, including undrawn amounts of loans.

The process of calculating a special provision on an individual basis is

4) FINANCIAL RISK MANAGEMENT (CONTINUED)

intended to measure impairment at client level. Individual provisions for Bank's portfolio are measured as the difference between the book value of a receivable and present value of expected future cash flows (excluding future impairments not recognized as already occurred) discounted using the effective interest rate for the particular financial asset (e.g. effective interest rate specified in the contract). In other words, the provision is set in the amount of the individual receivable for which collection is doubtful. In the event that the effective interest rate is not available, in calculating the provision an alternative interest rate is used, which is defined in accordance with the Bank's internal acts. In determining the present value of a receivable, first the discounted cash flow from repayment of principal, interest and any other cash flows associated with the loan are determined. Thereafter, the discounted cash flow from the net realizable value of impaired assets is determined for the given loan. Finally, the net present value of future cash flows is compared to the carrying amount of the particular asset and the amount of the loan loss provision is calculated and reported in the income statement. Special provisions for leasing's portfolio are determined in the amount of individual receivables that are not likely to be collected, based on the present value of the future cash flows of the loan or estimated collection from the foreclosure of the asset leased and additional collateral.

Calculation of provisions for exposures that are impaired and which are not classified as individually significant is performed on a group basis by grouping clients with a default status into homogenous categories with similar risk characteristics. In defining homogenous categories, the Bank uses segmentation criteria in developing the model for computing the loss rate upon occurrence of loss given default (LGD model). In defining homogenous categories for its portfolio Leasing relies on the categorization of clients according to the default status and criteria for LGD categorization.

Rules and Principles for General Provisioning

In determining provisions for exposures for which there are no objective evidence of impairment the Group uses the general provisioning method (IBNR). According to this method, provisions are calculated not just for exposures for which an event has been identified which leads to impairment, but also for exposures for which an event that leads to impairment has occurred, but has yet not been identified by the Group. Even though for such loans no indications of impairment exist, nor any credit risk losses as at the reporting date, historical information suggests that over time, for a portion of these loans, contractual obligations toward the Group will not be performed.

The method of general provisioning is based on the concept of expected loss according to Basel standards. Expected loss represents the average loss for a credit portfolio in the period of one year and depends on credit risk parameters. A parameter which links the concept of expected losses with the method of general provisioning is the period of identification of an occurred loss (Loss Confirmation Period – LCP). LCP represents a time period expressed as the number of months between the moment of occurrence or potential occurrence of an event that results in loan impairment and the moment when an event has been identified by the Group. Identification of the event itself is linked to the fulfilment of criteria for default status.

In order for an occurred (but still not identified) loss to be covered for a part of the credit portfolio without the existence of objective evidence of loan impairment, a general provision is calculated as the product of the expected loss for the period of one year and the LCP parameter expressed as parts of the year. The value of the LCP parameter is 12 months for legal entities, SME, entrepreneurs and individuals in accordance with the internal segmentation (corporate and retail segments) and 4 months for banks in accordance with the range recommended by the UniCredit Group, which is from 4 to 12 months

4) FINANCIAL RISK MANAGEMENT (CONTINUED)

The table below shows a breakdown of gross and net non-performing loans due from banks and customers. Non-performing loans are loans which have at least one repayment instalment over 90 days past due. Such loans are impaired and provided for in full, after considering collection from operating cash flows and/ collateral foreclosure.

Thousands of RSD

	Held-to-maturity financial assets (Note 23)		Loans and receivables due from banks and other financial institutions (Note 24)		Loans and receivables due from customers (Note 25)		Other assets (Note 33)		Off-balance sheet items	
	Gross	Net	Gross	Net	Gross	Net	Gross	Net	Gross	Net
December 31, 2017										
Corporate clients, rating 10	-	-	-	-	1.883.111	566.793	14.724	3.262	3.084	85
Corporate clients, rating 9	-	-	-	-	168.857	89.237	-	-	-	-
Corporate clients, restructured loans	-	-	7	-	10.592.819	4.209.604	30.170	12.700	213.576	90.139
Retail clients, > 90 days past due	-	-	-	-	1.400.737	961.028	3.076	139	724	583
Total	**-**	**-**	**7**	**-**	**14.045.524**	**5.826.662**	**47.970**	**16.101**	**217.384**	**90.807**
December 31, 2016										
Corporate clients, rating 10	623	-	-	-	6.480.923	896.724	97.176	952	5.154	88
Corporate clients, rating 9	-	-	-	-	153.792	83.130	91	-	-	-
Corporate clients, restructured loans	-	-	6	3	14.566.424	8.320.773	195.576	40.923	369.075	274.983
Retail clients, > 90 days past due	-	-	-	-	4.064.755	844.364	92.780	494	1.209	859
Total	**623**	**-**	**6**	**3**	**25.265.894**	**10.144.991**	**385.623**	**42.369**	**375.438**	**275.930**

The aging structure of matured and unimpaired loans as of December 31, 2017 is provided in the table below:

(Thousands of RSD)

	Up to 30 days past due	31 to 60 days past due	61 to 90 days past due	Over 90 days past due	Total
Loans and receivables due from customers					
Gross	7.532.185	959.672	211.591	-	**8.703.448**
Impairment allowance	(91.487)	(21.687)	(10.847)	-	**(124.021)**
Net carrying value	**7.440.698**	**937.985**	**200.744**	**-**	**8.579.427**

Security Instruments - Collaterals

Credit risk is mitigated through adequate collateral management process. The purpose of acquiring all available collaterals, proper booking, assessment and monitoring is to minimize risk as much as possible. Therefore the Group is especially dedicated to the management of collaterals, maintaining the acceptable relationship between the undertaken risk and real rate of the collateral recovery, control and mitigation of risks related to quality, concentration, or insurance of the receivables, maturity, currency, etc. Aiming at further enhancement of processes and systems with regards to credit risk mitigation, UniCredit Bank, as the parent entity, set up a special unit, whose activities included collateral appraisal, process of collateral monitoring, accurate reporting, management of the relationships with external associates, preparations of expert opinions, improvement of data quality and statistical monitoring of collaterals.

The Group uses relevant policies and procedures for collateral management. The most significant collaterals accepted and used by the Group for minimizing credit risk comprise:

- financial collaterals (cash deposits), allowed to be recognized in full amounts,
- payment guarantees issued by first-class banks and governments, allowed to be recognized in full amounts,
- mortgages on residential or commercial property, recognized up to 70% or 60%, respectively of the appraised value of property and
- securities issued by governments, central banks or institutions with adequate credit rating.

In the event that the currency of a security instrument differs from the currency of the loan for which it provides security, the value of the security instrument must be further reduced using a factor defined for every currency combination, as specified by the relevant internal bylaws governing credit risk mitigation.

4) FINANCIAL RISK MANAGEMENT (CONTINUED)

Appraised fair values of collaterals securing the Group's loans up to the credit risk exposure level as of December 31 are presented in the table below:

Thousands of RSD

	Loans and receivables due from banks and other financial institutions		Loans and receivables due from customers		Held-to-maturity financial assets		Available-for-sale financial assets		Other assets		Off-balance sheet assets	
	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016
Corporate clients, rating 10	**-**	**-**	**627.258**	**838.933**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**826**
Real estate	-	-	627.258	831.353	-	-	-	-	-	-	-	-
Other	-	-	-	7.580	-	-	-	-	-	-	-	826
Corporate clients, rating 9	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Real estate	-	-	-		-	-	-	-	-	-	-	
Other	-	-	-	-	-	-	-	-	-	-	-	-
Corporate clients, restructured loans	**-**	**-**	**3.217.452**	**6.131.575**	**-**	**-**	**-**	**-**	**-**	**-**	**75.832**	**76.252**
Real estate	-	-	2.313.590	4.440.111	-	-	-	-	-	-	70.805	58.780
Other	-	-	903.862	1.691.464	-	-	-	-	-	-	5.027	17.472
Retail clients, > 90 days past due	**-**	**-**	**376.898**	**437.005**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Real estate	-	-	376.898	436.616	-	-	-	-	-	-	-	-
Other	-	-	-	389	-	-	-	-	-	-	-	-
Group-level impairment allowance based on collateral appraisal	**1.304.963**	**3.193**	**59.485.755**	**63.520.472**	**-**	**-**	**-**	**-**	**-**	**-**	**10.298.486**	**9.620.687**
Real estate	2.000	3.193	50.342.776	48.556.331	-	-	-	-	-	-	5.555.007	4.889.206
Other	1.302.963	-	9.142.979	14.964.141	-	-	-	-	-	-	4.743.479	4.731.481
Total	**1.304.963**	**3.193**	**63.707.363**	**70.927.985**	**-**	**-**	**-**	**-**	**-**	**-**	**10.374.318**	**9.697.765**

The Bank will publish information and data in accordance with NBS Guidelines for Publishing Bank Data and Information on the Asset Quality within disclosures required by the Decision on the Publishing of Bank Data and Information (Official Gazette of RS no. 125/2014 and 4/2015). Such information will be disclosed on the Bank's website.

(c) Liquidity Risk

Liquidity risk is the risk that the Group will encounter difficulty in meeting obligations associated with its financial liabilities that are settled by delivering cash or another financial asset.

The Group is exposed to daily calls on its available cash resources from overnight deposits, current accounts, maturing deposits, loan drawdowns, calls on guarantees, margins and other obligations to pay out cash and cash equivalents. The Group does not maintain cash resources to meet all of these needs since historical experience demonstrates that a minimum level of reinvestment of maturing funds can be predicted with a high degree of certainty.

The matching and controlled mismatching of the maturities and interest rates of assets and liabilities is fundamental to the management of the Bank. It is not unusual for banks never to cover their balances, given that business transactions are often carried out for indefinite periods and are of different types. Open positions potentially increase profitability, but also increases the risk of losses.

The maturities of assets and liabilities and the ability to replace, at an acceptable cost, the interest bearing liabilities as they mature, are important factors in assessing the liquidity of the Bank and its exposure to changes in interest and exchange rates.

The Bank's management believes that the diversification of deposits by the type of deposit placed and the number of customers, as well as the historical experience of the Bank, provide adequate assurance that its deposits represent a stable and reliable source of finance.

4) FINANCIAL RISK MANAGEMENT (CONTINUED)

The Bank's liquidity is expressed through the liquidity ratio. The Group is under obligation to maintain the ratio between the sum of liquid receivables of first order and liquid receivables of second order, on the one hand, and the sum of the Bank's demand deposit and deposits without contractual maturity and deposits with contracted maturity, as follows:

- at least 1.0 – when calculated as an average of all working days in a month;
- not below 0.9 for over three consecutive days; and
- at least 0.8 – when calculated for one working day.

In addition, the Group is obligated to maintain the liquidity levels so that the rigid/cash liquidity ratios are as follows:

- at least 0.7 – when calculated as an average of all working days in a month;
- not below 0.6 for over three consecutive days,
- at least 0.5 – when calculated for one working day.

The Bank is under obligation to report to the National Bank of Serbia if the liquidity ratio is not within prescribed parameters for two consecutive working days, and must do so on the next working day. If the Parent bank determines a critically low liquidity ratio, it must report this to the National Bank of Serbia at the latest by the next working day. Such report should contain information on the amount of liquid assets that are not available, on the reasons for the lack of liquidity and on planned activities for resolving the cause of illiquidity. The Financial and Operational Risk Department prepares a report on daily liquidity for the National Bank of Serbia at daily level.

The Group's liquidity management is the responsibility of the Head of the Assets and Liabilities Management ("ALM") and Head of the Markets Department. The Liquidity Centre of UniCredit Group monitors the liquidity of its subsidiaries, maintains liquidity policy in the region and, when needed, orders corrective measures that are to be carried out by a subsidiary. Short term liquidity management in responsibility of Markets Department.

Depending on the crisis severity, the Group may declare the Warning Stage or the Alert Stage. The Group's liquidity policy in unforeseen events describes the engagement rules for each of the two stages. There are specific rules for activation of and response in each stage and each stage has a dedicated task force. Whenever a stage is activated, the relevant responsibility lines convene, assess the situation and make a decision on further actions. The Liaison Officer (LO) appointed by CRO (Chief Risk Officer – Head of the Risk Management Division) and CFO (Head of the Strategy and Finance Division)is responsible for scheduling the meeting, its agenda and minutes, and the further distribution of the minutes. LO enables transparency of the process and allows the organization to analyze the effectiveness of the liquidity policy in unforeseen events after the end of the crisis. CFO is responsible for liquidity transaction performance and coordination of all relevant operations, taking care of full harmonization of internal and external communications. CRO has an independent supervisory role.

Liquidity ratio (I grade)	2017	2016
- as at 31 December	1.39	1.29
- average for the period – December	1.32	1.37
- maximum for the period – December	1.40	1.49
- minimum for the period – December	1.25	1.27

Rigid/cash liquidity ratio:	2017	2016
- as of December 31	1.05	0.96
- average for the period – December	1.07	1.11
- maximum for the period – December	1.18	1.29
- minimum for the period – December	0.99	0.96

Early warning signals or indicators have been defined and the Bank monitors them on a daily basis. Early warning signals are aimed at assisting those in charge of liquidity maintenance to estimate the market.

In addition, the Group is required to calculate the liquidity coverage ratio twice a year at the consolidated level. The liquidity coverage ratio represents the Bank's liquidity buffer relative to the net outflows of liquid assets, which would occur within the 30 days from the calculation date in the assumed stress. The Bank is under obligation to maintain the liquidity coverage ratio aggregately for all the currencies at the level not below 100%.

(In EUR million)

Liquidity coverage ratio		
Item	**Bank**	**Banking Group**
Liquidity buffer	727.83	727.83
Net liquid asset outflows	396.03	390.94
Liquidity coverage ratio	183.78%	186.17%

4) FINANCIAL RISK MANAGEMENT (CONTINUED)

The following table provides breakdown of relevant maturity groups of the Group's financial assets and liabilities as of December 31, 2017:

(Thousands of RSD)

	Up to 1 month	From 1 to 3 months	From 3 to 12 months	From 1 to 5 years	Over 5 years	Total
Assets						
Cash and cash funds held with the central bank	29.661.017	-	-	-	-	**29.661.017**
Financial assets at fair value through profit and loss, held for trading	11	230.303	33.628	1.958.774	58.333	**2.281.049**
Financial assets available for sale	-	8.798.001	3.567.870	61.670.297	8.135.468	**82.171.636**
Financial assets held to maturity	48.681	29.205	-	-	-	**77.886**
Loans and receivables due from banks and other financial institutions	10.052.136	2.669	1.782.508	47.751	-	**11.885.064**
Loans and receivables due from customers	9.868.280	4.926.577	35.862.363	87.925.175	102.025.947	**240.608.342**
Receivables per financial derivatives designated as risk hedging instruments	-	-	-	9.195	-	**9.195**
Other assets	**1.000.303**	**-**	**-**	**-**	**-**	**1.000.303**
Total assets	**50.630.428**	**13.986.755**	**41.246.369**	**151.611.192**	**110.219.748**	**367.694.492**
Liabilities						
Financial liabilities at fair value through profit and loss, held for trading	54.456	-	-	98.690	53.857	**207.003**
Liabilities per financial derivatives designated as risk hedging instruments	-	-	-	17.524	431.270	**448.794**
Deposits and other liabilities due to banks, other financial institutions and the central bank	27.348.342	3.638.920	23.692.931	40.248.894	11.747.071	**106.676.158**
Deposits and other liabilities due to customers	146.517.472	14.033.430	14.298.078	10.489.356	1.320.497	**186.658.833**
Subordinated liabilities	1.022	-	2.717.468	-	-	**2.718.490**
Current tax liabilities	205.253	-	-	-	-	**205.253**
Other liabilities	2.644.579	-	-	-	-	**2.644.579**
Total liabilities	**176.771.124**	**17.672.350**	**40.708.477**	**50.854.464**	**13.552.695**	**299.559.110**
Net liquidity gap as at December 31, 2017	**(126.140.696)**	**(3.685.595)**	**537.892**	**100.756.728**	**96.667.053**	**68.135.382**

The structure of asset and liability maturities as at December 31, 2017 is indicative of maturity mismatch between the outstanding maturities of assets and those of liabilities in the time buckets of up to a month and from one to three months, primarily due to maturity structure of deposits, i.e., a significant share of demand deposits and short-term deposits in the total deposits due to banks and customers. Such customer behavior, i.e., focus on shorter maturities is a logical consequence of the current decline in the market interest rates. However, based on historical data and experience, a significant portion of demand deposits may be considered a long-term source of financing given the turnovers and withdrawals realized; in addition, a large number of term deposits are commonly renewed and placed for another term immediately upon maturity. At the same time, the Group is in possession of liquid instruments, securities that can be pledged with the National Bank of Serbia at any time, as well as agreed and not yet withdrawn lines of credit approved by the international financial institutions and the Parent Bank.

