



**ERSTE&STIERMÄRKISCHE BANK D.D.**

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## **Disclosure requirements for the Group Erste&Steiermärkische Bank d.d. as of 31 December 2018**

**Zagreb, April 2019**

Disclosure requirements according to Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms ("CRR") and according to Article 165 and 166 of Credit Institution Act for the Group Erste&Steiermärkische Bank d.d. as of 31 December 2018, as follows:

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## OVERVIEW OF DISCLOSED NOTES IN THE ANNUAL REPORT

CRR Article	Template	Disclosure description	Note in Annual Report	Page number in Annual Report
436 (b)-(e)	EU LI3	Regulatory Scope of Consolidation	50. Own funds and capital requirements	252
437(1)(a)	EU LI1	Statement of financial position reconciliation	50. Own funds and capital requirements	256-257
436 (b)	EU LI2	Main sources of differences between regulatory exposure amounts and carrying values in financial statements	50. Own funds and capital requirements	258
437(1)(d)(e)	-	Own funds during transitional period	50. Own funds and capital requirements	261-269
436		Explanations of differences between accounting and regulatory exposure amount	50. Own funds and capital requirements	258

## OVERVIEW OF DISCLOSED NOTES IN THE DISCLOSURE REQUIREMENTS

The disclosure of the templates according to Guidelines EBA/GL/2016/11 (Guidelines on disclosure requirements under Part Eight of Regulation (EU) No 575/2013) can be found in the following chapters:

Qualitative Template	Quantitative Template	Description	Chapter
EU OVA		Institution risk management approach	1.2. Risk policy and strategy
	EU OV1	Overview of RWA	2. Capital requirements
EU CRA		General qualitative information about Credit Risk	1.2. Risk policy and strategy
EU CRE		Qualitative disclosures related to IRB models	4. Credit risk
EU CRB-A		Additional disclosure related to the credit quality of assets	5. Credit risk adjustments
	EU CRB-B	Total and average net amount of exposures	4. Credit risk
	EU CRB-C	Geographical breakdown of exposures	4. Credit risk
	EU CRB-D	Concentration of exposures by industry or counterparty types	4. Credit risk
	EU CRB-E	Maturity of exposures	4. Credit risk
	EU CR1-A	Credit quality of exposures by exposure classes and instruments	5. Credit risk adjustments
	EU CR1-B	Credit quality of exposures by industry or counterparty types	5. Credit risk adjustments
	EU CR1-C	Credit quality of exposures by geography	5. Credit risk adjustments
	EU CR1-D	Ageing of past-due exposures	5. Credit risk adjustments
	EU CR1-E	Non-performing and forborne exposures	5. Credit risk adjustments

## Disclosure requirements

(in HRK million)

Qualitative Template	Quantitative Template	Description	Chapter
	EU CR2-A	Changes in stock of general and specific credit risk adjustment	5. Credit risk adjustments
	EU CR2-B	Changes in stock of defaulted loans and debt securities	5. Credit risk adjustments
EU CRD		Qualitative disclosures on banks' use of external credit ratings under the standardised approach for credit risk	4.1. Use of the IRB approach to credit risk
	EU CR4	Standardised approach – credit risk exposure and Credit Risk Mitigation (CRM) effects	12. Credit risk mitigation techniques
	EU CR5	Standardised approach – exposures by asset classes and risk weights	4.1. Use of the IRB approach to credit risk
	EU CR6	IRB - Credit risk exposures by portfolio and PD range	4.1. Use of the IRB approach to credit risk
	EU CR8	RWA flow statements of credit risk exposures under the IRB approach	2. Capital requirements
	EU CR9	IRB – Backtesting of probability of default (PD) per portfolio	4.1. Use of the IRB approach to credit risk
	EU CR10	IRB (specialised lending and equities)	4.1. Use of the IRB approach to credit risk 11. Exposures in Equity not included in the Trading book
EU CRC		Qualitative disclosure requirements related to credit risk mitigation techniques	12. Credit risk mitigation techniques
	EU CR3	Credit risk mitigation techniques – overview	12. Credit risk mitigation techniques
EU CCRA		Qualitative disclosure requirements related to CRR	3. Counterparty credit risk
	EU CCR1	Analysis of counterparty credit risk (CCR) exposure by approach	3. Counterparty credit risk
	EU CCR2	Credit valuation adjustment (CVA) capital charge	3. Counterparty credit risk
	EU CCR3	Standardised approach of CCR exposures by regulatory portfolio and risk weights	3. Counterparty credit risk
	EU CCR4	IRB – CCR exposures by portfolio and PD scale	3. Counterparty credit risk
	EU CCR5-A	Impact of netting and collateral held on exposure values	3. Counterparty credit risk
	EU CCR5-B	Composition of collateral for CCR exposure	3. Counterparty credit risk
EU MRA		Quantitative disclosure requirements related to Market risk	7. Market risk exposure
	EU MR1	Market risk under standardised approach	7. Market risk exposure

## 1. GENERAL INFORMATION

### DISCLOSURE REQUIREMENTS COVERED: ART. 436 (a) CRR

Erste&Steiermärkische Bank d.d. („Bank”) was established in 1954 and was entered into the Court Register as a joint stock company on 24 January 1990. The Bank’s registered head office is at Jadranski trg 3a, Rijeka, the Republic of Croatia.

The Bank is the holding company for the Erste Bank Croatia Group (“Group”) that operates in the Republic of Croatia, Republic of Montenegro, Republic of Slovenia and Republic of Macedonia.

The Bank is licensed to conduct commercial banking activities in the Republic of Croatia. The Bank’s main operations are as follows:

- accepting deposits from the clients and deposits placement,
- granting loans, issuing guarantees and letters of credit to the individuals, companies, public institutions and other clients,
- treasury operations in the interbank market,
- trust management and investment banking services,
- performing domestic and international payments,
- providing banking services through an extensive branch network in the Republic of Croatia.

The Bank’s share capital, fully subscribed, amounts to HRK 1,698,417,500.00 and is divided into 16,984,175 ordinary shares. As of December 30, 2015, all shares of the Bank hold companies Erste Group Bank AG (10,023,326 shares or 59.02%) and Steiermärkische Bank und Sparkassen AG (6,960,849 shares or 40.98%).

#### 1.1. GOVERNING BODIES

In its business, the Bank applies highest ethical standards of corporate governance and individual behavior. The Bank’s work environment has to be exempt from any inappropriate impacts and behaviour which is prescribed by the Bank’s internal regulations and is in accordance with the standards of Erste Group.

The Bank’s internal act established a general framework for the prevention of conflicts of interest in identified areas where a potential conflict of interest could arise (identifying and monitoring the risk of conflict of interest). The Bank’s internal act prescribe general principles for managing conflicts of interest, concerning of investment services and activities of the Bank, in the performance of outside activities, business gifts, confidential information, linkage and establishing a clear and documented decision-making process.

The Bank brings appropriate measures and establishes procedures for adequately managing conflict of interest.

The Bank’s Rulebook on Organization determines clear organizational structure with well-defined, transparent and consistent lines of authority and responsibility within the Bank, in order to avoid any possible conflict of interests.

The composition, duties and responsibilities of the Management Board and the Supervisory Board members are determined by the Articles of Association, Rules of Procedure of the Management Board and the Rules of Procedure of the Supervisory Board.