4) FINANCIAL RISK MANAGEMENT (CONTINUED)

The following table provides breakdown of relevant maturity groups of the Group's financial assets and liabilities as of December 31, 2016:

(Thousands of RSD)

	Up to 1 month	From 1 to 3 months	From 3 to 12 months	From 1 to 5 years	Over 5 years	Total
Assets						
Cash and cash funds held with the central bank	28.085.266	-	-	-	-	**28.085.266**
Financial assets at fair value through profit and loss, held for trading	-	127.323	60.901	2.002.449	124.644	**2.315.317**
Financial assets available for sale	5.468.533	1.681.629	16.693.745	47.035.284	5.441.473	**76.320.664**
Financial assets held to maturity	17.906	25.051	-	-	-	**42.957**
Loans and receivables due from banks and other financial institutions	16.787.092	10.054	1.656.256	37.030	-	**18.490.432**
Loans and receivables due from customers	8.255.943	5.870.910	32.941.341	97.006.983	64.264.296	**208.339.473**
Receivables per financial derivatives designated as risk hedging instruments	375	-	-	-	-	**375**
Other assets	**915.567**	**-**	**-**	**-**	**-**	**915.567**
Total assets	**59.530.682**	**7.714.967**	**51.352.243**	**146.081.746**	**69.830.413**	**334.510.051**
Liabilities						
Financial liabilities at fair value through profit and loss, held for trading	93.814	-	33.733	83.127	23.558	**234.232**
Liabilities per financial derivatives designated as risk hedging instruments	-	-	-	18.275	521.822	**540.097**
Deposits and other liabilities due to banks, other financial institutions and the central bank	36.192.130	905.967	4.919.137	36.688.417	7.755.048	**86.460.699**
Deposits and other liabilities due to customers	131.936.662	8.754.518	19.522.037	15.263.268	2.755.885	**178.232.370**
Subordinated liabilities	772	-	-	3.081.353	-	**3.082.125**
Current tax liabilities	31.749	-	-	-	-	**31.749**
Other liabilities	2.999.463	-	-	-	-	**2.999.463**
Total liabilities	**171.254.590**	**9.660.485**	**24.474.907**	**55.134.440**	**11.056.313**	**271.580.735**
Net liquidity gap as at December 31, 2016	**(111.723.908)**	**(1.945.518)**	**26.877.336**	**90.947.306**	**58.774.100**	**62.929.316**

(d) Market Risks

The Group is exposed to market risks. Market risk arise from open positions in interest rate, currency and securities, all of which are exposed to general and specific market movements. The Group applies a "value at risk" ("VaR") methodology to estimate the market risk of positions held and the maximum losses expected, based upon a number of assumptions for various changes in market conditions. The Supervisory Board sets limits on the value of risk that may be accepted, which is monitored on a daily basis.

(i) Interest Rate Risk

The Group is exposed to various risks that due to market interest rate fluctuations affect its financial position and cash flows. Interest rate margins can increase as the result of these fluctuations, but at the same time they can be reduced or cause losses in the event of unexpected fluctuations. Review of risk of fluctuation in interest rates is made using reports of acceptable interest rates based on which monetary assets and liabilities can be revaluated very quickly, with all risk of interest rate fluctuation becoming materially insignificant. The Supervisory Board sets limits on the level of mismatch of interest rate repricing that may be undertaken, which is monitored daily.

The Group is focused on interest rate spreads. The Group is aware that volatility of Interest Rate Risk (IRR) spread is potential interest rate risk indicator. This spread is managed by loan pricing, deposit pricing, and investing.

The methodology used to assess the Investment book interest rate risk is based on the gap/duration analysis. The difference between the interest bearing assets and liabilities within the separate time "buckets" shows how two balance sheet sides react differently to interest rate changes:

- in case of positive GAP the Group is exposed to the risk of loss if interest rates of the certain maturity of the observed currency fall,
- in case of negative GAP, Group is exposed to the risk of loss if interest rates of the certain maturity of the observed currency rise.

The number and the "buckets" schedule are defined on the ALCO and level of UniCredit Group. Gap limits are defined according to the currency (limits per currency).

4) FINANCIAL RISK MANAGEMENT (CONTINUED)

Resulting short and long positions are weighted by factors designed to reflect the sensitivity of the positions in the different time buckets to an assumed change in interest rates, based on an assumed parallel shift of 200 basis points throughout the time spectrum, and on proxies of modified duration.

	December 31, 2017		December 31, 2016	
	Nominal GAP duration	Effect of parallel shift in interest rate by 200 bp	Nominal GAP duration	Effect of parallel shift in interest rate by 200 bp
RSD	-	(2.316.315)	-	(1.464.600)
EUR	-	1.238.032	-	(714.901)
USD	-	(66.671)	-	25.684
GBP	-	-	-	-
CHF	-	319.604	-	(76.695)
JPY	-	-	-	-
CAD	-	-	-	-
AUD	-	-	-	-
DKK	-	-	-	-
NOK	-	-	-	-
SEK	-	-	-	-
Total effect	**-**	**(825.350)**	**-**	**(2.230.512)**

The Group prepares reports for measuring interest rate risk for all positions of assets, liability and off-balance items, as well as for all other compensations or expenditures that are exposed to interest rate risk. These reports are used to measure risk to Net Interest Income ("NII") arising from the re-pricing of assets and liabilities over time. The risk is measured upon the size and duration of potential movements in interest rates.

Interest rate risk management also entails monitoring the sensitivity of the Group's assets and liabilities to different standard and non-standard scenarios of changes in interest rates. The standard scenarios prepared on a daily basis entail parallel changes (increases and decreases) in the yield curve by 200 basis points (b.p.) in Serbia.

One of the objective targets of Finance department/ALM is to establish procedures to be in line with defined limits for interest rate risk. This is achieved through acting on financial market (through interbank trading) in collaboration with the Markets Department in order to hedge the interest rate risk in accordance with the risk profile. At the same time, ALM manages the Group's investment portfolio, which, along with the approved instruments, allows for achievement of such strategic position that would enable stability of interest income of the banking book. ALM also uses hedging transactions for protection against the interest rate risk.

The Group's sensitivity analysis, i.e. impact on the Bank's financial performance of the increase/decrease in the interest rates, both in the banking and trading books, assuming symmetrical movement in yield curves and constant financial position is presented in the table below:

Thousands of RSD

	Parallel increases by 200 b.p.	Parallel decreases by 200 b.p.
2017		
As at December 31	3.056.141	(3.056.141)
Average for the year	2.551.785	(2.551.785)
Maximum for the year	5.403.226	(5.403.226)
Minimum for the year	2.013.833	
2016		
As at December 31	2.405.429	(2.405.429)
Average for the year	2.165.075	(2.165.075)
Maximum for the year	3.029.115	(3.029.115)
Minimum for the year	866.117	(866.117)

Breakdown of VaR position of the Group's trading portfolio includes only the items from the Bank' trading book:

Thousands of RSD

	As at December 31	Average	Maximum	Minimum
2017				
Currency risk	314	4.010	20.722	209
Interest rate risk	3.033	2.787	6.945	118
Credit spread risk	3.691	3.460	8.170	1.116
Other price risks	-	-	-	-
Covariance	(2.333)	-	-	-
Overall	4.705	6.032	19.647	1.567
2016				
Currency risk	10.804	6.981	18.673	416
Interest rate risk	5.126	9.087	19.019	1.349
Credit spread risk	6.103	4.846	9.087	580
Other price risks	-	-	-	-
Covariance	(10.642)	-	-	-
Overall	11.391	12.708	29.968	4.047

Notes to the consolidated financial statements (CONTINUED)

4) FINANCIAL RISK MANAGEMENT (CONTINUED)

Exposure to interest rate movements as at December 31, 2017:

(Thousands of RSD)

	Carrying amount	Up to 1 month	From 1 to 3 months	From 3 months to 1 year	From 1 to 5 years	Over 5 years	Non-interest bearing
Cash and cash funds held with the central bank	29.661.017	15.965.402	-	-	-	-	13.695.615
Financial assets at fair value through profit and loss, held for trading	2.281.049	2.095.845	-	-	-	-	185.204
Financial assets available for sale	82.171.636	-	8.798.001	3.567.870	61.670.297	8.135.468	-
Financial assets held to maturity	77.886	48.681	29.205	-	-	-	-
Loans and receivables due from banks and other financial institutions	11.885.064	10.046.633	9.479	1.797.825	29.227	-	1.900
Loans and receivables due from customers	240.608.342	9.015.958	4.918.909	199.799.710	21.499.531	4.521.160	853.074
Receivables per financial derivatives designated as risk hedging instruments	9.195	-	-	-	-	-	9.195
Other assets	1.000.303	-	-	-	-	-	1.000.303
Total assets	**367.694.492**	**37.172.519**	**13.755.594**	**205.165.405**	**83.199.055**	**12.656.628**	**15.745.291**
Financial liabilities at fair value through profit and loss, held for trading	207.003	-	-	-	-	-	207.003
Liabilities per financial derivatives designated as risk hedging instruments	448.794	-	-	-	-	-	448.794
Deposits and other liabilities due to banks, other financial institutions and the central bank	106.676.158	26.102.605	4.372.532	70.365.199	5.320.867	-	514.954
Deposits and other liabilities due to customers	186.658.833	75.244.759	72.897.649	20.078.300	4.350.796	-	14.087.329
Subordinated liabilities	2.718.490	-	2.718.490	-	-	-	-
Current tax liabilities	205.253	-	-	-	-	-	205.253
Other liabilities	2.644.579	-	-	-	-	-	2.644.579
Total liabilities	**299.559.110**	**101.347.364**	**79.988.671**	**90.443.499**	**9.671.663**	**-**	**18.107.912**
Net interest rate risk sensitivity exposure at December 31, 2017	**68.135.382**	**(64.174.845)**	**(66.233.077)**	**114.721.906**	**73.527.392**	**12.656.628**	**(2.362.621)**

4) FINANCIAL RISK MANAGEMENT (CONTINUED)

Exposure to interest rate movements as at December 31, 2016:

(Thousands of RSD)

	Carrying amount	Up to 1 month	From 1 to 3 months	From 3 months to 1 year	From 1 to 5 years	Over 5 years	Non-interest bearing
Cash and cash funds held with the central bank	28.085.266	8.734.297	-	-	-	-	19.350.969
Financial assets at fair value through profit and loss, held for trading	2.315.317	2.039.136	-	129.508	-	-	146.673
Financial assets available for sale	76.320.664	2.901.036	-	73.419.628	-	-	-
Financial assets held to maturity	42.957	17.283	25.051		-	-	623
Loans and receivables due from banks and other financial institutions	18.490.432	14.932.329	1.863.266	1.658.773	33.386	-	2.678
Loans and receivables due from customers	208.339.473	7.229.762	7.807.641	167.479.706	20.886.983	3.927.742	1.007.639
Receivables per financial derivatives designated as risk hedging instruments	375	-	-	-	-	-	375
Other assets	915.567	-	-	-	-	-	915.567
Total assets	**334.510.051**	**35.853.843**	**9.695.958**	**242.687.615**	**20.920.369**	**3.927.742**	**21.424.524**
Financial liabilities at fair value through profit and loss, held for trading	234.232	-	-	-	-	-	234.232
Liabilities per financial derivatives designated as risk hedging instruments	540.097	-	-	-	-	-	540.097
Deposits and other liabilities due to banks, other financial institutions and the central bank	86.460.699	34.668.687	21.983.512	6.230.461	21.047.758	-	2.530.281
Deposits and other liabilities due to customers	178.232.370	41.891.707	62.257.932	27.702.886	13.677.022	-	32.702.823
Subordinated liabilities	3.082.125	-	3.082.125	-	-	-	-
Current tax liabilities	31.749	-	-	-	-	-	31.749
Other liabilities	2.999.463	-	-	-	-	-	2.999.463
Total liabilities	**271.580.735**	**76.560.394**	**87.323.569**	**33.933.347**	**34.724.780**	**-**	**39.038.645**
Net interest rate risk sensitivity exposure at December 31, 2016	**62.929.316**	**(40.706.551)**	**(77.627.611)**	**208.754.268**	**(13.804.411)**	**3.927.742**	**(17.614.121)**

4) FINANCIAL RISK MANAGEMENT (CONTINUED)

(ii.)Currency Risk

Foreign currency risk is the risk of potential negative effects on the Group's financial result and equity due to fluctuations in the foreign currency exchange rates.

The foreign currency risk ratio is the total open foreign currency position relative to the Group's capital, calculated in accordance with NBS Decision on Capital. The Group is under obligation to maintain the ratio between assets and liabilities in such a way that its foreign currency position at the end of a working day must not exceed 20% of its capital. The Financial and Operational Risk Department prepares a report on daily liquidity for NBS on daily and monthly bases.

The Group is exposed to the effects of exchange rate fluctuations of the most important foreign currencies on its financial position and cash flows. Group management sets limits for risk of exposure to particular foreign currencies and constantly monitors whether balances of various foreign currencies are within prescribed limits. Limits are effective for all relevant foreign currency products within the Markets Department. They comprise trade balances as well as selected strategic foreign currency ALM balances. These limits are defined in the General Section of the MIB Manual. All sensitivities that result from foreign currency balances are limited by the general VaR limit set for the Group in the aggregate and for ALM Department individually.

For the purpose of protecting itself against the risk of fluctuations in the foreign currency exchange rate the Group executes derivative contracts and loan and investment contracts indexed to a foreign currency.

Foreign currency risk management at the operating level of a Bank that is a member of UniCredit Group is the responsibility of the Markets Department.