## 1.1. GOVERNING BODIES (CONTINUED)

DISCLOSURE REQUIREMENTS COVERED: ART. 435 (2) (a-d) CRR

### SUPERVISORY BOARD

Willibald Cernko	President
Sava Ivanov Dalbokov	Deputy President
Mag. Franz Kerber	Member
Hannes Frotzbacher	Member
Dr. Judit Agnes Havasi	Member
Mag. Renate Veronika Ferlitz	Member
Nikolai Leo de Arnoldi	Member

As of 31 December 2018, the Supervisory Board members held the following supervisory board mandates or similar functions in the companies as it follows:

#### Willibald Cernko

Erste Bank der Österreichischen Sparkasse AG, member of the Supervisory Board  
Erste Group Bank AG, Management Board member  
Erste Reinsurance S.A. Verwaltungsrat – Management Board member  
Haftungsverbund GmbH (Shareholders Committee – member)  
SOS-Kinderdorf, member of the Supervisory Board

#### Hannes Frotzbacher

Allgemeine Sparkasse Oberösterreich BankAG, member of the Supervisory Board  
Intermarket Bank AG, member of the Supervisory Board  
Erste Bank a.d., Novi Sad, member of the Board of directors

#### Franz Kerber

Steiermärkische Bank und Sparkassen AG, deputy chairman of the Management Board  
Bankhaus Krentschker&CO AG, member of the Supervisory Board  
S Immo AG, deputy chairman of the Management Board  
Höller Privatstiftung, member of the Management Board  
McG Graz E.Gen, member of the Supervisory Board

## 1.1. GOVERNING BODIES (CONTINUED)

### Sava Ivanov Dalbokov

Steiermärkische Bank und Sparkassen AG, member of the Management Board  
Erste&Steiermärkische S-Leasing d.o.o., member of the Supervisory Board  
Banka Sparkasse d.d. Sarajevo, member of the Supervisory Board  
S-leasing d.o.o., Beograd, member of the Board of directors  
Sparkasse Bank Makedonija Ad Skopje, president of the Supervisory Board  
Erste Bank a.d. Podgorica, member of the Board of directors

### Judit Agnes Havasi

Vienna Insurance Group Wiener Städtische Versicherung AG, Management Board member  
Wiener Städtische Versicherung AG Vienna Insurance Group, Supervisory Board member  
Donau Versicherung AG Vienna Insurance Group, Supervisory Board member  
Komunálna poisťovňa, a.s., Vienna Insurance Group, Supervisory Board member  
Kooperativa poisťovňa, a.s., Vienna Insurance Group, Supervisory Board member  
Die Zweite Wiener Vereins-Sparcasse, Supervisory Board member  
Volkstheater Privatstiftung G.m.b.H., Supervisory Board member

### Nikolai Leo de Arnoldi

Triple A Rating AG, member of the Supervisory Board

## MANAGEMENT BOARD

The Bank is represented jointly by two members of the Management Board or by one member of the Management Board together with the procurator.

Christoph Schoefboeck	President
Borislav Centner	Member
Slađana Jagar	Member
Zdenko Matak	Member
Martin Hornig	Member

As of 31 December 2018, the Management Board members held the following supervisory board mandates or similar functions in the following companies:

### Christoph Schoefboeck

Erste & Steiermärkische S-Leasing d.o.o., president of the Supervisory Board  
Erste Factoring d.o.o. – deputy president of the Supervisory Board  
Erste Bank Ad Podgorica, member of Board of directors

## 1.1. GOVERNING BODIES (CONTINUED)

### **Slađana Jagar**

Erste nekretnine d.o.o., president of the Supervisory Board  
Erste Bank Ad Podgorica, president of the Board of directors

### **Borislav Centner**

Zagrebačka burza d.d., deputy president of the Supervisory Board  
Erste & Steiermärkische S-Leasing d.o.o., member of the Supervisory Board  
IR Real estate leasing u likvidaciji, deputy president of the Supervisory Board  
Erste Factoring d.o.o., president of the Supervisory Board  
Erste nekretnine d.o.o., deputy president of the Supervisory Board  
Erste Bank AD Podgorica, member of the Board of directors

### **Martin Hornig**

Valetudo d.o.o.– member of the company

### **Zdenko Matak**

Erste Card Club d.o.o., president of the Supervisory Board  
Erste d.o.o., member of the Supervisory Board

## **PROCURATORS**

On 31 December 2018, the Bank has no procurator.

Pursuant to the Decision made on 15 May 2014, the Supervisory Board has established following Committees:

- Remuneration Committee,
- Nomination Committee and
- Risk Committee

as determined by the relevant laws.

Risk committee has three members of which one is the president and comprises Supervisory Board members. In 2018 Risk Committee held two meetings and adopted five decision while had one session in writing, on which have adopted three one decisions.

General Assembly of the Bank made, with prior approval of the Management Board and the Supervisory Board, the Suitability Policy which governs the following related to the President, Management Board members. Supervisory Board members and key function holders:

- 1) general conditions to be fulfilled by the candidate for the President and a member of the Management Board, member of the Supervisory Board and the key function holders and the Management Board and the Supervisory Board as a whole, considering the targeted structure and especially:
  - their specific competence,



### 1.1. GOVERNING BODIES (CONTINUED)

- the required expertise, skills and experience necessary to fulfil the obligations under their jurisdiction,
  - a requirement for onboarding and continuous education,
  - a request for committed fulfilment of obligations under their jurisdiction.
- 2) administrative service responsible for performing the suitability assessment of the candidate,
  - 3) suitability assessment procedure, including time scheduled for submission of documents, deadlines and method of the procedure execution, method by which an assessed person responds and procedure results reporting,
  - 4) information and documents which the candidate should submit to the Bank to perform the assessment,
  - 5) situations and circumstances which may cause the necessity for extraordinary suitability assessment of the president or members of the Management Board, members of the Supervisory Board and the key function holders,
  - 6) form and method of filing the documents of suitability assessment procedure,
  - 7) the procedure of onboarding education of the President and members of the Management Board and the Supervisory board members in order to facilitate their clear understanding of the Bank's structure, business model, risk profile and governance arrangements and the role of the members within them and the procedure of permanent education of the President and members of the Management Board and the Supervisory Board members in order to ensure their knowledge is continuously suitable.

The objective and scope of the Policy, related to the Management Board members, is:

- 1) compliance of the Bank's operations with the relevant rules which regulate suitability of the members of the Management Board,
- 2) transparent and precise determination of conditions the candidate has to fulfil before appointment to the position of the president or a member of the Management Board,
- 3) professional education, experience and competences, as well as a good reputation, honesty and integrity of the president of the Management Board and each member of the Management Board and the Management Board as a whole, in order to ensure that the Bank's business operations are compliant with the relevant regulations and that the interests of the Bank's customers are protected,
- 4) avoidance of the conflict of interests especially between private interests of the president and the members of the Management Board and the Bank's interest when private interests affect or may affect impartiality of these persons in execution of their functions,
- 5) establishment and maintenance of effective corporate management aimed at risks mitigation and enhancement of the Bank's performance quality and transparency.

Staffing plan for Management Board Functions is created by Erste Group Bank AG. The diversity and inclusion policy was adopted for 2018, and it regulates the principles of diversity and inclusion that Erste Group undertakes to respect. In line with CRD IV, the Management Board of Erste Group Bank AG has set targets for the entire Group which defines that top management should be 35% of women (Boards members and B-1 directors) by 2019 and 35% of women in Supervisory Boards by 2019. This target only applies to banks as this applies to EU financial institutions and Group will try to apply this percentage to its management.

## 1.2. RISK POLICY AND STRATEGY

### EU OVA, EU CRA - DISCLOSURE REQUIREMENTS COVERED: ART. 435 (1) CRR

#### Introduction

Financial risk is in certain areas managed primarily on the Bank level (particularly related to legal obligation that applies only to the Bank) while in some areas it is monitored and managed at the Group level as deemed appropriate by the Management Board. The disclosures included in this note refer to the Group.

Risk is present in all Bank's activities but it is managed through the identification, measurement and monitoring of limits set for the associated risk. The Group has adopted a risk management system that aims to achieve optimal levels of profitability with an acceptable level of risk. The risk management system has been established as the active management of credit, market, liquidity risk and operational risk, as well as all other risks that may arise through regular Group business.

Risk monitoring and control is achieved through a clear organizational structure with defined roles and responsibilities.

#### The risk management system

##### *Supervisory Board*

The Supervisory Board has the responsibility to monitor the overall risk process within the Group.

##### *Management Board*

The Management Board and Supervisory Board in part that requires their approval, through the recognition and adoption of acts that define and regulate the operations of the Bank are authorized to determine the procedures and are responsible for their implementation. The Management Board provides overall supervision of risk and capital management of Group and is responsible for defining and implementing a comprehensive and aligned business and risk strategies for the Group.