(In RSD)

	2017	2016
Capital requirement for currency risk at the consolidated level		
- as at December 31	42.699.160	192.148.636

4) FINANCIAL RISK MANAGEMENT (CONTINUED)

The Group's net currency position as at December 31, 2017:

(Thousands of RSD)

	USD	EUR	CHF	Other currencies	RSD	Total
Cash and cash funds held with the central bank	190.858	10.011.837	97.931	126.245	19.234.146	29.661.017
Financial assets at fair value through profit and loss, held for trading	-	391.986	-	-	1.889.063	2.281.049
Financial assets available for sale	1.946.572	20.418.234	-	-	59.806.830	82.171.636
Financial assets held to maturity	-	-	-	-	77.886	77.886
Loans and receivables due from banks and other financial institutions	1.764.534	9.864.028	20.209	233.452	2.841	11.885.064
Loans and receivables due from customers	4.303.490	169.617.420	4.855.601	-	61.831.831	240.608.342
Fair value adjustments of risk hedged items	-	141	192.110	-	-	192.251
Receivables per financial derivatives designated as risk hedging instruments	-	9.195	-	-	-	9.195
Intangible assets	-	-	-	-	1.165.916	1.165.916
Property, plant and equipment	-	-	-	-	1.554.223	1.554.223
Investment property	-	-	-	-	1.364	1.364
Deferred tax assets	-	-	-	-	172.085	172.085
Other assets	601	46.494	4	330	952.874	1.000.303
Total assets	**8.206.055**	**210.359.335**	**5.165.855**	**360.027**	**146.689.059**	**370.780.331**
Financial liabilities carried at fair value through profit and loss, held for trading	-	152.548	-	-	54.455	207.003
Liabilities per financial derivatives designated as risk hedging instruments	-	171.484	277.310	-	-	448.794
Deposits and other liabilities due to banks, other financial institutions and the central bank	3.397.484	94.404.115	771.632	457	8.102.470	106.676.158
Deposits and other liabilities due to customers	15.120.973	96.095.671	1.443.969	1.160.204	72.838.016	186.658.833
Fair value adjustments of risk hedged items	-	-	2.718.490	-	-	2.718.490
Subordinated liabilities	-	-	-	-	1.076.838	1.076.838
Provisions	-	-	-	-	205.253	205.253
Current tax liabilities	194.790	1.106.983	1.852	4.235	1.336.719	2.644.579
Other liabilities	-	-	-	-	70.144.383	70.144.383
Equity	**18.713.247**	**191.930.801**	**5.213.253**	**1.164.896**	**153.758.134**	**370.780.331**
Off-balance sheet financial instruments	10.503.270	(18.275.802)	60.771	836.823	6.841.896	(33.042)
Net currency position as of December 31, 2017	**(3.922)**	**152.732**	**13.373**	**31.954**	**(227.179)**	**(33.042)**

Note: Assets and liabilities with a currency clause index are stated within currency to which they are indexed.

Notes to the consolidated financial statements (CONTINUED)

4) FINANCIAL RISK MANAGEMENT (CONTINUED)

The Group's net currency position as at December 31, 2016:

(Thousands of RSD)

	USD	EUR	CHF	Other currencies	RSD	Total
Cash and cash funds held with the central bank	123.601	17.633.937	130.023	90.867	10.106.838	28.085.266
Financial assets at fair value through profit and loss, held for trading	-	276.180	-	-	2.039.137	2.315.317
Financial assets available for sale	-	21.098.398	-	-	55.222.266	76.320.664
Financial assets held to maturity	-	-	-	-	42.957	42.957
Loans and receivables due from banks and other financial institutions	560.823	17.650.780	5.315	268.855	4.659	18.490.432
Loans and receivables due from customers	6.990.487	136.718.961	6.118.849	-	58.511.176	208.339.473
Fair value adjustments of risk hedged items	-	-	222.845	-	-	222.845
Receivables per financial derivatives designated as risk hedging instruments	-	375	-	-	-	375
Intangible assets	-	-	-	-	921.336	921.336
Property, plant and equipment	-	-	-	-	1.581.197	1.581.197
Investment property	-	-	-	-	1.397	1.397
Deferred tax assets	-	-	-	-	165.498	165.498
Other assets	2.393	60.396	846	71	851.861	915.567
Total assets	**7.677.304**	**193.439.027**	**6.477.878**	**359.793**	**129.448.322**	**337.402.324**
Financial liabilities carried at fair value through profit and loss, held for trading	-	140.418	-	-	93.814	234.232
Liabilities per financial derivatives designated as risk hedging instruments	-	231.786	308.311	-	-	540.097
Deposits and other liabilities due to banks, other financial institutions and the central bank	3.645.035	77.223.030	1.869.093	4.742	3.718.799	86.460.699
Deposits and other liabilities due to customers	15.475.851	99.810.869	1.331.747	1.358.839	60.255.064	178.232.370
Fair value adjustments of risk hedged items	-	103	-	-	-	103
Subordinated liabilities	-	-	3.082.125	-	-	3.082.125
Provisions	-	-	-	-	961.581	961.581
Current tax liabilities	-	-	-	-	31.749	31.749
Other liabilities	68.372	1.529.768	3.067	10.361	1.387.895	2.999.463
Equity	-	-	-	-	64.859.905	64.859.905
Total liabilities and equity	**19.189.258**	**178.935.974**	**6.594.343**	**1.373.942**	**131.308.807**	**337.402.324**
Off-balance sheet financial instruments	11.512.917	(12.497.872)	91.878	980.597	(217.911)	(130.391)
Net currency position as of December 31, 2016	**963**	**2.005.181**	**(24.587)**	**(33.552)**	**(2.078.396)**	**(130.391)**

Note: Assets and liabilities with a currency clause index are stated within currency to which they are indexed.

4) FINANCIAL RISK MANAGEMENT (CONTINUED)

(e) Concentration Risk

Concentration risk directly or indirectly arises from the Group's exposure to the same or similar risk origination source or the same or similar risk type. Concentration risk relates to:
- large exposures
- exposure groups with the identical or similar risk factors, such as industry, product type and similar
- collaterals, including maturity and currency mismatching between large exposures and collaterals securing large exposures.

Concentration risk mitigation and control are performed by the Bank as the Parent Entity, through active management of the loan portfolio and definition of appropriate exposure limits enabling portfolio diversification. The process of deciding on approval of the Bank's large exposures involves the Supervisory Board, Credit Committee and relevant organizational units within UniCredit Group, which ensures another aspect of concentration risk control. In its separate internal acts the Bank prescribes limit types used for managing this risk (regulatory and internal limits) as well as the manner of their monitoring and rules of procedure in instances of limit override or possible override. Appropriate exposure limits are set under relevant decisions of the Management Board in accordance with the internal guidelines, for a single entity or a group of related entities and exposure to certain industries. Compliance with the set limits is monitored at least quarterly (or semi-annually for subsidiaries) within regular CRO Report to the Supervisory Board and within regular quarterly report on the loan portfolio (Credit Portfolio Overview) intended for the Credit Committee as well as Management Board of the subsidiaries. Concentration per collateral is regularly monitored by the Strategic Risk Management and Control Department and reported to the Management Board within the regular report on the collaterals within the Bank's portfolio.

Concentrations of loans and receivables due from customers are disclosed in Notes 25.3 and 25.5.

(f) Exposure Risk

The Group's exposure risks encompass risks of exposure to a single entity or a group of related entities and risk of exposure to an entity related to the Group. In accordance with the NBS regulations and Decision on consolidated supervision of a banking group, the Group's total exposure to a single entity or a group of related entities cannot exceed 25% of the Group's total capital, net of prescribed deductible items. The aggregate amount of all Group's exposures in excess of 10% of the Group's capital cannot exceed 400% of the Group's capital. The total exposure to a single customer or a group of related customers in excess of 10% of the Group's capital must be approved by the Supervisory Board. The manner of large exposure calculation is defined under the Group's Decision on the Risk Management.

(g) Investment Risk

The Group's investment risk relates to the risk of investing in other entities, fixed assets and investment property. In accordance to Law on Banks and NBS Decision on consolidated supervision of a banking group, the Group's investments in a non-financial sector entity cannot exceed 10% of the Group's capital, whereby such investments entail investments through which the Group acquires equity interest or shares in a non-financial sector entity. The total Group's investment in non-financial sector entities, Group's own fixed assets and investment property cannot exceed 60% of the Group's capital, but this restriction does not apply to the acquisition of shares for further trading and sales thereof within six months from the acquisition date.

(h) Country Risk

Country risk is the risk of occurrence of negative effects on the Group's financial result and equity, arising from the Group's inability to collect receivables from borrowers from other countries, for reasons that are associated with political, economic or social conditions in the borrower's country of origin. Country risk comprises:
- political-economic risk which consists of the probability that losses will be incurred due to the impossibility of collecting the Group's receivables due to limitations stipulated by state and other institutions of the borrower's country of origin, as well as general and systemic conditions in that country
- transfer risk which comprises the probability that losses will be incurred due to the impossibility of collecting receivables denominated in a currency that is not the official currency of the borrower's country of origin, due to limitations on payments of liabilities to creditors from other countries in specific currencies, as prescribed by regulations issued by state and other institutions of the borrower's country of origin.

The Group's exposure to this risk is significantly limited due to the Group's business focus on the customers domiciled and operating in the territory of the Republic of Serbia with exception of operations with the financial institutions domiciled outside of the Republic of Serbia. For this purpose, with the support of UniCredit Group, the Group set adequate limits to the counterparty, including a component of the country risk, i.e., the risk of the country of origin of the financial institution.

(i) Compliance Risks

Compliance risk represents possibility of adverse effect on the Group's financial performance and capital due to the failure of the Group to align its operations with the effective laws and regulations, professional standards, procedures for prevention of money laundering and terrorist financing and other procedures and other bylaws aimed at improving banking operations. It particularly relates to the risk of regulatory sanctions, risk of financial loss and reputation

4) FINANCIAL RISK MANAGEMENT (CONTINUED)

risks. The Group has organized a special organizational unit whose competence covers compliance review.

The primary task of the compliance function is to identify and asses the Group's compliance risk and report thereon to the competent bodies in accordance with internal acts as well as propose plans on main compliance risks management. The Compliance Department of the Bank oversees the compliance function of the entire Group.

Moreover, compliance function supports other organizational units of the Group in defining procedures, introducing new products or modifying the existing ones, in implementation of the laws and bylaws, rules, standards and the Group's internal acts specifically governing the following areas: prevention of money laundering and terrorist financing, financial sanctions, banking secrets, protection of personal data, insider information and market abuse, professional market conduct standards, conflict of interests, corruption, loansharking, professional conduct with clients and provision of adequate advice, application of standards on consumer protection and transparency, protection of competition and other regulatory areas in accordance with the rules of UniCredit Group and adopted program for the Group's compliance function.

In addition, the Group's compliance function is in charge of the tasks of identification, measurement and monitoring and managing the risk of money laundering and terrorist financing proportionate to the volume, type and complexity of the Group's organizational structure, its risk profile and exposure to this risk.

(j) Strategic Risks

Strategic risk is a risk of adverse effects on the Group's financial performance and capital due to inadequate strategies and policies in place and their inadequate implementation as well as due to changes in the environment the Group operates in or the bank's failure to respond property to such changes.

Each and every employee within the Group's risk management system is responsible for strategic risk management, with the Supervisory Board having the key role in this system establishment, while the Management Board is in charge of its implementation, as well as for the risk identification, measurement and assessment. Among other things, the Group's governing bodies monitor the strategic risk through creation and monitoring of the budget, which is prepared annually, as well as through preparation of the multiannual strategic plan, which allows them, at least quarterly, to get to know and be able to respond to all the changes in the environment the Group operates in. The system of reporting to the Group's management, which is in place in all the operating segments, ensures an adequate and timely set of information required for the decision making process on the part of the Group's management in order to enable prompt responses to the changes in the business environment.

The Group's organizational structure, set up by the above said governing bodies, is defined and adjusted in such a manner that resources dedicated to the preparation and application of crediting policies and strategies, development and implementation of the respective methodologies, rulebooks and other acts. The Group continuously monitors, assesses and adjusts all the relevant acts and crediting processes and proposes improvements or actions to be taken in response to the changes in the environment in order to adequately decrease their impact on the Group's financial performance.

The critical element of the strategic risk management is the Group's internal control system, which enables continuous monitoring of all the risks the Group is or may be exposed to in its operations. The said system provides implementation of adequate strategies and policies in the Group's practice and elimination of weaknesses or inconsistences, if any, which represents additional strategic risk monitoring and management.

(k) Risk Money Laundering and Terrorist Financing

Risk of money laundering and terrorist financing is a risk of possible adverse effects on the Group's financial performance, capital or reputation due to the use of the Group for money laundering and/or terrorist financing.

Risk of money laundering and terrorist financing arises particularly as a result of the failure of banks to align their business operations with the effective legislation, regulations and internal acts governing prevention of money laundering and terrorist financing, or as a result of mutual nonalignment of the Group's internal acts governing this matter.

The Group has in place adequate policies and procedures for identification, measurement, assessment and management of this risk.

Within the Compliance Department a separate organizational unit has been formed – Unit for Prevention of Money Laundering and Terrorist Financing – to take care of the improvement and continuous implementation of the policies and procedures for managing the risk of money laundering and terrorist financing. The Parent Bank has provided the staff of the Unit with appropriate HR, material, IT and other resources for work as well as with ongoing professional education and trainings.

(l) Operational Risks

Operational risk is the risk of loss resulting from error, breach, interruption, damage caused by internal processes, employees or systems or external events. Operational risk is defined as an event occurring as the result of inappropriate or unsuccessful internal processes, actions of employees and systems or systemic and other external events: internal or external malversation, employment practice and safety at work, receivables from clients, distribution of products, fines and penalties for injury, damage to property, disruption in operation and system errors, process management. Strategic risks, business risks and reputation risks differ from operational risks, while legal risks and compliance risk are included in the definition of operational risk.

The Financial and Operational Risk Department is responsible for recording, monitoring and managing the Bank's operational risks and directly answers to the Chief Risk Officer (CRO).This Department's basic task is to coordinate and cooperate with operating risk managers and to communicate with colleagues at the Operational Risk Department in Milan, with the purpose of securing information for the efficient monitoring of operational risk at all levels. On a daily basis the Department monitors changes in specially defined accounts and on a weekly basis it reports to members of the Management Board regarding all changes in operational risks. For the purpose of efficient monitoring of significant changes in connection with operational risks within the Bank, Operational Risk Managers and Deputy Managers have been appointed from various organizational units that are responsible for the accuracy and timeliness of recording data on all harmful events in their organizational unit into a database. All events that have occurred are recorded in the Group's ARGO application.

The Operational Risk Committee meets quarterly for more efficient internal control and process improvement to minimize risks arising from operational risk. The Bank's Management Board is responsible for decision making on operational risk. It is responsibility of the Department to calculate the capital requirements for operational risks, which is computed using the standardized approach and to prepare reports for local management and UniCredit Group.

(m) Capital Management

As the Bank's (and the Group's) regulator, the National Bank of Serbia ("NBS") defines the method of calculating capital and capital adequacy based on Basel III Regulatory Framework. Regulatory capital, capital adequacy ratios and calculation of risk-weighted assets are defined by the Decision on Capital Adequacy of Banks effective as from June 30, 2017 (the "Decision"). In accordance with NBS Decision on Consolidated Supervision of a Banking Group, the parent entity is required to calculate the banking group's capital, capital adequacy ratios and capital requirements in accordance with the said Decision and the relevant Decision governing the capital adequacy. The Bank monitors its capital adequacy ratio on a quarterly basis using the standardized approach.

The Banking Group is required to calculate the following capital adequacy ratios:

1. the Common Equity Tier 1 capital ratio (CET 1 ratio) represents the common equity Tier 1 capital relative to the risk-weighted assets, expressed as percentage. The minimum CET 1 ratio defined by the Decision is 4.5%;
2. the Tier 1 capital ratio (T1 ratio) is the core capital adequacy ratio, representing the core capital relative to the risk-weighted assets, expressed as percentage. The minimum T1 ratio defined by the Decision is 6%;
3. the total capital adequacy ratio (CAR) represents the Bank's capital relative to the risk-weighted assets, expressed as percentage. The minimum CAR defined by the Decision is 8%.

The Banking Group is required to maintain its core capital in RSD equivalent amount of EUR 10,000,000 at all times, using the official middle exchange rate of NBS effective as at the calculation date. In addition, the Banking Group is required to maintain at all times its capital in the amount necessary for coverage of all risks the Banking Group is or may be exposed to in its operations, yet no less than the amount required to maintain the minimum capital adequacy ratios or increased capital adequacy ratios – in case NBS orders the Banking Group to achieve and maintain capital adequacy ratios higher than the prescribed ones. In 2017 NBS did not impose on the Banking Group capital adequacy ratios higher than the prescribed ones.

The Banking Group's capital is the sum of the core capital (Tier 1) and supplementary capital (Tier 2). The core capital is the sum of the common equity Tier 1 capital and additional Tier 1 capital.