The Board member responsible for risk management ("CRO") ensures the consideration of Group particularities within Group ICAAP standards. EBC CRO is responsible for the Group implementation, maintenance and adherence to Erste Group standards after their respective local Board approval. This includes, but is not limited to, ensuring the availability of resources and infrastructure. EBC CRO reviews the regular Group results/reports, draws conclusions and takes decisions within his/her responsibility as a member of the EBC Board of Directors.

The Management Board is supported by several divisions established to perform operating risk control functions and exercise strategic risk management responsibilities.

##### *Risk Management Division*

Risk management division is responsible for setting the grounds for effective risk management and managing and control of decisions that are related to the Group's risk exposure.

Risk management division is also responsible for developing strategy and management principle, setting the framework, policies and limits of acceptable risk exposure and is responsible for implementation and maintenance of procedures which enables independent control process.

## 1.2. RISK POLICY AND STRATEGY (CONTINUED)

Risk management division is obligated to revise internal acts within its responsibility, to do appropriateness controls and impact analysis and, if necessary, any alignments for the upcoming period.

### *Credit Risk Management Division*

The Credit Risk Management Division implements credit risk management and monitors the balance of credit portfolios of clients that are categorized as belonging to the Large Corporates Division, SME Division, Retail Division and the Financial Markets Division. The Division analyses requests for loans and based on them, issues opinion on the credit risk from the risk perspective. It analyses the projects and evaluates its eligibility for financing from the risk perspective. It also performs an analysis of the Bank's overall exposure to the client and controls the payment of outstanding debts to the Bank.

### *Collection and Work-out Division*

The Collection and Work-out Division is in charge of managing collection and bad placements by means of a continuous and systematic development of solutions to eliminate and reduce risks in dealing with work-out clients which includes coordination of early collection, restructuring, voluntary and forced collection.

### *Asset and Liability Management Division ("ALM")*

ALM has the responsibility of managing the Bank's assets and liabilities as well as the overall financial structure. It is primarily responsible for the funding and liquidity risk of the Bank.

### *Internal Audit Division*

The processes of risk management are regularly reviewed by the internal audit function, which examines both the adequacy of procedures and their compliance by the Bank. The results of assessment are reported to the Management Board along with its findings and recommendations.

## **Risk measurement and reporting**

The Group's risks are measured using a method which reflects both the expected losses likely to arise in normal circumstances and unexpected losses which are an estimate of the maximum loss based on statistical methods. The models use probabilities derived from historical experience, adjusted to reflect real economic conditions and their validity is regularly tested.

Risk monitoring and controlling is primarily performed based on limits set by the Bank. The limits reflect the market conditions and business strategy, as well as the risk that the Bank is willing to assume.

In addition, the Bank monitors and measures the overall risk bearing capacity in relation to total risk exposure with all risk types and activities.

Information obtained from all businesses activity is examined and processed in order to analyze, control and identify signs of early risks.

The Management Board and Supervisory Board are briefed on regularly bases about portfolio quality with various aspects of risk and are provided with all information necessary for understanding the credit risk to which the Group is exposed. The reports contain detailed information on exposures, ratings, concentration and changes in risk profile. The Risk Management Division prepares additional reports which provide information necessary for proactive risk management of the credit portfolio and the timely identification of any deterioration in the quality of the credit portfolio, which may result in material losses for the Bank.

## 1.2. RISK POLICY AND STRATEGY (CONTINUED)

With the aim of prudent risk management, the Bank applies the method of early detection of increased credit risk by monitoring all the relevant information on the level of individual portfolio, as well as individual client, with the prediction of changes in variables in the future, which primarily includes the current client's behavior in settling obligations and monitoring information from the market. Monitoring market conditions (including the monitoring of macro-economic variables, as well as their evaluation of the future period), changes in rating and days overdue ensures the early detection of increased credit risk.

Risk Management Division / Market and Liquidity Risk Management Department monitors and reports of market risk. Market risk may arise in Trading Book as well as in Banking Book. Trading book means all positions in financial instruments and commodities held by an institution either with trading intent, or in order to hedge positions held with trading intent. Position part of the Trading Book if position is taken by a designated trading unit and with trading intent. Positions which do not fulfill the relevant criteria for the trading book are instead assigned to the Banking book. Market risk of specific products is measured by the sensitivity limits (PVBP, CRPV, FX Delta, Equity Delta), Stop Loss limits and VaR. Value at Risk (VaR) calculation is performed in ESB using Erste Group's MRS system.

On a daily basis, the responsible members of the Management Board get information on the utilization of market limits, analysis, as well as other changes related to the risk exposure. These changes in risk exposure are reported in the form of an aggregated report.

### Information flow of risk

#### DISCLOSURE REQUIREMENTS COVERED: ART. 435 (2) (e) CRR

The Bank collects information about the client based on client's obligation to update and deliver information to the Bank (each time a new loan application is submitted and via client duties to regularly submit updated information), via various externally available information, but also based on the client's current business operations with the Bank. The collected data is, before use and entry into the operating system of the Bank, checked on several levels. This is to ensure adequate availability of information needed for efficient and prudent risk management of individual client, but also the portfolio as a whole.

Furthermore, all the information needed to successfully manage risk, effective management of risk-weighted assets and capital requirements are regularly filled in a central database that is used for risk management, and quality of that data is also regularly controlled. This ensures adequate, accurate, well structured, centralized and long-term database of information on the basis of which the Bank can monitor the status of the portfolio, a single client or a specific set of data on a certain day, as well as changes in the variables and the portfolio over time. This ensures centralized analysis, model development, uniform way of calculating the indicators and segmentation throughout the Bank and the Group.

The information is further transfer to management through regular reporting (predefined schedule and scope of the report) as well as *ad hoc* reporting on the risks that ensures the timely availability of high quality and accurate information to governing bodies to ensure adequate risk management and the EBC Group itself.

## **1.2. RISK POLICY AND STRATEGY (CONTINUED)**

Data loss resulting from inadequate or failed internal processes, people and systems or from external events are located in a centralized database for the purpose of control and efficient management and reporting of operational risk. That ensures consistent tracking of historical data and operational risk management in accordance with the best practices.

### **Risk mitigation**

The Group has a strategy of accepting risk as well as policies that include risk monitoring procedures and guidelines for overcoming risks. Policies are regularly, but at least on an annual basis, updated and adapted to ensure appropriate risk alignment, capital levels and business performance.

As part of the overall risk management, the Bank uses derivatives and other financial instruments to manage exposure resulting from changes in interest rates, foreign exchange rates, equity risks, credit risks, and exposures arising from forward transactions.

The Bank actively uses collateral to reduce its credit risk.

### **Risk concentration**

Risk concentration means potential negative consequences which may arise due to exposure concentration towards significant number of clients with similar business activities or same/similar economic characteristics resulting in inability to carry out the contractual liabilities towards the Bank. Risk concentration may arise also due to high exposure toward one individual or group of connected clients. Concentration shows sensitivity of achieving the Group results towards development of events affecting a particular market segment. Risk is managed through avoiding excessive concentration of risk through specific guidelines to focus on maintaining a diversified portfolio. Therefore, the Group has implemented a comprehensive system for the identification, measurement, control, reporting and management of risk concentrations. This is of key importance for securing the long-term viability of every single credit institution especially in phases with an adverse macroeconomic environment.