The Banking Group's common equity Tier 1 capital is the sum of the following items adjusted for the regulatory adjustments less deductible items:

- shares and other equity instruments;
- relevant share premium with the common equity Tier 1 instruments;
- the Bank's profit;
- revaluation reserves and other unrealized gains;
- reserves from profit and other reserves of the Bank;
- reserve funds for general banking risks.

Regulatory adjustments – When calculating the value of its capital components, the Banking Group is bound to exclude from any capital component any increase in equity determined under IFRS/IAS resulting from securitization of exposures. Since the Republic of Serbia has no regulations enacted to govern this area, the said regulatory adjustment is not applicable.

The Banking Group does not include in its capital the following:

- fair value reserves relating to gains or losses in cash flow hedging instruments for financial instruments measured at other than fair value, including the projected cash flows;
- gains or losses on the Bank's liabilities measured at fair value, resulting from the changes in the Bank's credit quality;

4) FINANCIAL RISK MANAGEMENT (CONTINUED)

- gains or losses arising from the credit risk for liabilities per derivatives measured at fair value, where the Bank may not offset such gains or losses against those arising from its counterparty credit risk.

Unrealized gains or losses on assets or liabilities measured at fair value, except for the above listed gains or losses, are included in the calculation of capital.

Deductible from the common equity Tier 1 capital are:

- current and prior year's losses and unrealized losses;
- intangible assets, including goodwill, decreased for the amount of deferred tax liabilities that would be derecognized in case of impairment or derecognition of intangible assets under IFRS/IAS;
- deferred tax assets dependable on the Bank's future profitability in line with the effective regulations;
- defined benefit pension fund assets on the Bank's balance sheet;
- the Bank's direct, indirect and synthetic holdings of its own common equity Tier 1 instruments, including those that the Bank is under an actual or contingent obligation to repurchase by virtue of a constructive obligation;
- the Bank's direct, indirect and synthetic holdings of common equity Tier 1 instruments of financial sector institutions (hereinafter: FSI) entities where those entities have reciprocal holdings in the Bank, designed to artificially inflate the bank's capital;
- the Bank's applicable direct, indirect and synthetic holdings of common equity Tier 1 instruments of FSI entities where the Bank holds no significant investments in accordance with Articles 19 and 20 of the Decision;
- the Bank's applicable direct, indirect and synthetic holdings of common equity Tier 1 instruments of FSI entities where the Bank holds significant investments in accordance with Sections 19 of the Decision;
- the amount for which the Bank's additional Tier 1 capital deductible items exceed the Bank's additional Tier 1 capital;
- the amount of exposures qualifying for application of a risk weight of 1.25%, where the Bank decides to deduct the exposure from the common equity Tier 1 rather than apply the said risk weight, such as:
  - holdings in non-FSI entities exceeding 10% of their capital and/or holdings enabling effective execution of significant influence on the management of such entities or their business policies;
  - securitized items in accordance with Section 201, paragraph 1, item 2), Section 202, paragraph 1, item 2), and Section 234 of the Decision;
  - free deliveries, if the counterparty has failed to settle its liability within four working days from the agreed delivery/payment date, in accordance with Section 299 of the Decision;
- any tax charge relating to the common equity Tier 1 items foreseeable at the moment of its calculation, except where the Bank has previously suitably adjusted the amount of common equity Tier 1 items in the amount such tax charges reduce the amount up to which those items may be used to absorb risks or losses;
- amount of the required reserve for estimated losses on the Bank's balance sheet assets and off-balance sheet items.

Upon determining deductible deferred tax assets items and the Bank's applicable direct, indirect and synthetic holdings of common equity Tier 1 instruments of FSI entities where the Bank holds significant investments, the Bank is not required to deduct from the common equity Tier 1 capital the amounts of items that in the aggregate are equal to or lower than the limit which is arrived at by multiplying the common equity Tier 1 items remaining after the regulatory adjustments and decrease for deductible items by 17.65%:

- deferred tax assets dependable on the Bank's future profitability, arising from the temporary differences in the amount lower than or equal to 10% of the Bank's common equity Tier 1 capital calculated in accordance with Section 21, paragraph 2 of the Decision;
- the Bank's direct, indirect and synthetic holdings of common equity Tier 1 instruments of FSI entities where the Bank holds significant investments in the amount lower than or equal to 10% of the Bank's common equity Tier 1 capital calculated in accordance with Section 21, paragraph 2 of the Decision.

The Banking Group's additional Tier 1 capital consists of the sum of the following items less respective deductibles:

- shares and other equity instruments that meet the requirements referred to in Section 23 of the Decision;
- relevant share premium.

As of December 31, 2017 the Banking Group had no additional Tier 1 capital.

The Group's supplementary (Tier 2) capital consists of the sum of the following items less respective deductibles:

- shares and other Tier 2 instruments and liabilities under subordinated loans;
- the relevant share premium, i.e., amounts paid in above the par value of such instruments;
- general credit risk adjustments gross of tax effects, of up to 1.25% of the risk-weighted credit risk exposures for banks calculating the risk-weighted exposures amounts by applying the standardized approach.

The amount in which the supplementary Tier 2 capital instruments, i.e., subordinated liabilities, are included in the calculation of the supplementary Tier 2 capital during the final five years before they mature, is calculated as follows: the ratio of their nominal value and/or the principal amount on the first day of the final five-year period before their mature and the number of calendar days in that period is multiplied by the number of the calendar days remaining to maturity of the instruments or subordinated liabilities at the calculation date.

4) FINANCIAL RISK MANAGEMENT (CONTINUED)

The Group includes into the supplementary Tier 2 capital subordinated liabilities in the amount and in manner prescribed by the Decision.

The following table presents the Group's balance of capital and total risk-weighted assets as of December 31, 2017:

(Thousands of RSD)

	2017	2016*
Common equity Tier 1 capital - CET1		
Paid in common equity Tier 1 instruments	23.607.620	23.607.620
Relevant share premium with the common equity Tier 1 instruments	562.156	562.156
Prior years' profits qualifying for inclusion in common equity capital	655.690	609.513
Revaluation reserves and other unrealized gains	1.545.736	1.529.305
(-) Unrealized losses	(5.416)	(11.823)
Other reserves	36.997.080	32.020.480
(-) Intangible assets, including goodwill, decreased for the amount of deferred tax liabilities)	(1.165.916)	(921.336)
(-) Tax charge relating to the common equity Tier 1 items foreseeable at the moment of its calculation, except where the Bank has previously suitably adjusted the amount of common equity Tier 1 items in the amount such tax charges reduce the amount up to which those items may be used to absorb risks or losses	(231.860)	-
(-) The required reserve for estimated losses on the Bank's balance sheet assets and off-balance sheet items	(13.237.592)	(18.504.195)
(-) Other deductible items	-	-
Total common equity Tier 1 capital - CET1	48.727.498	38.891.720
Additional Tier 1 capital - AT1	**-**	**-**
Total core Tier 1 capital - T1 (CET1 + AT1)	**48.727.498**	**38.891.720**
Supplementary capital - T2		
Paid amount of subordinated liabilities	538.731	616.271
Deductible items	-	-
Total supplementary capital - T2	**538.731**	**616.271**
Total regulatory capital (T1 + T2)	**49.266.229**	**39.507.991**

* Regulatory capital for 2016 has been adjusted to the requirements of KAP form, which has been in use since June 30, 2017.

In 2017 the Group achieved capital adequacy ratios within the limits prescribed by NBS Decision on Capital Adequacy of Banks and Decision on Risk Management.

5) USE OF ESTIMATES AND JUDGMENTS

The preparation of the consolidated financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under given circumstances. Revision to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

These disclosures supplement the comments on financial risk management (Note 4).

(a) Key Sources of Estimation Uncertainty

(i) Provisions for Credit Losses

Assets accounted at amortized cost are assessed for impairment on a basis described in accounting policy 3(j)(vii).

The specific counterparty component of the total allowances for impairment applies to financial assets evaluated individually for impairment and is based upon management's best estimate of the present value of the cash flows that are expected to be received. In estimating these cash flows, management makes judgments about counterparty's financial situation and the net realizable value of any underlying collateral. Each impaired asset is assessed on its quality and the workout strategy and estimate of cash flows considered recoverable are independently approved by the Credit Risk function.

Collectively assessed impairment allowances cover credit losses inherent in portfolios of loans and receivables and held-to-maturity investment securities with similar credit risk characteristics when there is objective evidence to suggest that they contain impaired items cannot yet be identified. In assessing the need for collective loss allowances, management considers factors such as credit quality, portfolio size, concentrations and economic factors. In order to estimate the required allowances, assumptions are made to define the way inherent losses are modelled and to determine the required input parameters, based on historical experience and current economic conditions.

The accuracy of the allowances depends on the estimates of future cash flows for specific counterparty allowances and the model assumptions and parameters used in determining collective (group-level) allowances.

(ii.) Fair Value Estimates

Determination of fair value for financial assets and liabilities for which there is no observable market price requires the use of valuation techniques as described in accounting policy 3(j)(vi). For financial instruments that trade infrequently and have little price transparency, fair value is less objective, and requires varying degrees of judgment depending on liquidity, concentration, uncertainty of market factors, pricing assumptions and other risks affecting the specific instrument.

(b) Critical Accounting Judgments in Applying the Group's Accounting Policies

Critical accounting judgments made in applying the Group's accounting policies include the following:

(i) Measurement of Financial Instruments

The Group's accounting policy on fair value measurement is disclosed in accounting policy 3(j)(vi).

The Group measures fair values using the following fair value hierarchy that reflects the significance of the inputs used in making the measurements:

- Level 1: Quoted market price (unadjusted) in an active market for an identical instrument.
- Level 2: Valuation techniques based on observable inputs other than quoted prices, either directly (i.e. as prices) or indirectly (i.e. derived from prices). This category includes instruments valued using: quoted market prices in active markets for similar instruments; quoted prices for identical or similar instruments in markets that are considered less than active; or other valuation techniques where all significant inputs are directly or indirectly observable from market data.
- Level 3: Valuation techniques using significant unobservable inputs. This category includes all instruments where the valuation technique includes inputs not based on observable data and the unobservable inputs have a significant effect on the instrument's valuation. This category includes instruments that are valued based on quoted prices for similar instruments where significant unobservable adjustments or assumptions are required to reflect differences between the instruments.

Fair values of financial assets and financial liabilities that are traded in active markets are based on quoted market prices. For all other financial instruments the Group determines fair values using valuation techniques.

Valuation techniques include net present value and discounted cash flow models, comparison to similar instruments for which market observable price exist and other valuation models. Assumptions

5) USE OF ESTIMATES AND JUDGMENTS (CONTINUED)

and inputs used in valuation techniques include risk-free and benchmark interest rates, credit spreads and other factors used in estimating discount rates, bond and equity prices, foreign exchange rates, equity and equity index prices and expected price volatilities and correlations. The objective of valuation techniques is to arrive at a fair value determination that reflects the price of the financial instrument at the reporting date, which would have been determined by market participants acting at arm's length.

The Group uses widely recognized valuation models for determining the fair value of common and more simple financial instruments, such as interest rate and currency swaps that use only observable market data and require little management judgment and estimation. Observable prices and model inputs are usually available in the market for listed debt and equity securities, exchange traded derivatives and simple over the counter derivatives like interest rate swaps.

Availability of observable market prices and model inputs reduces the need for management judgment and estimation and also reduces the uncertainty associated with determination of fair values. Availability of observable market prices and inputs varies depending on the products and markets and is prone to changes based on specific events and general conditions in the future markets.

(ii) Estimated Useful Lives of Intangible Assets, Property and Equipment and Amortization/Depreciation Rates Used

The calculation of amortization/depreciation charge and amortization/depreciation rates applied are based on the estimated useful lives of intangible assets, property and equipment, which are subject to an ongoing review. The estimated useful lives are reviewed for adequacy at least annually, or more frequently if there is any indication that significant changes have occurred to the factors determining the previously defined estimated useful lives or other events affecting the estimated useful lives. Useful life estimates require the management to make significant estimates and judgments based on the historical experience with similar assets, as well as anticipated technical advancement and changes in economic and industrial factors.

(iii) Impairment of Non-Financial Assets

At each reporting date, the Group's management reviews the carrying amounts of the its non-financial assets other than investment property and deferred tax assets in order to determine the indications of impairment losses. If there is any indication that such assets have been impaired, the recoverable amount of the asset is estimated in order to determine the extent of impairment loss. If the estimated recoverable amount of an asset is below its carrying value, the carrying amount of the asset is reduced to its recoverable amount. An impairment loss is immediately recognized as an expense of the current period. Assessment of indicators and objective evidence of impairment requires the management to make significant estimates regarding the expected cash flows, discount rates and usage capacity of the assets subject to review.

(iv) Deferred Tax Assets

Deferred tax assets are recognized to the extent that it is probable that taxable profit will be available against which such deferred tax assets may utilized. The Group's management needs to make prudent assessments of deferred tax assets which may be recognized, based on their period of inception and amounts, as well as on the amount of future taxable income and tax policy planning strategy.

(v) Provisions for Litigations

The Group is involved in a number of lawsuits and labor disputes. Provisions are recognized when the Group has a present obligation (legal or constructive) as a result of past events, it is probable that the Group will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation. Estimates of the provisions for legal suits requires the Group's management and Legal Unit to make significant estimates and judgments, including the estimate of the probability of negative suit outcomes and probable and reasonable estimates of loss amounts. The required provision amounts represent the best estimates made by the management based on the information available as at the reporting date. However, they may be subject to future changes due to new events taking place or obtaining new information.

(vi) Provisions for Employee Benefits

The costs of provisions for employee retirement benefits are determined by actuarial calculation. The actuarial calculation includes an assessment of the discount rate, future salary growth rate, future employee turnover rate and mortality rates. Actual outcome may vary significantly from the said estimates, particularly given the long term they relate to.

Notes to the consolidated financial statements (CONTINUED)

6) FINANCIAL ASSETS AND LIABILITIES - ACCOUNTING CLASSIFICATION AND FAIR VALUES

The following table show the breakdown of financial instruments measured at fair value at the end of the reporting period, grouped in fair value hierarchy levels:

(Thousands of RSD)

	Note	Level 1	Level 2	Level 3	Total
2017					
Financial assets at fair value through profit and loss, held for trading	21	-	2.281.049	-	2.281.049
Financial assets available for sale	22	1.946.572*	80.225.064	-	82.171.636
Fair value adjustments of risk hedged item	26	-	17.956	174.295	192.251
Receivables per derivatives designated as risk hedging instruments	27	-	9.195	-	9.195
		1.946.572	**82.533.264**	**174.295**	**84.654.131**
Financial liabilities at fair value through profit and loss, held for trading	33	-	207.003	-	207.003
Liabilities per financial derivatives designated as risk hedging instruments	34	-	448.794	-	448.794
Losses on the fair value adjustments of risk hedged items	37	-	-	-	-
		-	**655.797**	**-**	**655.797**

(Thousands of RSD)

	Note	Level 1	Level 2	Level 3	Total
2016					
Financial assets at fair value through profit and loss, held for trading	21	-	105.553	2.209.764	2.315.317
Financial assets available for sale	22	-	76.669	76.243.995	76.320.664
Fair value adjustments of risk hedged items	26	-	24.067	198.778	222.845
Receivables per derivatives designated as risk hedging instruments	27	-	375	-	375
		-	**206.664**	**78.652.537**	**78.859.201**
Liabilities per financial derivatives designated as risk hedging instruments	33	-	87.814	146.418	234.232
Liabilities per financial derivatives designated as risk hedging instruments	34	-	540.097	-	540.097
Fair value adjustments of risk hedged items	37	-	11	92	103
		-	**627.922**	**146.510**	**774.432**

*Financial assets available for sale – level 1 include Treasury bills of the Republic of Serbia denominated in USD, listed in EU Stock Exchanges as highly liquid assets.