### **Risk profile of the institution**

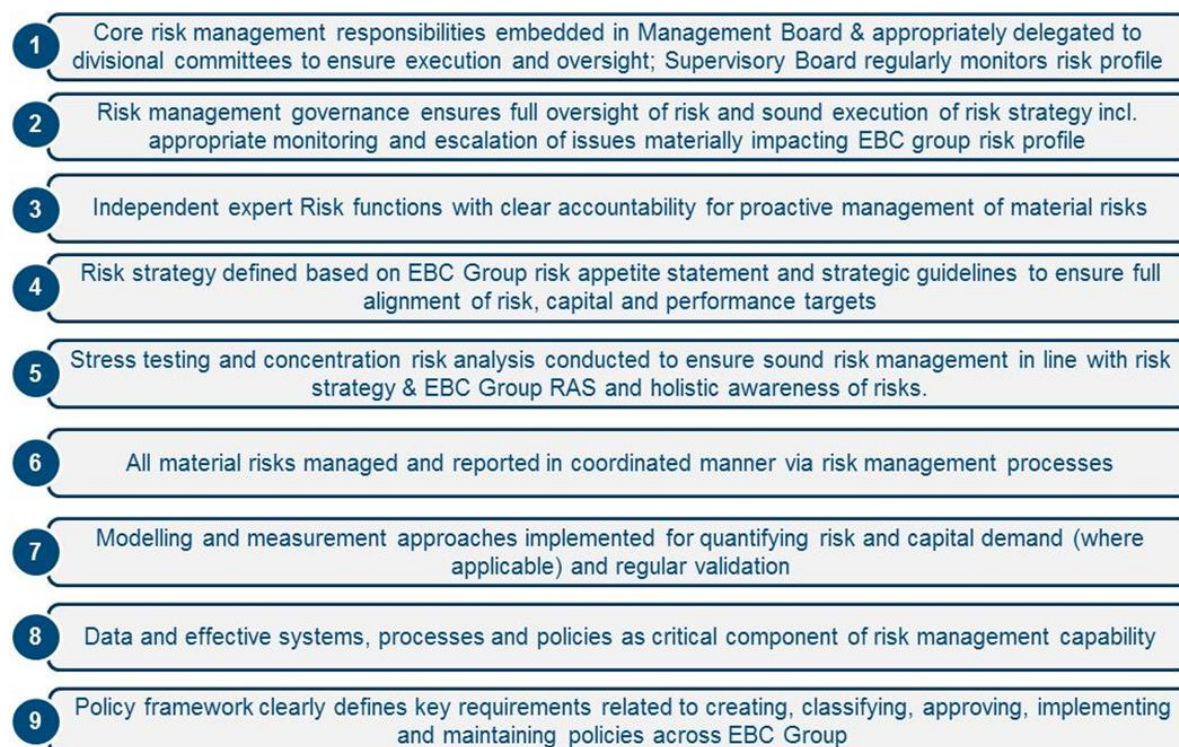
A key function of each credit institution is risk-taking in a conscious and selective manner and professional managing. Proactive policy and risk strategy that is promoted by the Group aims to achieve a balance between risk and return in order to achieve adequate and sustainable return on equity. The Group uses risk management and control system that is proactive and adapted to their own risk profile and business. It is based on a clear strategy that is consistent with the Group's business strategies and focuses on the early identification and management of risks and trends. Further, to achieve the internal objective of implementation of efficient and effective risk management, risk management and control system are designed to be compliant with external, especially regulatory requirements.

The Group's aim at achieving balanced risk and return in order to generate a sustainable growth and adequate return on equity. Therefore the Group policy is to ensure that risks are assumed in the context of the bank's business, recognized at an early stage and properly managed. This is achieved by fully integrating risk management into daily business activities, strategic planning and developing the business consistently with the defined risk appetite.

## 1.2. RISK POLICY AND STRATEGY (CONTINUED)

Risk management is governed by following principles:

**Picture 1: Principles of Risk management**

- 
- 1 Core risk management responsibilities embedded in Management Board & appropriately delegated to divisional committees to ensure execution and oversight; Supervisory Board regularly monitors risk profile
  - 2 Risk management governance ensures full oversight of risk and sound execution of risk strategy incl. appropriate monitoring and escalation of issues materially impacting EBC group risk profile
  - 3 Independent expert Risk functions with clear accountability for proactive management of material risks
  - 4 Risk strategy defined based on EBC Group risk appetite statement and strategic guidelines to ensure full alignment of risk, capital and performance targets
  - 5 Stress testing and concentration risk analysis conducted to ensure sound risk management in line with risk strategy & EBC Group RAS and holistic awareness of risks.
  - 6 All material risks managed and reported in coordinated manner via risk management processes
  - 7 Modelling and measurement approaches implemented for quantifying risk and capital demand (where applicable) and regular validation
  - 8 Data and effective systems, processes and policies as critical component of risk management capability
  - 9 Policy framework clearly defines key requirements related to creating, classifying, approving, implementing and maintaining policies across EBC Group

Due to the business strategy of the Group, the key risks for the Group are credit, market, liquidity and funding risk and non-financial risk, as well as currency-induced credit risk and business/strategic risk. The Group focuses also on the management of macroeconomic risk and concentrations risk within risk types. The Group continually strives to improve existing methods and processes in all areas of risk management. In 2018 management continued to focus on critical NPL portfolios and on improvement of overall portfolio quality. NPL portfolio sales contributed to the clean-up activities as well as write-offs and collection. In 2018 the focus remained on optimizing the risk costs resulting from the workout portfolio.

The Bank uses the internet as a medium for the publication of data according to Art. 434 CRR. Details are available on the website of Erste&Steiermärkische Bank d.d. where the Annual report for 2018 can be found in which the key data and ratios which provide a comprehensive overview of how the management of the Group's operations and risk management can be seen.

The Group defines risk strategy and risk appetite through the annual strategic planning process in order to have appropriate compliance of risk, capital and target values of profitability. Risk appetite statement (RAS) is a strategic statement expressing the maximum level that the Group is willing to take in order to achieve a business objective.

It consists of a series of key measures of risk appetite that provide a quantitative approach to risk management from which "top-down" limits are derived, creating a holistic view of the capital, financing and so called "risk-return trade-offs" as well as qualitative statements in the form of business principles that form part of the strategic guidelines for risk management.



## 1.2. RISK POLICY AND STRATEGY (CONTINUED)

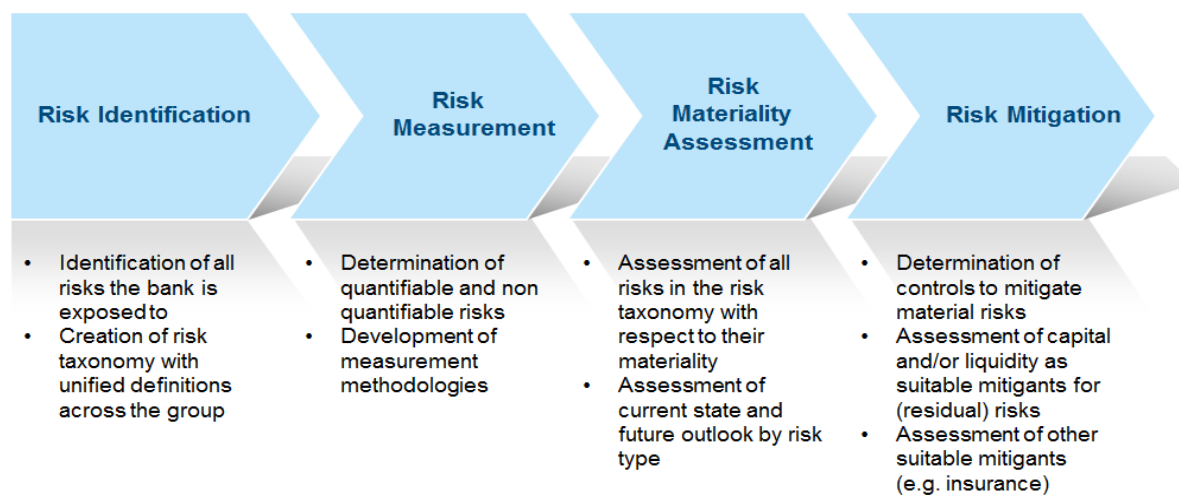
The key objectives of the *Group Risk Appetite Statement* are to:

- Ensure that the Group has sufficient resources to support business at any given point in time and absorb stress market events,
- Set ultimate boundaries of the Group's risk-return target setting,
- Define levels at which detailed analysis, escalation and mitigation strategies are triggered,
- Provide the basis for ongoing monitoring through the risk report discussed regularly by the Management and Supervisory Boards,
- Form a key input into the annual strategic planning process,
- Preserve and promote stakeholders' perception of the Group's financial strength and the robustness of its controls and systems.
- Represent the key factor for the remuneration program at the Group and local level as the determination of the annual bonus pool, which requires the relevant core metrics to be within the Group and subsidiaries' RAS.

Key measures of risk appetite include basic indicators (e.g. capital adequacy, leverage ratio, etc.) as well as indicators for credit risk, market, non-financial, liquidity and funding risk. In order to ensure that the defined risk appetite is operationally efficient, indicators are classified as target values, limits or principles with the main differences mechanisms that are triggered in the event of exceeding a certain level.

As part of its risk strategy, the Bank analyses its actual risk profile and determines a target risk profile based on its strategic goals. The target risk profile is a result of the risk assessment process in combination with the boundaries set by the business strategy and the risk appetite framework.

**Picture 2: Risk assessment process**



The target value is basically carried out as part of the planning process, in which the final plan is aligned with defined objectives. Trigger levels within the risk appetite are defined in a way that takes into account the regulatory requirements and the basic expectations of sustainable financial profile, which may vary over time depending on market conditions, competition and investor expectations. Any breach requires a discussion if the strategy change or remediation measure is needed.

## 1.2. RISK POLICY AND STRATEGY (CONTINUED)

To allow an effective overview of the risk appetite, regular checks and reports are performed for the senior management, which at all times have an insight into the current state of the taken risk level. Business Principles which are defined within the risk appetite are applied *ex ante*, including qualitative strategic statements, and are implemented through strategies, guidelines, regulations and policies for risk management.

During 2018 the relevant risk appetite indicators have evolved within defined limits.

### Internal Capital Adequacy

#### DISCLOSURE REQUIREMENTS COVERED: ART. 438 (a) CRR

Internal capital adequacy assessment process ("ICAAP") is based on an economic view and determines whether the bank has sufficient capital for covering all risks it is exposed to.

In addition to applying advanced methods for calculating capital requirements, ICAAP is also considering external factors such as the results of the comprehensive stress test. New methods and calculation methodology are constantly considered. In order to improve the stress testing, the Bank seeks to carry out constant reviews of the scenarios and define new ones.

ICAAP is used to assess the capital adequacy of the Group, or coverage potential by comparing it with the accepted risk at the Group level. The objective of the ICAAP is a clear definition of such level of capital that is sufficient to cover all risks to which the Group is exposed. ICAAP should also provide management with a stressed view on economic capital adequacy based on severe but plausible scenario. The risk capacity calculation thus includes both stressed economic capital and a stressed coverage potential. The process of assessing capital adequacy is designed in such a way that the Management and Supervisory Board at any time are able to assess all the risks to which the Group is or might be exposed.

By determining the coverage potential the Group indirectly sets the maximum level of risk that is willing to accept, and consequently, actively manages its risks. Through ICAAP apart from adequacy assessment internal capital planning is carried out. Planning of internal capital also ensures maintaining its capital levels that can fully support the factors such as the expected growth in loans, future funding sources and their usage, dividend policy and changes in the minimum amount of regulatory capital.

The framework of internal capital adequacy assessment reflects the risk strategy and limits set where ICAAP serves as a comprehensive management model.

The Group adheres to the basic principles in the assessment of internal capital adequacy reflecting expectations of the regulator taking into account the principles of good business practice:

1. a process of internal capital adequacy assessment is established with the level of capital in accordance with the risk profile of the Group,
2. the Management Board is responsible for establishing the ICAAP on overall Group level,
3. ICAAP is prescribed in detail with management functions (Management Board and Supervisory Board) taking responsibility for the results and the implementation of actions in accordance with them,
4. ICAAP is an integral part of the Group management,
5. regular review of the ICAAP process,
6. ICAAP is comprehensive and based on the risks taken,
7. in the assessment of internal capital adequacy, future trends are also taken into account,



## 1.2. RISK POLICY AND STRATEGY (CONTINUED)

8. ICAAP is based on adequate measurement and risk assessment methods,
9. the result of the internal capital adequacy assessment must be reasonable and in accordance with the risks taken,
10. the results of assessment of internal capital adequacy are taken into consideration during the planning and budgeting process as well as in creating of a business strategy of the Group.

The process consists of the quantification of risk-taking capacity (the sum of all material risks) in relation to the coverage potential. Total eligible amount of risk-taking in relation to the internal capital represents the economic capital adequacy. Stressed economic capital adequacy puts into relation stressed economic capital and stressed coverage potential. The results are analyzed within the Risk Management Division, and are reported to the Management Board and the Asset and Liability Committee ("ALCO") as part of the quarterly ICAAP report and in case of over-utilization, in accordance with the "traffic lights" system, specific actions are proposed, i.e. undertaken to reduce risk exposure or increase internal capital. As for the risk materiality assessment, all risk types to which the Group is exposed are considered, i.e., all the risks that exist in the processes and systems of the Group on the portfolio and product level. The combination of comprehensive quantitative and qualitative analysis results in grades that defines materiality of each risk type and forms the overall risk profile (Risk Taxonomy) across the Group. In addition to the current status of the risk types, RMA provides the information on the expected development of the risk profile in the future (one-year horizon). The Risk Materiality can be classified in four categories: high, medium, low and irrelevant. Based on the final risk materiality assessment for each category the specific principals, which are in line with assessment, are defined. Identification of all risk types and determining their exposure value is based on a comprehensive risk assessment, according to individual operations, products and activities.

The Group continually assesses the risk profile and regularly revises the ICAAP process, at the same time developing methodologies for the assessment of other risk types in order to establish, i.e. improve the efficiency of the risk management on the Group level.

## 2. CAPITAL REQUIREMENTS

### DISCLOSURE REQUIREMENTS COVERED: ART. 438 CRR

The total amount of capital requirements are measured in relation to regulatory capital. The amounts of capital have to be sufficient to cover the minimum capital requirements. The following capital requirements arise from credit risk, market risk and operational risk. Regulatory capital for the entire reporting period was sufficient.

**Table 1: EU OV1 - Overview of RWAs**

			RWAs		Minimum capital requirements
			31.12.2018	31.12.2017	31.12.2018
	<b>1</b>	<b>Credit risk (excluding CCR)</b>	<b>38,551</b>	<b>36,895</b>	<b>3,084</b>
Article 438(c)(d)	2	Of which the standardised approach	10,129	10,505	810
Article 438(c)(d)	3	Of which the foundation IRB (FIRB) approach	20,428	18,695	1,634
Article 438(c)(d)	4	Of which the advanced IRB (AIRB) approach	6,247	5,998	500
Article 438(d)	5	Of which equity IRB under the simple risk-weighted approach or the IMA	526	496	42
<b>Article 107</b> <b>Article 438(c)(d)</b>	<b>6</b>	<b>CCR</b>	<b>108</b>	<b>120</b>	<b>9</b>
Article 438(c)(d)	7	Of which mark to market	89	94	7
Article 438(c)(d)	8	Of which original exposure	-	-	-
	9	Of which the standardised approach	-	-	-
	10	Of which internal model method (IMM)	-	-	-
Article 438(c)(d)	11	Of which risk exposure amount for contributions to the default fund of a CCP	-	-	-
Article 438(c)(d)	12	Of which CVA	19	26	2
<b>Article 438(e)</b>	<b>13</b>	<b>Settlement risk</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Article 449(o)(i)</b>	<b>14</b>	<b>Securitisation exposures in the banking book (after the cap)</b>	<b>-</b>	<b>-</b>	<b>-</b>
	15	Of which IRB approach	-	-	-
	16	Of which IRB supervisory formula approach (SFA)	-	-	-
	17	Of which internal assessment approach (IAA)	-	-	-
	18	Of which standardised approach	-	-	-
<b>Article 438 (e)</b>	<b>19</b>	<b>Market risk</b>	<b>57</b>	<b>354</b>	<b>5</b>
	20	Of which the standardised approach	57	354	5
	21	Of which IMA	-	-	-
<b>Article 438(e)</b>	<b>22</b>	<b>Large exposures</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Article 438(f)</b>	<b>23</b>	<b>Operational risk</b>	<b>5,548</b>	<b>5,739</b>	<b>444</b>
	24	Of which basic indicator approach	594	1,763	48
	25	Of which standardised approach	4,954	3,976	396
	26	Of which advanced measurement approach	-	-	-
<b>Article 437(2), Article 48 and Article 60</b>	<b>27</b>	<b>Amounts below the thresholds for deduction (subject to 250% risk weight)</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Article 500</b>	<b>28</b>	<b>Floor adjustment</b>	<b>-</b>	<b>-</b>	<b>-</b>
	<b>29</b>	<b>Total</b>	<b>44,264</b>	<b>43,108</b>	<b>3,542</b>

## 2. CAPITAL REQUIREMENTS (CONTINUED)

For exposures subject to Part Three, Title II, Chapter 3 of the CRR (IRB approach) the variations of RWAs over the period are analyzed.