6) FINANCIAL ASSETS AND LIABILITIES - ACCOUNTING CLASSIFICATION AND FAIR VALUES (CONTINUED)

(i) Fair Value Hierarchy for Assets and Liabilities Other than Measured at Fair Value

Estimated fair values of financial assets and liabilities other than measured at fair value are provided in the table below, according to the fair value hierarchy levels under IFRS 13:

(Thousands of RSD)

	Note	Level 1	Level 2	Level 3	Total Fair Value	Carrying Value
2017						
Cash and cash funds held with the central bank	20	-	-	29.661.017	29.661.017	29.661.017
Financial assets held to maturity	23	-	-	81.780	81.780	77.886
Loans and receivables due from banks and other financial institutions	24	-	9.248.386	2.636.678	11.885.064	11.885.064
Loans and receivables due from customers	25	-	80.231.248	177.322.790	257.554.038	240.608.342
Other assets	32	-	1.000.303	-	1.000.303	1.000.303
		-	**90.479.937**	**209.702.265**	**300.182.202**	**283.232.612**
Deposits and other liabilities due to banks, other financial institutions and the central bank	35	-	85.780.106	22.341.839	108.121.945	106.676.158
Deposits and other liabilities due to customers	36	-	34.783.435	152.525.877	187.309.312	186.658.833
Subordinated liabilities	38	-	2.718.490	-	2.718.490	2.718.490
Current tax liabilities	19.4	-	205.253	-	205.253	205.253
Other liabilities	40	-	2.644.579	-	2.644.579	2.644.579
		-	**126.131.863**	**174.867.716**	**300.999.579**	**298.903.313**

(Thousands of RSD)

	Note	Level 1	Level 2	Level 3	Total Fair Value	Carrying Value
2016						
Cash and cash funds held with the central bank	20	-	-	28.085.266	28.085.266	28.085.266
Financial assets held to maturity	23	-	-	44.819	44.819	42.957
Loans and receivables due from banks and other financial institutions	24	-	14.618.710	3.871.722	18.490.432	18.490.432
Loans and receivables due from customers	25	-	73.870.874	148.230.093	222.100.967	208.339.473
Other assets	32	-	915.567	-	915.567	915.567
		-	**89.405.151**	**180.231.900**	**269.637.051**	**255.873.695**
Deposits and other liabilities due to banks, other financial institutions and the central bank	35	-	20.872.714	67.155.645	88.028.359	86.460.699
Deposits and other liabilities due to customers	36	-	54.497.172	124.053.207	178.550.379	178.232.370
Subordinated liabilities	38	-	3.082.125	-	3.082.125	3.082.125
Current tax liabilities	19.4	-	31.749	-	31.749	31.749
Other liabilities	40	-	2.999.463	-	2.999.463	2.999.463
		-	**81.483.223**	**191.208.852**	**272.692.075**	**270.806.406**

Valuation techniques and models the Group uses for fair value calculations are disclosed in Note 5b(i).

(ii) Assets The Fair Values of which Approximate their Carrying Values

For financial assets and financial liabilities that are highly liquid or having a short term original maturity (less than one year) it is assumed that the carrying amounts approximate their fair values. The basic assumption used here is that in the near term, for highly liquid assets, no significant market changes will occur that can affect the fair value. This assumption is also applied to demand deposits, savings accounts without specified maturity and all variable interest rate financial instruments.

(iii) Financial Instruments with Fixed Interest Rates

The fair values of fixed rate financial assets and liabilities carried at amortized cost are estimated by comparing market interest rates when

Notes to the consolidated financial statements (CONTINUED)

6) FINANCIAL ASSETS AND LIABILITIES - ACCOUNTING CLASSIFICATION AND FAIR VALUES (CONTINUED)

they were first recognized with current market rates offered for similar financial instruments. The estimated fair values of fixed interest bearing financial instruments are based on discounted cash flows using prevailing money-market interest rates for financial instruments with similar credit risk characteristics and maturities.

Financial assets held to maturity and loans and deposits include a portion of the loan portfolio at fixed interest rates, which causes differences between the carrying amounts and fair values of such instruments.

7) NET INTEREST INCOME

Net interest income includes:

(Thousands of RSD)

	2017	2016
Interest income		
Cash and cash funds held with the central bank	288.892	274.123
Financial assets at fair value through profit and loss, held for trading	219.701	206.992
Financial assets available for sale	3.613.540	4.163.368
Financial assets held to maturity	6.951	3.793
Loans and receivables due from banks and other financial institutions	141.147	116.524
Loans and receivables due from customers	10.561.733	10.699.550
Financial derivatives and assets held for risk hedging purposes	313.677	275.021
Total interest income	15.145.641	15.739.371
Interest expenses		
Financial liabilities carried at fair value through profit and loss, held for trading	114.804	84.553
Liabilities per financial derivatives designated as risk hedging instruments	80.105	79.480
Deposits and other liabilities due to banks, other financial institutions and the central bank	1.167.001	1.645.868
Deposits and other liabilities due to customers	1.284.698	1.465.050
Subordinated liabilities	135.462	138.959
Total interest expenses	2.782.070	3.413.910
Net interest income	**12.363.571**	**12.325.461**

In accordance with the Group's accounting policy 3 (d), interest income from non-performing impaired loans amounted to RSD 261,402 thousand in 2017 (2016: RSD 465,999 thousand).

Notes to the consolidated financial statements (CONTINUED)

8) NET FEE AND COMMISSION INCOME

Net fee and commission income includes:

(Thousands of RSD)

	2017	2016
Fee and commission income		
Payment transfer activities	1.166.390	977.855
Fees on issued guarantees and other contingent liabilities	586.770	637.726
Brokerage fees	19.725	20.154
Custody fees	363.251	390.544
Fees arising from card operations	1.186.667	924.032
Fees per deposits	369.753	343.732
Loan origination and processing fees	360.645	295.861
Other fees and commissions	309.422	296.071
Total fee and commission income	4.362.623	3.885.975
Fee and commission expenses		
Payment transfer activities	163.834	152.340
Fees arising on guarantees, sureties and letters of credit	11.688	22.958
Fees arising from card operations	1.027.211	844.148
Other fees and commissions	153.102	135.329
Total fee and commission expenses	**1.355.835**	**1.154.775**
Net fee and commission income	**3.006.788**	**2.731.200**

9) NET GAINS ON THE FINANCIAL ASSETS HELD FOR TRADING

Net gains on the financial assets held for trading include:

(Thousands of RSD)

	2017	2016
Net gains on the sales of securities held for trading	44.559	88.376
Net losses on the changes in the fair value securities held for trading	(3.550)	(8.545)
Net gains/(losses) on the fair value changes of derivatives held for trading	207.458	(48.842)
Net gains on the financial assets held for trading	**248.467**	**30.989**

10) NET LOSSES ON THE HEDGES AGAINST RISKS

Net losses on the hedges against risks include:

(Thousands of RSD)

	2017	2016
Net (losses)/gains on the fair value changes of loans, receivables and securities	(90.429)	36.715
Net gains/(losses) on the fair value changes of derivatives held for risk hedging purposes	56.564	(40.459)
Net losses on the hedges against risks	**(33.865)**	**(3.744)**

11) NET GAINS ON THE FINANCIAL ASSETS AVAILABLE FOR SALE

Net gains on the financial assets available for sale include:

(Thousands of RSD)

	2017.	2016.
Gains on the sale of securities available for sale	433.080	210.242
Losses on the sale of securities available for sale	(171.908)	(43.986)
Net gains on the financial assets available for sale	**261.172**	**166.256**

Notes to the consolidated financial statements (CONTINUED)

12) NET FOREIGN EXCHANGE GAINS AND POSITIVE CURRENCY CLAUSE EFFECTS

Net foreign exchange gains and positive currency clause effects include:

(Thousands of RSD)

	2017	2016
Foreign exchange gains and positive currency clause effects	62.456.406	93.198.993
Foreign exchange losses and negative currency clause effects	(61.098.619)	(91.774.952)
Net foreign exchange gains and positive currency clause effects	**1.357.787**	**1.424.041**

13) NET INVESTMENT INCOME

Net investment income represents gains on the sales of the shares the Bank owned in the company MasterCard:

(Thousands of RSD)

	2017	2016
Income from the sales of investments	120.379	-
Total investment income	**120.379**	**-**

Notes to the consolidated financial statements (CONTINUED)

14) OTHER OPERATING INCOME

Other operating income includes:

(Thousands of RSD)

	2017	2016
Reversal of unreleased provisions for litigations	23.044	29.388
Reversal of unreleased provisions for other liabilities	4.895	10.977
Dividend income	120	342
Gains on the sale of other loans and receivables	12.760	58.609
Other operating income	94.242	44.269
Total other operating income	**135.061**	**143.585**

15) NET LOSSES FROM IMPAIRMENT OF FINANCIAL ASSETS AND CREDIT RISK-WEIGHTED OFF-BALANCE SHEET ASSETS

Net losses from impairment of financial assets and credit risk-weighted off-balance sheet assets include:

(Thousands of RSD)

	2017.	2016.
Loans and receivables due from customers		
Individual impairment allowance charge, net	2.917.525	3.029.650
Collective impairment allowance reversal, net	(117.915)	(110.310)
	2.799.610	2.919.340
Contingent liabilities		
Individual impairment allowance charge, net (Note 39)	27.069	19.970
Collective impairment allowance charge, net (Note 39)	537	65.164
	27.606	85.134
Write-off	1.757	10.334
Collection of receivables previously written off	(202.208)	(3.103)
Total	**2.626.765**	**3.011.705**

Notes to the consolidated financial statements (CONTINUED)

16) STAFF COSTS

Staff costs comprise:

(Thousands of RSD)

	2017	2016
Net salaries	1.685.117	1.630.862
Payroll taxes and contributions	630.236	601.795
Net provisioning for retirement benefits and unused annual leaves (vacations)	5.613	20.496
Other staff costs	573.789	499.619
Total	**2.894.755**	**2.752.772**

17) DEPRECIATION AND AMORTIZATION CHARGE

Depreciation and amortization charge includes:

(Thousands of RSD)

	2017.	2016.
Amortization of intangible assets (Notes 28.2, 28.3)	273.687	375.931
Depreciation of investment property (Note 30)	33	33
Depreciation of property and equipment (Notes 29.2, 29.3)	265.183	226.439
Total	**538.903**	**602.403**

Notes to the consolidated financial statements (CONTINUED)

18) OTHER EXPENSES

Other expenses include:

(Thousands of RSD)

	2017	2016
Business premises costs	91.578	95.026
Office supplies	39.827	48.944
Rental costs	673.730	674.463
Information system maintenance	513.390	446.196
Property and equipment maintenance	55.846	51.677
Marketing, advertising, entertainment and donations	305.170	324.738
Lawyer fees, other consultant services and auditing fees	199.302	162.028
Telecommunications and postage services	139.682	135.116
Insurance premiums	775.287	683.426
Insurance of property and security services	85.509	89.699
Professional training costs	21.005	16.298
Servicing	92.448	99.792
Transportation services	17.780	20.678
Employee commuting allowances	38.836	37.328
Accommodation and meal allowance – business travel costs	31.102	26.916
Other taxes and contributions	469.872	457.072
Provisions for litigations and other provisions (Note 39)	127.009	72.423
Losses on disposal of property, equipment and intangible assets	17.349	8.263
Other costs	409.600	407.060
Total	**4.104.322**	**3.857.143**

19) INCOME TAXES

19.1 Basic components of income taxes as at December 31 were as follows:

(Thousands of RSD)

	2017	2016
Current income tax expense	(521.163)	(343.243)
Increase in deferred tax assets and decrease in deferred tax liabilities	28.593	22.256
Decrease in deferred tax assets and increase in deferred tax liabilities	(20.528)	-
Total	**(513.098)**	**(320.987)**

19.2 Numerical reconciliation of the effective tax rate is provided below:

(Thousands of RSD)

	2017	2016
Profit before taxes	7.294.615	6.593.765
Effective income tax at the legally prescribed tax rate of 15%	1.094.192	989.065
Tax effects of permanent differences:		
Tax effects of expenses not recognized for tax purposes	43.266	21.024
Tax effects of income adjustment	(632.306)	(692.432)
Tax effects of temporary differences:		
Difference between depreciation/amortization calculated for tax and financial reporting purposes	(6.976)	11.930
Tax effects of expenses recognized in the forthcoming period	22.987	13.656
Current income tax expense	**521.163**	**343.243**
Effective tax rate	**7,14%**	**5,21%**

19.3 Income taxes recognized within other comprehensive income are provided below:

(Thousands of RSD)

	2017			2016		
	Before taxes	Tax expense	After taxes	Before taxes	Tax expense	After taxes
Actuarial losses	(1.967)	(1.478)	(3.445)	(12.203)	380	(11.823)
Balance at December 31	**(1.967)**	**(1.478)**	**(3.445)**	**(12.203)**	**380**	**(11.823)**

19.4 The Group's calculated current income tax payable for the year 2017 amounted to RSD 521,163 thousand, of which RSD 315,910 thousand was settled through several tax advance payments. The outstanding current tax liabilities as of December 31, 2017 hence amounted to RSD 205,253 thousand.

Notes to the consolidated financial statements (CONTINUED)

20) CASH AND CASH FUNDS HELD WITH THE CENTRAL BANK

20.1 Cash and cash funds held with the central bank include:

(Thousands of RSD)

	2017	2016
RSD cash on hand	1.577.892	1.363.614
Gyro account balance	17.645.389	8.734.298
Foreign currency cash on hand	1.034.221	1.024.061
Other foreign currency cash funds	38.226	43.692
Obligatory foreign currency reserve held with NBS	9.365.485	16.920.376
	29.661.213	**28.086.041**
Impairment allowance	(196)	(775)
Balance at December 31	**29.661.017**	**28.085.266**

The gyro account balance includes the RSD obligatory reserves, which represent the minimum amount of RSD reserves allocated in accordance with the Decision on Obligatory Reserves Held with the NBS. In accordance with the said Decision, the obligatory RSD reserves are calculated based on the average daily carrying amount of RSD deposits, loans, securities and other RSD liabilities during a single calendar month, using a rate in the range between 0% and 5%, depending on the maturity of liabilities and their sources of funding. The reserve is thereafter held on the Bank's gyro account. In 2017 NBS paid interest on the balance of the Bank's obligatory RSD reserve at the annual interest rate of 1.75%.

The obligatory foreign currency reserve with the National Bank of Serbia represent the minimum foreign currency reserve amount allocated in accordance with the Decision on Obligatory Reserves Held with the NBS. In accordance with the said Decision, the obligatory foreign currency reserves are calculated based on the average daily carrying amount of foreign currency deposits, loans and other foreign currency liabilities or those in RSD with a currency clause index (EUR to RSD) during a single calendar month. The obligatory foreign currency reserve rates remained unaltered during 2017 and equaled 20% for foreign currency deposits with maturities of up to 2 years and 13% for foreign currency deposits with maturities of over 2 years. The rate applied to the portion of the foreign currency reserve comprised of RSD liabilities with a currency clause index was 100%.

The Group is under obligation to maintain the average daily balance of the allocated foreign currency reserve in the amount of the calculated foreign currency obligatory reserve on the foreign currency accounts held with NBS. Foreign currency obligatory reserve does not accrue interest.

20.2 Movements on the account of impairment allowance of cash and cash funds held with the central bank during the current year are provided in the table below:

(Thousands of RSD)

	Individual level		Group level	
	2017	2016	2017	2016
Balance at January 1	-	-	(775)	(398)
Reversal/(charge for the year)			497	(363)
Foreign exchange effects	-	-	82	(14)
Total for the year	-	-	579	(377)
Balance at December 31	**-**	**-**	**(196)**	**(775)**

21) FINANCIAL ASSETS AVAILABLE FOR SALE

Financial assets available for sale comprise:

(Thousands of RSD)

	2017	2016
Securities held for trading:		
- RS Ministry of Finance Treasury bills	2.095.845	2.168.644
	2.095.845	**2.168.644**
Receivables per derivative held for trading:		
- interest rate swaps	157.024	146.673
- FX swaps and forwards	28.180	-
	185.204	**146.673**
Balance at December 31	**2.281.049**	**2.315.317**

As of December 31, 2017 investments in securities held for trading totaling RSD 2,095,845 thousand represent investments in the Treasury bills of the Republic of Serbia with maturities up to 2022.

Notes to the consolidated financial statements (CONTINUED)

22) FINANCIAL ASSETS AVAILABLE FOR SALE

Financial assets available for sale comprise:

(Thousands of RSD)

	2017	2016
Securities available for sale		
- RS Treasury bills and local municipality bonds	70.182.412	70.275.281
- local municipality bonds and RS Treasury bills – hedged items	11.989.224	6.045.383
Balance at December 31	**82.171.636**	**76.320.664**

As of December 31, 2017 investments in available-for-sale securities totaling RSD 11,989,224 thousand represent investments in bonds issued by local municipalities and the RS Treasury bills as hedged items with maturities up to 2023, while the amount of RSD 70,182,412 represent investments in the local municipality and RS Treasury bills with maturities up to 2023.

For hedging local municipality and RS Treasury bills against the interest rate risk, the Bank implemented micro fair value hedging, i.e., designated as hedge items investments in bonds issued by local municipalities and the RS Treasury bills with the aggregate face value of EUR 97.4 million, while interest rate swaps with the aggregate notional value of EUR 97.4 million were designated as hedging instruments. As of December 31, 2017, an effectiveness test was performed, which showed that the hedging was highly effective.

23) FINANCIAL ASSETS HELD TO MATURITY

23.1 Financial assets held to maturity comprise:

(Thousands of RSD)

	2017	2016
Securities held to maturity:		
- receivables per discounted bills of exchange	79.534	44.149
Impairment allowance	(1.648)	(1.192)
Balance at December 31	**77.886**	**42.957**

As of December 31, 2017 receivables per discounted bills of exchange of RSD 79,534 thousand represent investments with maturities of up to a year and at a discount rate equal to 1-month BELIBOR plus 2% to 3.9% per annum.

23.2 Movements on the account of impairment allowance of financial assets held to maturity during the year are provided in the table below:

(Thousands of RSD)

	Individual level		Group level	
	2017	2016	2017	2016
Balance at January 1	(623)	-	(569)	-
Opening balance of the parent entity	-	(16.252)	-	(9.113)
Effects of acquisition through business combination	-	-	-	-
	-	(16.252)	-	(9.113)
Impairment loss:				
(Charge for the year) / reversal	-	-	(1.079)	8.544
Write-off without debt acquittal	623	15.629	-	-
Total impairment allowance	**623**	**15.629**	**(1.079)**	**8.544**
Balance at December 31	**-**	**(623)**	**(1.648)**	**(569)**

Notes to the consolidated financial statements (CONTINUED)

24) LOANS AND RECEIVABLES DUE FROM BANKS AND OTHER FINANCIAL INSTITUTIONS

24.1 Loans and receivables due from banks and other financial institutions include:

(Thousands of RSD)

	2017	2016
Foreign currency accounts held with:		
- other banks within UniCredit Group	712.860	4.953.054
- other foreign banks	1.797.310	698.387
Total foreign currency accounts	**2.510.170**	**5.651.441**
Overnight deposits:		
- in foreign currencies	7.463.780	11.112.514
Total overnight deposits	**7.463.780**	**11.112.514**
Guarantee foreign currency deposit placed for purchase and sale of securities	4.739	4.939
Foreign currency special purpose deposits	11.509	13.602
Short-term loans:		
- in RSD	687	1.586.635
Total short-term loans	**687**	**1.586.635**
Long-term loans:		
- in RSD	1.786.030	90.070
Total long-term loans	**1.786.030**	**90.070**
Other foreign currency placements	57.261	2.256
Finance lease receivables in RSD	**59.589**	**61.090**
Impairment allowance	**(8.701)**	**(32.115)**
Balance at December 31	**11.885.064**	**18.490.432**

24.2 Movements on the account of impairment allowance of loans and receivables due from banks are provided in the table below:

(Thousands of RSD)

	Individual level		Group level	
	2017	2016	2017	2016
Balance at January 1	(3)	-	(32.112)	-
Opening balance of the parent entity	-	(1)	-	(15.747)
Effects of acquisition through business combination	-	-	-	(1.309)
	-	(1)	-	(17.056)
Impairment loss				
(Charge for the year) / reversal	(4)	(2)	22.981	(14.649)
Foreign exchange effects	-	-	437	(407)
Write-off	**-**	**-**	**-**	**-**
Total impairment allowance	(4)	(2)	23.418	(15.056)
Balance at December 31	**(7)**	**(3)**	**(8.694)**	**(32.112)**

25) LOANS AND RECEIVABLES DUE FROM CUSTOMERS

25.1 Loans and receivables due from customers include:

(Thousands of RSD)

	2017	2016
Short-term loans:		
- in RSD	27.469.938	25.565.936
- in foreign currencies	3.023.971	1.766.592
Total short-term loans	**30.493.909**	**27.332.528**
Long-term loans:		
- in RSD	194.066.817	169.111.255
- in foreign currencies	10.849.201	16.342.875
Total long-term loans	**204.916.018**	**185.454.130**
Receivables in respect of acceptances, sureties and payments made per guarantees:		
- in RSD	49.474	182.225
- in foreign currencies	14.807	3.834.365
Total	**64.281**	**4.016.590**
RSD factoring receivables	560.067	508.122
Finance lease receivables in RSD	8.257.936	7.503.481
Other placements in RSD	5.892.542	-
Impairment allowance	(9.576.411)	(16.475.378)
Balance at December 31	**240.608.342**	**208.339.473**

Loans with a currency clause index (EUR, CHF, USD) are presented within RSD loans.

25.2 Movements on the account of impairment allowance of loans and receivables due from customers are provided in the table below:

(Thousands of RSD)

	Individual level		Group level	
	2017	2016	2017	2016
Balance at January 1	(15.120.903)	-	(1.354.475)	-
Opening balance of the parent entity	-	(19.899.044)	-	(1.005.727)
Effects of acquisition through business combination	-	(53.318)	-	(438.102)
	-	(19.952.362)	-	(1.443.829)
Impairment loss				
(Charge for the year) / reversal	(2.931.255)	(2.935.902)	95.500	106.385
Foreign exchange effects	661.660	(268.446)	(98.574)	(17.031)
Interest income adjustment	(207.918)	(240.968)	-	-
Portfolio sale effects	1.833.636	366.717	-	-
Write-off with debt acquittal	246.249	392.053	-	-
Write-off without debt acquittal*	7.299.669	7.518.005	-	-
Total impairment allowance	**6.902.041**	**4.831.459**	**(3.074)**	**89.354**
Balance at December 31	**(8.218.862)**	**(15.120.903)**	**(1.357.549)**	**(1.354.475)**

*Write-off without debt acquittal, i.e., accounting write-off, is a write-off of receivables made in accordance with the Decision on the Accounting Write-Off of Bank Balance Sheet Assets of the National Bank of Serbia (Official Gazette of RS no. 77/2017), effective as from September 30, 2017. The bank wrote off balance sheet assets with highly unlikely recoverability, i.e., made a full accounting write-off of impaired receivables. Within the meaning of the aforesaid Decision, the accounting write-off entailed transfer of the written-off receivables from the Bank's balance sheet assets to its off-balance sheet items.

Notes to the consolidated financial statements (CONTINUED)

25) LOANS AND RECEIVABLES DUE FROM CUSTOMERS (CONTINUED)

25.3 Breakdown of loans and receivables due from customers is provided below:

(Thousands of RSD)

	2017			2016		
	Gross Amount	Impairment Allowance	Carrying Amount	Gross Amount	Impairment Allowance	Carrying Amount
Public sector	11.667.494	(30.021)	11.637.473	6.765.010	(117.902)	6.647.108
Corporate customers	157.364.612	(8.477.777)	148.886.835	147.151.497	(12.496.811)	134.654.686
Retail customers	81.152.647	(1.068.613)	80.084.034	70.898.344	(3.860.665)	67.037.679
Balance at December 31	**250.184.753**	**(9.576.411)**	**240.608.342**	**224.814.851**	**(16.475.378)**	**208.339.473**

25.4. Corporate loans were mostly approved for maintaining daily liquidity (current account overdrafts), financing working capital, imports and investments. They were used for funding business activities in trade and services, manufacturing industry, construction industry, agriculture and food industry and other purposes. Short-term loans were approved for periods ranging from 30 days to a year. Interest rates on short-term loans with a currency clause index ranged from 1-month, 3-month or 6-month EURIBOR increased by 2.65%, on the average, while RSD short-term loans accrued interest at the rates between 1-month, 3-month or 6-month BELIBOR increased by 1.01% on the average.

Long-term loans were approved for periods from 2 to 10 years. Interest rate applied to long-term loans with a currency clause index ranged from 1-month, 3-month or 6-month EURIBOR increased by 2.85% annually on the average, while RSD long-term loans accrued interest at the rates between 1-month, 3-month or 6-month BELIBOR increased by 1.14% annually on the average, according to other costs and the Group's interest rate policy.

Retail housing loans were approved for periods of 5 to 30 years, at the nominal interest rates ranging from 6-month EURIBOR plus 2.3% to 4.2% annually. In early October 2017 the Group launched a campaign where up to the end of the year the clients were allowed to apply for pre-approval of housing loans, whereby the loan approval process was optimized in accordance with the clients' needs and requirements. The Group included in its product mix housing loans with combined and fixed interest rates thus responding to the needs of its clients with regard to the volatility of the interest rates.

Long-term RSD cash loans were approved to retail customers for periods of up to 7 years and up to 10 years for loans with insurance for which in 2017 the Bank and the Group increased the maximum loan amount to RSD 3 million.

Further, the Group continued sales of cash loans approved to pensioners with life insurance at either a fixed interest rate of 17.9% or a rate equal to 3-month BELIBOR plus 4.2% to 8.5% annually.

In 2017, interest rates applied to investment funding of small entities and entrepreneurs equaled 6/12-month EURIBOR plus 3% to 6% annually, while interest rates for working capital loans with maturity up to 42-month loans ranged from 12-month EURIBOR plus 3% to 7.5 annually or, in instances of fixed-interest rate loans, from 3.2% to 7.5%. Interest rates applied to RSD loans equaled 1/3-month BELIBOR plus 2.3% to 7% annually.

All impaired loans provided for were adjusted to their recoverable amounts with impairment allowance apportioned as a reduction of loans and receivables due from customers.

Finance lease receivables relate to receivables from legal entities (corporate customers) per leases approved for the purchase of vehicles and equipment at interest rates ranging from 1.8% to 6.75% over the lease terms from 2 to 5 years.

Finance lease receivables also relate to receivables from private individuals per leases approved for the purchase of automobiles at average interest rate of 3,29% and repayment period from 4 to 5 years.

As a hedge against interest rate risk, the Group implemented micro fair value hedging, i.e. it designated as a hedged item a customer loan with the present value of EUR 1,613,491 as at December 31, 2017, while an interest swap of the same amount was designated as a hedging instrument. The Group also implemented macro fair value hedging, where loan portfolios with the net carrying value of EUR 20,100, 000 and CHF 8,589,846 were designated as hedged items, while interest swaps of the same notional amounts were designated as hedging instruments. As of December 31, 2017 an effectiveness test was performed, which showed that the hedging was highly effective.

25) LOANS AND RECEIVABLES DUE FROM CUSTOMERS (CONTINUED)

25.5 The concentration of total loans and receivables due from customers per industry was as follows:

(Thousands of RSD)

	2017	2016
Corporate customers		
- Energy	2.305.917	1.534.998
- Agriculture	6.692.229	5.890.471
- Construction industry	8.289.481	8.847.057
- Mining and industry	55.399.678	53.098.860
- Trade	40.129.255	31.110.658
- Services	23.015.638	20.233.391
- Transportation and logistics	16.939.365	21.684.422
- Other	4.593.049	4.751.640
	157.364.612	**147.151.497**
Public sector	11.667.494	6.765.010
Retail customers		
- private individuals	77.477.184	68.122.231
- entrepreneurs	3.675.463	2.776.113
	81.152.647	**70.898.344**
Total	**250.184.753**	**224.814.851**
Allowance for impairment	**(9.576.411)**	**(16.475.378)**
Balance, December 31	**240.608.342**	**208.339.473**

The Group's management structures the levels of credit risk it assumes by placing credit risk exposure limits for a single borrower or a group of borrowers as well as per geographic area and industry segments. This risk is monitored on an ongoing basis and is subject to an annual or more frequent review. Exposure to credit risk is managed by the regular solvency analysis, i.e., analysis of the ability of borrowers and potential borrowers to meet interest and principal repayment obligations, and by changing the limits set for a single borrower, as appropriate. Exposure to credit risk is also partially managed by obtaining collaterals.

26) FAIR VALUE ADJUSTMENTS OF RISK HEDGED ITEMS

Fair value adjustments of risk hedged items include:

(Thousands of RSD)

	2017	2016
Fair value adjustments of risk hedged items	192.251	222.845
Balance at December 31	**192.251**	**222.845**

As a hedge against the interest rate risk inherent in loans approved in CHF and EUR at fixed interest rates, the Group implemented macro fair value hedging (Note 34). As of December 31, 2017 an effectiveness test was performed, which showed that the hedging was highly effective.

27) RECEIVABLES PER FINANCIAL DERIVATIVES DESIGNATED AS RISK HEDGING INSTRUMENTS

Receivables per financial derivatives designated as risk hedging instruments comprise:

(Thousands of RSD)

	2017	2016
Fair value adjustments of derivatives designated as risk hedging instruments	9.195	375
Balance at December 31	**9.195**	**375**

In 2017, the fair value adjustments of derivatives designated as risk hedging instruments pertained to the micro fair value hedging (Note 25.4) while in 2016 those adjustments related to the macro fair value hedging (Note 37).