**Table 2: EU CR8 – RWA flow statements of credit risk exposures under the IRB approach**

Most significant changes on risk weight assets are driven by change of asset size and asset quality:

		RWA amounts	Capital requirements
1	RWAs as at the end of the previous reporting period <sup>1</sup>	31,674	2,534
2	Asset size	326	26
3	Asset quality	(3,677)	(294)
4	Model updates	-	-
5	Methodology and policy	-	-
6	Acquisitions and disposals	-	-
7	Foreign exchange movements	100	8
8	Other	-	-
9	RWAs as at the end of the reporting period	<b>28,423</b>	<b>2,274</b>

The decrease of the risk weighted assets compared to the previous reporting period is mainly caused by improvement of asset quality, i.e. by positive movements of assets to a better rating of the categories.

<sup>1</sup> The previous reporting period is 30.06.2018.

**2.1. CAPITAL INSTRUMENTS' MAIN FEATURES**

DISCLOSURE REQUIREMENTS COVERED: ART. 437 (1) (b) CRR

**Table 3: Capital instruments' main features (Common Equity Tier 1 instruments)**

		Common Equity Tier 1 instruments
1.	Issuer	Erste&Steiermärkische Bank d.d.
2.	Unique identifier (e.g. CUSIP, ISIN or Bloomberg identifier for private placement)	HRRIBARA0001
3.	Governing law(s) of the instrument	Art.167. and 169. Company law
<b>Regulatory treatment</b>		
4.	Transitional CRR rules	Common Equity Tier 1
5.	Post-transitional CRR rules	Common Equity Tier 1
6.	Eligible at solo/(sub-) consolidated/ solo and (sub-) consolidated	solo and consolidated
7.	Instrument type (types to be specified by each jurisdiction)	ordinary shares
8.	Amount recognised in regulatory capital (currency in million, as of most recent reporting date)	1,698 HRK
9.	Nominal amount of instrument	1,698,417,500.00 HRK
9.a	Issue price	100.00 HRK
9.b	Redemption price	N/A
10.	Accounting classification	shareholders' equity
11.	Original date of issuance	20 November 1954
12.	Perpetual or dated	no maturity
13.	Original maturity date	no maturity
14.	Issuer call subject to prior supervisory approval	no
15.	Optional call date, contingent call dates and redemption amount	N/A
16.	Subsequent call dates, if applicable	N/A
<b>Coupons / dividends</b>		
17.	Fixed or floating dividend/coupon	floating
18.	Coupon rate and any related index	N/A
19.	Existence of a dividend stopper	no
20.a	Fully discretionary, partially discretionary or mandatory (in terms of timings)	fully discretionary
20.b	Fully discretionary, partially discretionary or mandatory (in terms of amount)	fully discretionary
21.	Existence of step up or other incentive to redeem	no
22.	Noncumulative or cumulative	noncumulative
23.	Convertible or non-convertible	nonconvertible
24.	If convertible, conversion trigger(s)	N/A
25.	If convertible, fully or partially	N/A
26.	If convertible, conversion rate	N/A
27.	If convertible, mandatory or optional conversion	N/A
28.	If convertible, specify instrument type convertible into	N/A
29.	If convertible, specify issuer of instrument it converts into	N/A
30.	Write-down features	no
31.	If write-down, write-down triggers(s)	N/A
32.	If write-down, full or partial	N/A
33.	If write-down, permanent or temporary	N/A
34.	If temporary write-down, description of write-up mechanism	N/A
35.	Position in subordinated hierarchy in liquidation (specify instrument type immediately senior to instrument)	N/A
36.	Non-compliant transitioned features	no
37.	If yes, specify non-compliant features	N/A

"N/A" not applicable

## 2.1. CAPITAL INSTRUMENTS' MAIN FEATURES (CONTINUED)

**Table 4: Capital instruments' main features (Tier 2 Capital instruments)**

		Tier 2 Capital instruments			
1.	Issuer	Erste& Steiermärkische Bank d.d.	Erste& Steiermärkische Bank d.d.	Erste& Steiermärkische Bank d.d.	Erste& Steiermärkische Bank d.d.
2.	Unique identifier (e.g. CUSIP, ISIN or Bloomberg identifier for private placement)	subordinated loan	subordinated loan	subordinated loan	subordinated loan
3.	Governing law(s) of the instrument	Croatian Law	Croatian Law	Croatian Law	Croatian Law
<b>Regulatory treatment</b>					
4.	Transitional CRR rules	Tier 2 instrument	Tier 2 instrument	Tier 2 instrument	Tier 2 instrument
5.	Post-transitional CRR rules	Tier 2 instrument	Tier 2 instrument	Tier 2 instrument	Tier 2 instrument
6.	Eligible at solo/(sub-) consolidated/ solo and (sub-) consolidated	solo and (sub-) consolidated	solo and (sub-) consolidated	solo and (sub-) consolidated	solo and (sub-) consolidated
7.	Instrument type (types to be specified by each jurisdiction)	subordinated loan	subordinated loan	subordinated loan	subordinated loan
8.	Amount recognised in regulatory capital (currency in million, as of most recent reporting date)	225 HRK	225 HRK	190 HRK	423 HRK
9.	Nominal amount of instrument	30,000,000.00 EUR	30,000,000.00 EUR	30,000,000.00 EUR	80,000,000.00 EUR
9.a	Issue price	N/A	N/A	N/A	N/A
9.b	Redemption price	N/A	N/A	N/A	N/A
10.	Accounting classification	liability - amortised cost	liability - amortised cost	liability - amortised cost	liability - amortised cost
11.	Original date of issuance	11 December 2017	19 March 2015	19 March 2015	10 July 2014
12.	Perpetual or dated	dated	dated	dated	dated
13.	Original maturity date	11 December 2024	31 December 2022	19 March 2022	09 July 2021
14.	Issuer call subject to prior supervisory approval	no	no	no	no
15.	Optional call date, contingent call dates and redemption amount	N/A	N/A	N/A	N/A
16.	Subsequent call dates, if applicable	N/A	N/A	N/A	N/A

"N/A" not applicable

The table is continued on the next page.

## 2.1. CAPITAL INSTRUMENTS' MAIN FEATURES (CONTINUED)

		Tier 2 Capital instruments			
	<i>Coupons/ dividends</i>				
17.	Fixed or floating dividend/ coupon	N/A	N/A	N/A	N/A
18.	Coupon rate and any related index	N/A	N/A	N/A	N/A
19.	Existence of a dividend stopper	no	no	no	no
20.a	Fully discretionary, partially discretionary or mandatory (in terms of timings)	mandatory	mandatory	mandatory	mandatory
20.b	Fully discretionary, partially discretionary or mandatory (in terms of amount)	mandatory	mandatory	mandatory	mandatory
21.	Existence of step up or other incentive to redeem	no	no	no	no
22.	Noncumulative or cumulative	noncumulative	noncumulative	noncumulative	noncumulative
23.	Convertible or non-convertible	nonconvertible	nonconvertible	nonconvertible	nonconvertible
24.	If convertible, conversion trigger(s)	N/A	N/A	N/A	N/A
25.	If convertible, fully or partially	N/A	N/A	N/A	N/A
26.	If convertible, conversion rate	N/A	N/A	N/A	N/A
27.	If convertible, mandatory or optional conversion	N/A	N/A	N/A	N/A
28.	If convertible, specify instrument type convertible into	N/A	N/A	N/A	N/A
29.	If convertible, specify issuer of instrument it converts into	N/A	N/A	N/A	N/A
30.	Write-down features	no	no	no	no
31.	If write-down, write-down triggers(s)	N/A	N/A	N/A	N/A
32.	If write-down, full or partial	N/A	N/A	N/A	N/A
33.	If write-down, permanent or temporary	N/A	N/A	N/A	N/A
34.	If temporary write-down, description of write-up mechanism	N/A	N/A	N/A	N/A
35.	Position in subordinated hierarchy in liquidation (specify instrument type immediately senior to instrument)	Instruments are subordinated to Tier 1 capital			
36.	Non-compliant transitioned features	no	no	no	no
37.	If yes, specify non-compliant features	N/A	N/A	N/A	N/A