28) INTANGIBLE ASSETS

28.1 Intangible assets, net:

(Thousands of RSD)

	2017	2016
Intangible assets	1.004.775	725.467
Investments in progress	161.141	195.869
Balance at December 31	**1.165.916**	**921.336**

28.2 Movements on the account of intangible assets in 2017 are presented in the table below:

(Thousands of RSD)

	Intangible Assets	Investments in Progress	Total
Cost			
Balance at January 1, 2017	2.993.722	195.869	3.189.591
Additions	552.995	(23.379)	529.616
Disposal and retirement	(202.986)	(11.349)	(214.335)
Balance at December 31, 2017	**3.343.731**	**161.141**	**3.504.872**
Accumulated amortization and impairment losses			
Balance at January 1, 2017	2.268.255	-	2.268.255
Amortization charge for the year	273.687	-	273.687
Disposal and retirement	(202.986)	-	(202.986)
Balance at December 31, 2017	**2.338.956**	**-**	**2.338.956**
Net book value at December 31, 2017	**1.004.775**	**161.141**	**1.165.916**
Net book value at January 1, 2017	**725.467**	**195.869**	**921.336**

28.3 Movements on the account of intangible assets in 2016 are presented in the table below:

(Thousands of RSD)

	Intangible Assets	Investments in Progress	Total
Cost			
Balance at January 1, 2016	-	-	-
Opening balance of the Parent Entity	2.665.406	150.398	2.815.804
Effects of acquisition through business combination	15.898	-	15.898
	2.681.304	**150.398**	**2.831.702**
Additions	312.418	48.149	360.567
Other	-	(2.678)	(2.678)
Balance at December 31, 2016	**2.993.722**	**195.869**	**3.189.591**
Accumulated amortization and impairment losses			
Balance at January 1, 2016	-	-	-
Opening balance of the Parent Entity	1.881.686	-	1.881.686
Effects of acquisition through business combination	10.638	-	10.638
	1.892.324	**-**	**1.892.324**
Change in the scope of consolidation			
Amortization charge for the year	375.931	-	375.931
Balance at December 31, 2016	**2.268.255**	**-**	**2.268.255**
Net book value at December 31, 2016	**725.467**	**195.869**	**921.336**

29) PROPERTY, PLANT AND EQUIPMENT

29.1 Property, plant and equipment comprise:

(Thousands of RSD)

	2017	2016
Buildings	566.288	580.714
Equipment and other assets	731.592	731.549
Leasehold improvements	200.575	222.018
Investments in progress	55.768	46.916
Balance at December 31	**1.554.223**	**1.581.197**

29.2 Movements on the account of property and equipment in 2017 are presented below:

(Thousands of RSD)

	Buildings	Equipment and other assets	Leasehold improvements	Investments in progress	Total
Cost					
Balance at January 1, 2017	671.034	1.840.068	481.302	46.916	3.039.320
Additions	-	-	-	248.334	248.334
Transfer from investments in progress	541	209.631	29.310	(239.482)	-
Disposal and retirement	(541)	(366.330)	(27.553)	-	(394.424)
Other	-	(7.551)	-	-	(7.551)
Balance at December 31, 2017	**671.034**	**1.675.818**	**483.059**	**55.768**	**2.885.679**
Accumulated depreciation and impairment losses					
Balance at January 1, 2017	90.320	1.108.519	259.284	-	1.458.123
Depreciation charge for the year	14.502	203.389	47.292	-	265.183
Disposal and retirement	(76)	(360.452)	(24.092)	-	(384.620)
Other	-	(7.230)	-	-	(7.230)
Balance at December 31, 2017	**104.746**	**944.226**	**282.484**	**-**	**1.331.456**
Net book value at December 31, 2017	**566.288**	**731.592**	**200.575**	**55.768**	**1.554.223**
Net book value at January 1, 2017	**580.714**	**731.549**	**222.018**	**46.916**	**1.581.197**

29.3 Movements on the account of property and equipment in 2016 are presented below:

(Thousands of RSD)

	Buildings	Equipment and other assets	Leasehold improvements	Investments in progress	Total
Cost					
Balance at January 1, 2016	-	-	-	-	-
Opening balance of the parent entity	671.034	1.387.988	388.889	25.543	2.473.454
Effects of acquisition through business combination	-	23.167	1.115	-	24.282
	671.034	1.411.155	390.004	25.543	2.497.736
Additions	**-**	**2.944**	**-**	**627.178**	**630.122**
Transfer from investments in progress	6.122	442.678	157.005	(605.805)	-
Disposal and retirement	(6.122)	(13.399)	(65.707)	-	(85.228)
Other	-	(3.310)	-	-	(3.310)
Balance at December 31, 2016	671.034	1.840.068	481.302	46.916	3.039.320
Accumulated depreciation and impairment losses					
Balance at January 1, 2016	**-**	**-**	**-**	-	**-**
Opening balance of the parent entity	**77.008**	**930.993**	**283.713**	**-**	**1.291.714**
Effects of acquisition through business combination	**-**	**21.370**	**573**	**-**	**21.943**
	77.008	**952.363**	**284.286**	**-**	**1.313.657**
Depreciation charge for the year	**14.006**	**172.031**	**40.402**	**-**	**226.439**
Disposal and retirement	**(694)**	**(12.851)**	**(65.404)**	**-**	**(78.949)**
Other	**-**	**(3.024)**	**-**	**-**	**(3.024)**
Balance at December 31, 2016	**90.320**	**1.108.519**	**259.284**	**-**	**1.458.123**
Net book value at December 31, 2016	**580.714**	**731.549**	**222.018**	**46.916**	**1.581.197**

Notes to the consolidated financial statements (CONTINUED)

30) INVESTMENT PROPERTY

Movements on the account of investment property in 2017 are presented below:

(Thousands of RSD)

	Investment property	Investments in progress	Total
Cost			
Balance at January 1, 2017	1.642	-	1.642
Balance at December 31, 2017	1.642	-	1.642
Accumulated depreciation and impairment losses			
Balance at January 1, 2017	245	-	245
Depreciation charge for the year	33	-	33
Balance at December 31, 2017	278	-	278
Net book value at December 31, 2017	**1.364**	**-**	**1.364**
Net book value at January 1, 2017	**1.397**	**-**	**1.397**

31) DEFERRED TAX ASSETS

31.1 Deferred tax assets relate to:

(Thousands of RSD)

	2017			2016		
	Assets	Liabilities	Net	Assets	Liabilities	Net
Difference in the net carrying amount of tangible assets for tax and financial reporting purposes	28.313		28.313	48.841	-	48.841
Deferred tax assets in respect of unrecognized current year expenses	143.163	-	143.163	114.570	-	114.570
Deferred tax assets in respect of actuarial losses based on defined benefit plans	609	-	609	2.087	-	2.087
Total	**172.085**	**-**	**172.085**	**165.498**	**-**	**165.498**

31.2 Movements on temporary differences during 2017 are presented as follows:

(Thousands of RSD)

	Balance at January 1	Recognized in Profit or Loss	Recognized in Other Comprehensive Income	Balance at December 31
Difference in the net carrying amount of tangible assets for tax and financial reporting purposes	48.841	(20.528)	-	28.313
Deferred tax assets in respect of unrecognized current year expenses	114.570	28.593	-	143.163
Deferred tax assets in respect of actuarial losses based on defined benefit plans	2.087	-	(1.478)	609
Total	**165.498**	**8.065**	**(1.478)**	**172.085**

Notes to the consolidated financial statements (CONTINUED)

32) OTHER ASSETS

32.1 Other assets relate to:

(Thousands of RSD)

	2017	2016
Other assets in RSD:		
Fee and commission receivables calculated per other assets	65.081	196.199
Advances paid, deposits and retainers	18.013	9.311
Receivables per actual costs incurred	344.889	369.249
Receivables from the RS Health Insurance Fund	65.501	59.908
Other receivables from operations	397.319	462.141
Assets acquired through collection of receivables	5.517	60.853
Receivables for prepaid taxes and contributions	165	165
Other investments	4.992	4.992
Accrued other income receivables	27.341	14.232
Deferred other expenses	90.130	43.448
Total	**1.018.948**	**1.220.498**
Other assets in foreign currencies:		
Fee and commission receivables calculated per other assets	320	3.850
Advances paid, deposits and retainers	-	109
Other receivables from operations	12.008	17.363
Accrued other income receivables	1.439	17.560
Total	**13.767**	**38.882**
Impairment allowance	**(32.412)**	**(343.813)**
Balance at December 31	**1.000.303**	**915.567**

32.2 Movements on the impairment allowance accounts of other assets are provided in the table below:

(Thousands of RSD)

	Individual level		Group level	
	2017	2016	2017	2016
Balance at January 1	(343.254)	-	(559)	-
Opening balance of the parent entity	-	(294.594)	-	(10.952)
Effects of acquisition through business combination	-	(3.591)	-	-
	-	(298.185)	-	(10.952)
Impairment loss				
Reversal/(charge for the year)	13.734	(93.746)	16	10.393
Foreign exchange effects	561	(203)	-	-
Portfolio sale effects	**38.515**	**472**	**-**	**-**
Write-off with debt acquittal	**12.675**	**3.225**		
Write-off without debt acquittal	**245.900**	**45.183**	**-**	**-**
Total impairment allowance	**311.385**	**(45.069)**	**16**	**10.393**
Balance at December 31	**(31.869)**	**(343.254)**	**(543)**	**(559)**

32.3 Other investments in associates comprise equity investments of up to 10% of equity in the following entities:

(Thousands of RSD)

	2017	2016
FAP Priboj a.d.	4.737	4.737
Fund for Supplementary Education of Young Farmers	147	147
Tržište novca a.d. [Money Market, shareholding company]	108	108
	4.992	4.992
Impairment allowance	(4,992)	(4,992)
Balance at December 31	**-**	**-**

Investments in associates totaling RSD 4,992 thousand were impaired in full.

33) FINANCIAL LIABILITIES CARRIED AT FAIR VALUE THROUGH PROFIT AND LOSS, HELD FOR TRADING

Financial liabilities carried at fair value through profit and loss, held for trading include:

(Thousands of RSD)

	2017	2016
Instrument types:		
- currency swaps and forwards	54.455	93.814
- interest rate swaps	152.548	140.418
Balance at December 31	**207.003**	**234.232**

34) LIABILITIES PER FINANCIAL DERIVATIVES DESIGNATED AS RISK HEDGING INSTRUMENTS

Liabilities per financial derivatives designated as risk hedging instruments include.

(Thousands of RSD)

	2017	2016
Instrument types:		
- interest rate swaps	448.794	540.097
Balance at December 31	**448.794**	**540.097**

The Group uses interest rate swaps to protect itself from the exposure to the changes in the fair values of the local municipality bonds and RS Treasury bills with fixed return rates (Note 22), and loans extended in CHF and EUR at fixed interest rates (Note 26).

35) DEPOSITS AND OTHER LIABILITIES DUE TO BANKS, OTHER FINANCIAL INSTITUTIONS AND THE CENTRAL BANK

35.1 Deposits and other liabilities due to banks, other financial institutions and the central bank include:

(Thousands of RSD)

	2017	2016
Demand deposits:		
- in RSD	4.446.328	1.446.791
- in foreign currencies	959.936	1.326.813
Total demand deposits	**5.406.264**	**2.773.604**
Overnight deposits:		
- in RSD	672.376	539.588
- in foreign currencies	14.223.612	21.682.567
Total overnight deposits	**14.895.988**	**22.222.155**
Short-term deposits:		
- in RSD	2.534.084	1.386.002
- in foreign currencies	15.937.684	13.576.227
Total short-term deposits	**18.471.768**	**14.962.229**
Long-term deposits:		
- in RSD	617.334	547.233
- in foreign currencies	39.536.765	18.151.034
Total long-term deposits	**40.154.099**	**18.698.267**
Long-term borrowings:		
- in foreign currencies	27.641.588	27.740.483
Total long-term borrowings	27.641.588	27.740.483
Other financial liabilities:		
- in foreign currencies	106.451	63.961
Total other financial liabilities	**106.451**	**63.961**
Balance at December 31	**106.676.158**	**86.460.699**

Short-term RSD deposits were placed by other banks for periods of up to a year at annual interest rates from 1.66% to 3.4%, while short-term foreign currency deposits of other banks maturing within a year accrued interest at the rates ranging from -0.7% to 1.6 annually, depending on the currency.

35.2 Breakdown of foreign borrowings from banks is provided below:

(Thousands of RSD)

	2017	2016
European Bank for Reconstruction and Development (EBRD)	3.318.653	6.776.790
Kreditanstalt fur Wiederaufbau Frankfurt am Main (KfW)	1.125.387	1.882.732
European Investment Bank, Luxembourg	672.252	2.197.981
International Financial Corporation, Washington	1.385.101	1.805.921
European Fund for Southeast Europe SA, Luxembourg	9.245.983	1.520.280
MIDF B.V, Netherlands	-	1.173.869
Green for Growth Fund, Southeast Europe, Luxembourg	2.348.419	1.210.486
UniCredit Bank Austria AG	2.315.214	4.829.444
UniCredit S.P.A. Milan	7.230.579	-
EFSE Netherlands B.V.	-	6.342.980
Balance at December 31	**27.641.588**	**27.740.483**

The above listed long-term borrowings were approved to the Group for periods from 2 to 15 years at nominal interest rates ranging up to 3.39% per annum.

Notes to the consolidated financial statements (CONTINUED)

36) DEPOSITS AND OTHER LIABILITIES DUE TO CUSTOMERS

36.1 Deposits and other liabilities due to customers comprise:

(Thousands of RSD)

	2017	2016
Demand deposits:		
- in RSD	45.701.976	42.078.829
- in foreign currencies	76.454.097	69.595.210
Total demand deposits	**122.156.073**	**111.674.039**
Overnight deposits:		
- in RSD	1.775.281	5.278.666
- in foreign currencies	2.475.327	343.800
Total overnight deposits	**4.250.608**	**5.622.466**
Short-term deposits:		
- in RSD	22.531.919	11.072.515
- in foreign currencies	20.425.493	23.448.515
Total short-term deposits	**42.957.412**	**34.521.030**
Long-term deposits:		
- in RSD	2.878.358	1.618.759
- in foreign currencies	8.226.646	12.835.532
Total long-term deposits	**11.105.004**	**14.454.291**
Long-term borrowings		
- in foreign currencies	5.845.446	10.478.736
Total long-term borrowings	**5.845.446**	**10.478.736**
Other financial liabilities		
- in RSD	136.031	208.014
- in foreign currencies	208.259	1.273.794
Total other financial liabilities	**344.290**	**1.481.808**
Balance at December 31	**186.658.833**	**178.232.370**

36.2 Breakdown of deposits and other liabilities due to customers:

(Thousands of RSD)

	2017	2016
Public sector	1.243.399	4.273.234
Corporate customers	122.593.576	108.674.462
Retail customers	56.976.412	54.805.938
Long-term borrowings (Note 36.3)	5.845.446	10.478.736
Balance at December 31	**186.658.833**	**178.232.370**

RSD demand deposits of corporate customers accrued interest at the annual rate of 0.8%, on the average, while EUR-denominated demand deposits accrued interest at the annual rate of 0.2% on the average.

Corporate RSD term deposits accrued interest at the average rate of 3.51% annually, while EUR-denominated corporate deposits were placed at average interest rate of 1.05% annually.

Retail customers' RSD demand deposits accrued interest at annual rates of up to 0.15% Foreign currency retail demand deposits accrued interest at the rates ranging up to 0.1% annually, while funds held on current accounts accrued interest at the annual rate of 0.05%.

Short-term foreign currency deposits of retail customers were placed at interest rates ranging from 0.05% to 0.4% annually, depending on the period

36) DEPOZITI I OSTALE OBAVEZE PREMA DRUGIM KOMITENTIMA (NASTAVAK)

of placement. The annual interest rates applied to medium-term deposits (18 to 36 months) were in the range between 0.4% and 0.9%. Short-term RSD deposits of retail customers accrued interest at the rates ranging from 1.3% to 1.9% annually, depending on the period of placement.

RSD deposits placed by small entities and entrepreneurs were deposited at annual interest rates between 0.8% and 1.2% while foreign currency deposits of these customers accrued interest at the rates ranging from 0.1% to 0.7% annually.

36.3 Breakdown of long-term foreign currency borrowings from customers is provided below:

(Thousands of RSD)

	2017	2016
NBS - European Investment Bank, Luxembourg	-	8.567.215
NBS Revolving Credit Fund	5.807.101	390.517
Government of the Republic of Italy	38.345	1.521.004
Balance at December 31	**5.845.446**	**10.478.736**

Long-term borrowings obtained from customers were approved to the Group for periods from 6 to 13 years at nominal interest rates of up to 2.15% per annum.

37) FAIR VALUE ADJUSTMENTS OF RISK HEDGED ITEMS

Fair value adjustments of risk hedged items include:

(Thousands of RSD)

	2017	2016
Fair value adjustments of risk hedged items	-	103
Balance at December 31	**-**	**103**

As a hedge against the interest rate risk inherent in loans approved in EUR at fixed interest rates, the Group implemented macro fair value hedging (Note 27).

38) SUBORDINATED LIABILITIES

Subordinated liabilities relate to:

(Thousands of RSD)

	2017	2016
UniCredit Bank Austria AG, Vienna	2.718.490	3.082.125
Balance at December 31	**2.718.490**	**3.082.125**

As at December 31, 2017 subordinated liabilities in foreign currencies in the amount of RSD 2,718,490 thousand pertain to the subordinated long-term borrowing received from UniCredit Bank Austria AG in the amount of CHF 26,830,000. This loan was approved to the Bank for a period of 12 years at the interest rate equal to 3-month CHF LIBOR increased by 2.93%, but the interest rate was subsequently set at the fixed rate of 4.51%. The loan is not securitized with collateral and all the liabilities arising from this loan agreement are considered subordinated, i.e. in the event of the Bank's liquidation or bankruptcy, such liabilities will be settled only after settlement of liabilities to all other creditors.

Notes to the consolidated financial statements (CONTINUED)

39) PROVISIONS

Provisions relate to:

(Thousands of RSD)

	2017	2016
Individual provisions for off-balance sheet items	126.577	99.508
Group provisions for off-balance sheet items	198.264	197.727
Provisions for other long-term employee benefits	59.878	67.622
Provisions for potential litigation losses	348.129	247.839
Provisions for other liabilities	343.990	348.885
Balance at December 31	**1.076.838**	**961.581**

Movements on the accounts of provisions during the year are provided below:

(Thousands of RSD)

	Individual Provisions for Off- Balance Sheet Items	Group Provisions for Off- Balance Sheet Items	Provisions for Long-Term Employee Benefits	Provisions for Potential Litigation Losses	Provisions for Other Liabilities	total
Balance, January 1	99.508	197.727	67.622	247.839	348.885	961.581
Charge for the year						
- in the income statement	94.263	675	5.079	127.009	-	227.026
- in the statement of other comprehensive income	-	-	(9.856)	-	-	(9.856)
	94.263	675	(4.777)	127.009	-	217.170
Release of provisions	-	-	(2.967)	(3.675)	-	(6.642)
Reversal of provisions (Note 14)	(67.194)	(138)	-	(23.044)	(4.895)	(95.271)
Balance, at December 31	**126.577**	**198.264**	**59.878**	**348.129**	**343.990**	**1.076.838**

40) OTHER LIABILITIES

Other liabilities include:

(Thousands of RSD)

	2017	2016
Advances received, deposits and retainers:		
- in RSD	39.748	71.593
- in foreign currencies	3.669	3.139
Trade payables:		
- in RSD	229.898	182.145
- in foreign currencies	294.110	498.105
Other liabilities:		
- in RSD	497.427	563.428
- in foreign currencies	771.940	863.897
Fees and commissions payable per other liabilities:		
- in RSD	8.645	5.762
- in foreign currencies	13.974	14.230
Deferred other income:		
- in RSD	217.653	162.405
- in foreign currencies	56.364	82.037
Accrued other expenses:		
- in RSD	398.877	318.445
- in foreign currencies	35.124	43.350
Liabilities per managed funds	19.288	51.069
Taxes and contributions payable	57.862	139.858
Balance at December 31	2.644.579	2.999.463

Notes to the consolidated financial statements (CONTINUED)

41) RECONCILIATION OF OUTSTANDING BALANCES OF RECEIVABLES AND LIABILITIES WITH CREDITORS AND DEBTORS

In accordance with the Law on Accounting, the Group reconciled its balances of payables and receivables with its debtors and creditors. The balance reconciliations were made as of September 30, 2017. Out of the total amount of receivables for balance reconciliation, unreconciled balances totaled RSD 76,347 thousand, gross, while non-responded balance confirmation requests amounted to RSD 16,909,697 thousand. Out of the total amount of liabilities for balance reconciliation, unreconciled balances totaled RSD 123,725 thousand, while non-responded balance confirmation requests amounted to RSD 73,564,802 thousand. As for off-balance sheet items, the unreconciled balances amounted to RSD 889,977 thousand and confirmation requests totaling RSD 302,869,144 thousand were not responded to.

42) EQUITY

42.1 Equity is comprised of:

(Thousands of RSD)

	2017	2016
Issued capital – share capital	23.607.620	23.607.620
Share premium	562.156	562.156
Retained earnings	7.437.207	6.882.290
Reserves	38.537.400	33.807.839
Balance at December 31	**70.144.383**	**64.859.905**

As of December 31, 2017 the Group's share capital totaled RSD 23,607,620 thousand and comprised 2,360,762 common stock (ordinary) shares with the individual par value of RSD 10,000. All shares issued by the Group are ordinary shares.

Ordinary shareholders are entitled to dividend payment pursuant to the relevant decision on profit distribution enacted by the Group's (the Bank's) Supervisory Board and to one vote per share in the Bank's Shareholder General Meeting.

In accordance with the reorganization of the Banking Group's activities in Central and Eastern European countries, under the Demerger and Takeover Agreement executed by and between UniCredit Bank Austria AG and UCG Beteillingsverwaltung GmbH on August 31, 2016 and Merger and Acquisition Agreement executed by and between UCG Beteillingsverwaltung GmbH and UniCredit SpA on September 30, 2016, UniCredit Bank Austria AG transferred its sole (100%) ownership of the Bank to the Austrian holding company UCG Beteillingsverwaltung GmbH. Through merger of UCG Beteillingsverwaltung GmbH with UniCredit SpA, UniCredit SpA became the sole shareholder of UniCredit Bank Srbija a.d., Beograd as the parent entity.

Reserves from fair value adjustments relate to the net cumulative changes in the fair values of securities available for sale.

42.2 Breakdown of other comprehensive income after taxes is provided in the table below:

(Thousands of RSD)

	2017	2016
Actuarial gains/(losses) per defined employee benefits	8.378	(2.153)
Net fair value adjustments of financial assets available for sale	(255.417)	(834.514)
Other comprehensive income, net of taxes	**(247.039)**	**(836.667)**

Notes to the consolidated financial statements (CONTINUED)

43) CASH AND CASH EQUIVALENTS

Breakdown of cash and cash equivalents as reported within the statement of cash flows is provided below:

(Thousands of RSD)

	2017	2016
In RSD:		
Gyro account (Note 20)	17.645.389	8.734.298
Cash on hand (Note 20)	1.577.892	1.363.614
	19.223.281	**10.097.912**
In foreign currencies:		
Foreign currency accounts (Note 24)	2.510.170	5.651.441
Cash on hand (Note 20)	1.034.221	1.024.061
Other cash funds (Note 20)	38.226	43.692
	3.582.617	**6.719.194**
Balance at December 31	**22.805.898**	**16.817.106**

44) CONTINGENT LIABILITIES AND COMMITMENTS

44.1 Litigation:

As of December 31, 2017 there were 304 legal suits filed against the Group (including 7 labor lawsuits) with claims totaling RSD 1,207,990 thousand. In 14 of these proceedings plaintiffs are legal entities and in 290 proceedings private individuals appear as plaintiffs.

The Group made provisions of RSD 348,129 thousand in respect of the legal suits filed against it (Note 39). The aforesaid amount of provisions includes those for the labor lawsuits filed.

For certain lawsuits, provisions were not made in the exact amount of the claim, primarily based on the estimate of the outcome of such suits as favorable for the Group, i.e. the estimate that the Group will incur no outflows in respect of those legal suits or that there are minor contingent liabilities at issue, which require no provisioning.

The Group is involved in a number of lawsuits filed against third parties, primarily for collection of outstanding receivables.

44.2. The Group's commitments for operating lease liabilities for business premises (including parking spots and lease of spaces for ATMs) are provided below:

(Thousands of RSD)

	2017	2016
Commitments due		
- within a year	452.590	411.148
- from 1 to 5 years	1.682.441	1.591.338
- after 5 years	1.166.115	1.343.996
Total	**3.301.146**	**3.346.482**

44.3. The Group's contingent liabilities are provided in the table below:

(Thousands of RSD)

	2017	2016
Contingent liabilities		
Payment guarantees		
- in RSD	11.544.832	11.063.135
- in foreign currencies	11.350.088	9.699.275
Performance bonds		
- in RSD	40.258.699	28.487.153
- in foreign currencies	5.200.519	6.028.667
Letters of credit		
- in RSD	-	27.718
- in foreign currencies	2.023.063	4.208.584
Irrevocable commitments for undrawn loans	24.619.436	19.006.574
Other irrevocable commitments	21.323.572	11.331.633
Balance at December 31	116.320.209	**89.852.739**

Notes to the consolidated financial statements (CONTINUED)

44) CONTINGENT LIABILITIES AND COMMITMENTS (CONTINUED)

44.4. Breakdown of the Group's irrevocable commitments is provided below:

(Thousands of RSD)

	2017	2016
Commitments		
Current account overdrafts approved	3.629.513	1.322.601
Unused portion of approved credit card loan facilities	922.145	986.087
Unused framework loans	18.675.532	14.706.730
Letters of intent	1.392.246	1.991.156
Other irrevocable commitments	21.323.572	11.331.633
Balance at December 31	**45.943.008**	**30.338.207**

44.5. Undrawn foreign line of credit funds approved to the Group amounted to RSD 1,777,091 thousand as of December 31, 2017 (2016: RSD 10,929,274 thousand).

45) RELATED PARTY DISCLOSURES

The Group is under control of UniCredit S.p.A., Milan, domiciled and registered in Italy, which is the sole owner of the Group's common stock shares (100%). In the normal course of business, a number of banking transactions are performed with related parties. These include loans, deposits, investments in equity securities and derivative instruments. Related party transactions are performed at arm's length.

Balances of receivables and payables from related party transactions as of the year-end are provided in the table below:

(Thousands of RSD)

		2017	2016
Statement of financial position			
Loans and receivables due from banks and other financial institutions			
1.	UniCredit Bank Austria AG, Vienna	619.359	381.052
2.	UniCredit Bank AG, Munich	26.109	20.229
3.	UniCredit Bank Czech Republic and Slovakia a.s.	6	-
4.	UniCredit Bulbank, Sofia	22	23
5.	UniCredit S.P.A. Milan	7.515.042	14.407.879
6.	UniCredit Banka Slovenia, Ljubljana	-	331
7.	Zagrebačka banka d.d. Croatia	550	4.220
8.	UniCredit Bank Hungary Z.r.t., Hungary	5.212	7.469
9.	UniCredit Bank ZAO Moscow	9.924	6.943
10.	UniCredit Bank BIH	416	-
11.	Bank Polska Kasa Opieki SA*	-	2.692
		8.176.640	**14.830.838**
Loans and receivables due from customers			
1.	The Group's Management Board	22.433	11.186
2.	UCTAM D.O.O.	82.004	104.719
		104.437	**115.905**
Other assets			
1.	UniCredit S.P.A. Milan	23.183	12.165
2.	UniCredit Bank Austria AG, Vienna	2.766	222.077
3.	UniCredit Bank AG, Munich	2.518	3.174
4.	Zagrebačka banka d.d. Croatia	316	282
5.	UniCredit Bank BIH	287	6
6.	UniCredit Banka Slovenia, Ljubljana	4	4
7.	UniCredit Bank ZAO Moscow	6	6
8.	UniCredit Bank Hungary Z.r.t., Hungary	28.538	2.696
9.	UniCredit Rent d.o.o.	275	101
10.	UniCredit Business Partner S.C.P.A., Milan	-	3.017
11.	UniCredit Bank AG, London	1.025	-
12.	UniCredit Tiriac Bank SA, Romania	1.483	-
13.	UCTAM D.O.O.	80	1
14.	UNICREDIT S.p.A. Zweigniederlassung Vienna, Austria	-	30
		60.481	**243.559**

* Bank Polska Kasa Opieki SA was no longer member of UniCredit Group since 2017.

Notes to the consolidated financial statements (CONTINUED)

45) RELATED PARTY DISCLOSURES (CONTINUED)

(Thousands of RSD)

		2017	2016
Deposits and other liabilities due to banks, other financial institutions and the central bank			
1.	UniCredit Bank Austria AG, Vienna	17.956.684	21.523.116
2.	UniCredit Bank AD Banja Luka	241.132	252.008
3.	Zagrebačka banka d.d. Croatia	53.062	39.985
4.	UniCredit Bank AG, London	36	12
5.	UniCredit Banka Slovenia, Ljubljana	4.639	6.933
6.	UniCredit Bank AG, Munich	6.091	2.928
7.	UniCredit Bank Hungary Z.r.t., Hungary	2.790	1.500
8.	UniCredit Bulbank, Sofia	2	2
9.	UniCredit S.P.A. Milan	46.920.057	29.267.389
10.	UniCredit Bank Czech Republic and Slovakia a.s.	42.071	2.420
11.	UniCredit Bank ZAO Moscow	-	193
12.	Bank Polska Kasa Opieki SA	-	111
		65.226.564	**51.096.597**
Deposits and other liabilities due to customers			
1.	The Group's Management Board	27.501	21.122
2.	UniCredit Rent d.o.o	168.222	13.528
3.	BA CA Leasing Deutschland GmbH, Germany	4.591	4.621
4.	Ambassador Parc Dedinje d.o.o.	451.858	414.801
5.	UniCredit CAIB AG, Vienna	63	65
6.	UCTAM D.O.O.	22.433	43.613
		674.668	**497.750**
Subordinated liabilities			
1.	UniCredit Bank Austria AG, Vienna	2.718.490	3.082.125
		2.718.490	**3.082.125**
Other liabilities			
1.	UniCredit Bank AG, Munich	-	3.387
2.	UniCredit Bank Austria AG, Vienna	89.522	-
3.	UniCredit Bank Hungary Z.r.t., Hungary	155	190
4.	UniCredit Bank AD Banja Luka	14.431	-
5.	UniCredit S.P.A. Milan	141.118	223.703
6.	UniCredit Bulbank, Sofia	5.552	-
7.	Yapi ve Kredi Bankasi AS, Turkey	1.292	-
8.	UniCredit Rent d.o.o.	-	201
9.	UBIS G.m.b.H, Vienna	1.412	291.324
10.	UniCredit Business Integrated Solutions S.C.P.A, Czech Republic	2.793	2.682
		256.275	**521.487**
Liabilities, net as of December 31		**60.534.439**	**40.007.657**

The following table summarizes income and expenses from related party transactions:

(Thousands of RSD)

	2017	2016
Income statement		
Interest income	10.964	8.671
Interest expenses	(789.863)	(1.100.120)
Fee and commission income and other income	154.720	139.663
Fee and commission expenses and other expenses	(533.567)	(511.910)
Expenses, net as of December 31	**(1.157.746)**	**(1.463.696)**

Total gross salaries and other remunerations of the Management Board members amounted to RSD 97,074 thousand.

45) EVENTS AFTER THE REPORTING PERIOD

At its regular session held on January 31, 2018, the Bank's Supervisory Board adopted Decision no. 18/18 on the relief of duty of the Management Board Member and Chairperson Ms. Csilla Ihász, at her personal request, due to transfer to a position outside UniCredit Group effective from March 1, 2018.

At the same session the Bank's Supervisory Board adopted Decision no.19/18 on the appointment of Mr. Nikola Vuletić, a member of the Board as the Management Board Chairperson effective from March 1, 2018.

Beograd, 22. februar 2018. godine

Potpisano od strane rukovodstva UniCredit Bank Srbija A.D., Beograd:

Csilla Ihász
Predsednica Izvršnog odbora

Sandra Vojnović
Član Izvršnog odbora
Direktor Sektora za strategiju i finansije

Mirjana Kovačević
Direktor Direkcije za računovodstvo

Maximise commercial bank value.

We continue to maximise commercial bank value, with the ongoing transformation resulting in higher productivity. Our activities in Western Europe are benefitting from the revamped network with new service models for retail and SME customers as well as a strong multichannel strategy. We have further strengthened our leadership positions in CEE and CIB, while keeping a strong focus on risk.

Banking that matters.

UniCredit Bank

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