"N/A" not applicable

## 2.1. CAPITAL INSTRUMENTS' MAIN FEATURES (CONTINUED)

### DISCLOSURE REQUIREMENTS COVERED: ART. 437 (1) (c) CRR

**Ordinary shares** of the Erste&Steiermärkische Bank d.d. represent fully subscribed share capital in amount of HRK 1,698,417,500.00 and it is fully paid. Bank's share capital is divided into 16,984,175 ordinary shares issued in dematerialized form, each par value of HRK 100.00, which are registered at Central Depository and Clearing Company ("SKDD") under RIBA-R-A mark and has no maturity. Each share bears one voting right on General Assembly. Bank's shares are conducted in central depository and Clearing Company Inc., Zagreb. Dividends are paid out to shareholders according to their share in capital. Every increase or decrease of paid up capital has to be based on decision by General Assembly. Instruments are not secured neither are covered with guarantee which upgrade status from creditor.

**Subordinated loans** shown in table main capital's features meet the conditions regulated by Article 63 CRR for recognition as Tier II capital instruments.

### 3. COUNTERPARTY CREDIT RISK

#### EU CCRA - DISCLOSURE REQUIREMENTS COVERED: ART. 439 CRR

Counterparty credit risk ("CCR") is calculated, monitored and controlled within credit risk management system. Limits for counterparty credit risk are monitored and setup within credit risk limits. Internal capital for counterparty credit risk is made on the basis of Value at Risk model ("VaR").

**Table 5: EU CCR1 – Analysis of CCR exposure by approach**

		Notional	Replace ment cost/cur rent market value	Potential future credit exposure	EEPE	Multiplier	EAD post CRM	RWAs
1	Mark to market		6	138			138	69
2	Original exposure	-					-	-
3	Standardised approach		-			-	-	-
4	IMM (for derivatives and SFTs)				-	-	-	-
5	Of which securities financing transactions				-	-	-	-
6	Of which derivatives and long settlement transactions				-	-	-	-
7	Of which from contractual cross-product netting				-	-	-	-
8	Financial collateral simple method (for SFTs)					-	-	-
9	Financial collateral comprehensive method (for SFTs)						1,558	20
10	VaR for SFTs						-	-
11	<b>Total</b>							<b>89</b>



### 3. COUNTERPARTY CREDIT RISK (CONTINUED)

**Table 6: EU CCR2 – CVA capital charge**

		Exposure Value	RWAs
1	Total portfolios subject to the advanced method	-	-
2	(i) VaR component (including the 3× multiplier)	-	-
3	(ii) SVaR component (including the 3× multiplier)	-	-
4	All portfolios subject to the standardised method	98	19
EU4	Based on the original exposure method	-	-
<b>5</b>	<b>Total subject to the CVA capital charge</b>	<b>98</b>	<b>19</b>

Bank's credit exposure to counterparty credit risk is calculated based on the standardized method and shows the stability during the reported period.

**Table 7: EU CCR3 – Standardised approach – CCR exposures by regulatory portfolio and risk**

	Exposure Classes	RW										Total	of which Unrated
		0%	2%	4%	10%	20%	50%	70%	75%	100%	150%		
1	Central governments or central banks	-	-	-	-	-	-	-	-	-	-	-	-
2	Regional government or local authorities	-	-	-	-	-	-	-	-	-	-	-	-
3	Public sector entities	-	-	-	-	-	-	-	-	-	-	-	-
4	Multilateral development banks	-	-	-	-	-	-	-	-	-	-	-	-
5	International organisations	-	-	-	-	-	-	-	-	-	-	-	-
6	Institutions	-	-	-	-	-	-	-	-	-	-	-	-
7	Corporates	-	-	-	-	-	-	-	-	48	-	48	48
8	Retail	-	-	-	-	-	-	-	-	-	-	-	-
13	Institutions and corporates with a short term credit assessment	-	-	-	-	-	-	-	-	-	-	-	-
16	Other items	-	-	-	-	-	-	-	-	-	-	-	-
<b>17</b>	<b>Total</b>	-	-	-	-	-	-	-	-	<b>48</b>	-	<b>48</b>	<b>48</b>

### 3. COUNTERPARTY CREDIT RISK (CONTINUED)

**Table 8: EU CCR4 – IRB approach – CCR exposures by portfolio and PD scale (Institutions)**

Exposure class	PD scale	EAD post CRM	Average PD	Number of obligors	Average LGD	Average maturity	RWA	RWA density
Institutions	0.00 do <0.15	1,391	0.14%	1	1.15%	-	10	0.72%
Institutions	0.15 do <0.25	-	0.00%	-	0.00%	-	-	0.00%
Institutions	0.25 do <0.50	-	0.00%	-	0.00%	-	-	0.00%
Institutions	0.50 do <0.75	-	0.00%	-	0.00%	-	-	0.00%
Institutions	0.75 do <2.50	16	1.83%	1	0.99%	-	0	2.02%
Institutions	2.50 do <10.00	95	3.96%	2	2.77%	-	8	7.50%
Institutions	10.00 do <100.00	52	10.24%	1	0.05%	-	0	0.19%
Institutions	100.00 (Default)	-	0.00%	-	0.00%	-	-	0.00%
Institutions	<b>Sub-total</b>	<b>1,554</b>	<b>0.73%</b>	<b>5</b>	<b>1.21%</b>	<b>-</b>	<b>18</b>	<b>1.13%</b>
	<b>Total (all portfolios)</b>	<b>1,647</b>	<b>0.87%</b>	<b>26</b>	<b>1.88%</b>	<b>-</b>	<b>40</b>	<b>2.43%</b>

**Table 9: EU CCR4 – IRB approach – CCR exposures by portfolio and PD scale (Corporate)**

Exposure class	PD scale	EAD post CRM	Average PD	Number of	Average LGD	Average maturity	RWA	RWA density
Corporate	0.00 do <0.15	-	0.00%	-	0.00%	-	-	0.00%
Corporate	0.15 do <0.25	-	0.00%	-	0.00%	-	-	0.00%
Corporate	0.25 do <0.50	-	0.00%	-	0.00%	-	-	0.00%
Corporate	0.50 do <0.75	1	0.69%	2	45.00%	-	1	84.24%
Corporate	0.75 do <2.50	23	1.45%	11	40.45%	-	17	73.43%
Corporate	2.50 do <10.00	42	6.23%	7	3.45%	-	4	9.75%
Corporate	10.00 do <100.00	-	0.00%	-	0.00%	-	-	0.00%
Corporate	100.00 (Default)	-	0.00%	-	0.00%	-	-	0.00%
Corporate	<b>Sub-total</b>	<b>66</b>	<b>4.46%</b>	<b>20</b>	<b>17.11%</b>	<b>-</b>	<b>22</b>	<b>33.30%</b>
	<b>Total (all portfolios)</b>	<b>1,647</b>	<b>0.87%</b>	<b>26</b>	<b>1.88%</b>	<b>-</b>	<b>40</b>	<b>2.43%</b>

**3. COUNTERPARTY CREDIT RISK (continued)****Table 10: EU CCR5-A – Impact of netting and collateral held on exposure values**

		Gross positive fair value or net carrying amount	Netting benefits	Netted current credit exposure	Collateral held - financial collateral	Net credit exposure
1	Derivatives	138	-	-	68	70
2	SFTs	1,978	-	-	1,915	63
3	Cross-product netting	-	-	-	-	-
4	<b>Total</b>	<b>2,116</b>	<b>-</b>	<b>-</b>	<b>1,983</b>	<b>133</b>

**Table 11: EU CCR5-B - Composition of collateral for exposures to CCR**

	Collateral used in derivative transactions				Collateral used in SFTs	
	Fair value of collateral received		Fair value of posted collateral		Fair value of collateral received	Fair value of posted collateral
	Segregated	Unsegregated	Segregated	Unsegregated		
Cash	9	-	-	-	-	-
Securities	-	-	-	-	2,155	-
<b>Total</b>	<b>9</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>2,155</b>	<b>-</b>

The Bank exchanges financial collaterals for repo and derivatives exposure. The majority of the derivatives are contracted through regular business with the clients, during which the closing of the positions with Erste Group Bank AG is done. Exposure to counterparty credit risk after credit risk mitigation from derivative transactions as at 31 December 2018 was HRK 70 million. Counterparty credit risk exposure is calculated on the basis of mark-to-market method.

**Collateral assurance**

Bank employs repurchase agreements and master netting agreements (on-balance sheet and off-balance sheet netting) as a means of reducing credit risk of derivative and financing transactions. They qualify as potential offsetting agreements. Master netting agreements are relevant for counterparties with multiple derivative contracts.

They provide for the net settlement of all the contracts in the event of default of any counterparty. Repurchase agreements are primary financing transactions. They are structured as a sale and subsequent repurchase of securities at a pre-agreed price and time. This ensures that the securities stay in the hands of a lender as collateral in case that the debtor defaults in fulfilling any of its obligations.

Collaterals used in these transactions are mostly high rated securities. When securities are used as collaterals additional haircuts are done depending on residual maturity of the collateral.

Additional information for the purpose of Article 439 CRR can be found in the Annual report for the year 2018 published on the web site of the Bank under Note 15 Derivatives held for trading.

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### 3. COUNTERPARTY CREDIT RISK (continued)

#### DISCLOSURE REQUIREMENTS COVERED: ART. 439 (c), (e) AND (f) CRR

Wrong-way risk is the risk that occurs when exposure to a counterparty is adversely correlated with the credit quality of that counterparty. In short it arises when default risk and credit exposure increase together. Credit value adjustments (CVA) for counterparty risk and debt value adjustments (DVA) for the own default credit risk are applied to OTC derivatives. For the CVA the adjustment is driven by the expected positive exposure and the credit quality of the counterparty. DVA is driven by the expected negative exposure and the Bank's credit quality. The bank has implemented an approach, where the modelling of the expected exposure is based on option replication strategies. This modelling approach is considered for the most relevant portfolios and products. The probability of default of counterparties which are not traded in an active market is determined from internal PDs mapped to a basket of liquid companies being present in the central European market. Thereby market based valuation concepts have been incorporated.

Counterparties with liquid bond or CDS markets are valued by the respective single-name market based PD derived from the prices. The Bank's probability of default has been derived from the buy-back levels of the Bank's issuances.

#### 4. CREDIT RISK

Credit risk represents the risk that exposes the Group and the Bank to the risk of incurred loss due to the default of a client. Credit risk management system includes all measures and rules determined by the applicable law regulations and internal regulations as well as to proactively comply with the guidelines and best practices of the Basel III standards.

The role of the Risk Management Division, Credit Risk Management Division and the Collection and Work-out Division is control in all parts of the loan approval process and further credit portfolio monitoring. This includes a review and quality assessment of the loan portfolio, the establishment and revision of adequate provisions for loan losses, per client and for the overall portfolio.

For this purpose, the classification of assets into risk groups is set, based on internal ratings of customers which follow best business practices of credit risk management.

#### The total and average amount of exposure classified according to different categories of exposure

DISCLOSURE REQUIREMENTS COVERED: ART. 442 (c) CRR

**Table 12: Total exposure amount sorted based on the exposure categories**

Net credit risk exposure by exposure category	Loans, deposits, interest claims and other claims	Securities	Off balance sheet items	Derivatives
	Total amount	Total amount	Total amount	Total amount
Exposure to central governments or central banks	11,345	9,150	36	-
Exposure to regional governments and local authorities	987	-	332	-
Exposure to public sector entities	2,328	162	8	-
Exposure to institutions (credit institutions and investment firm)	2,065	128	214	69
Exposure to multilateral development banks	-	-	-	-
Exposure to corporates	16,836	324	8,756	69
Exposure to retail	20,688	-	2,978	-
Exposures secured by mortgages on immovable property	897	-	-	-
Exposures in default <sup>2</sup>	276	-	20	-
Exposures to subjects of collective investments undertakings (CIU)	138	-	-	-
Other exposures	810	-	-	-
Equity exposures	217	-	-	-
<b>TOTAL</b>	<b>56,587</b>	<b>9,764</b>	<b>12,344</b>	<b>138</b>

<sup>2</sup> In accordance to Art. 112 CRR exposures in default are shown in STD approach.

**4. CREDIT RISK (CONTINUED)****Table 13: EU CRB-B – Total and average net amount of exposures**

		Net exposure at the end of the period	Average net exposure over the period
1	Central governments or central banks	12,891	12,608
2	Institutions	2,292	2,903
3	Corporates	21,333	21,157
4	<i>Of Which: Specialised Lending</i>	3,778	3,505
5	<i>Of Which: SME</i>	10,586	10,544
6	Retail	17,632	17,297
7	Secured by real estate property	6,025	5,939
8	<i>SME</i>	402	402
9	<i>Non-SME</i>	5,623	5,537
10	<i>Qualifying Revolving</i>	-	-
11	<i>Other Retail</i>	11,607	11,358
12	<i>SME</i>	555	546
13	<i>Non-SME</i>	11,052	10,812
14	Equity	205	207
<b>15</b>	<b>Total IRB approach</b>	<b>54,353</b>	<b>54,172</b>
16	Central governments or central banks	7,640	7,590
17	Regional governments or local authorities	1,319	1,181
18	Public sector entities	2,498	2,270
19	Multilateral Development Banks	-	-
20	International Organisations	-	-
21	Institutions	184	214
22	Corporates	4,652	4,969
23	<i>of which: SME</i>	2,258	2,279
24	Retail	6,034	5,713
25	<i>of which: SME</i>	647	625
26	Secured by mortgages on immovable property	897	871
27	<i>of which: SME</i>	108	102
28	Exposures in default	296	396
29	Items associated with particularly high risk	-	-
30	Covered bonds	-	-
31	Claims on institutions and corporates with a short-term credit assessment	-	-
32	Collective investments undertakings (CIU)	138	138
33	Equity exposures	12	12
34	Other exposures	810	831
<b>35</b>	<b>Total SA approach</b>	<b>24,480</b>	<b>24,185</b>
<b>36</b>	<b>Total</b>	<b>78,833</b>	<b>78,357</b>

#### 4. CREDIT RISK (CONTINUED)

DISCLOSURE REQUIREMENTS COVERED: ART. 442 (e) CRR

**Table 14: EU CRB-C – Geographical breakdown of exposures**

		Regional Department West	Regional Department Rijeka	Regional Department Central Croatia	Regional Department South	Regional Department Istra	Regional department Slavonija	Total Croatia
1	Central governments or central banks	11,279	-	-	-	-	-	11,279
2	Institutions	356	-	-	-	-	-	356
3	Corporates	11,762	2,366	1,990	3,011	812	977	20,918
4	Of Which: Specialised Lending	2,820	128	77	551	25	34	3,635
5	Of Which: SME	4,145	1,514	1,638	1,907	707	675	10,586
6	Retail	5,021	3,803	3,514	2,602	1,251	1,378	17,569
7	Secured by real estate property	2,131	1,227	828	947	429	401	5,963
8	SME	49	79	97	89	36	52	402
9	Non-SME	2,082	1,148	731	858	393	349	5,561
10	Qualifying Revolving	-	-	-	-	-	-	-
11	Other Retail	2,890	2,576	2,686	1,655	822	977	11,606
12	SME	92	107	133	122	59	42	555
13	Non-SME	2,798	2,469	2,553	1,533	763	935	11,051
14	Equity	108	-	-	-	-	-	108
15	<b>Total IRB approach</b>	<b>28,526</b>	<b>6,169</b>	<b>5,504</b>	<b>5,613</b>	<b>2,063</b>	<b>2,355</b>	<b>50,230</b>
16	Central governments or central banks	6,499	-	-	-	-	-	6,499
17	Regional governments or local authorities	971	14	99	66	19	3	1,172
18	Public sector entities	2,060	-	1	-	275	-	2,336
19	Multilateral Development Banks	-	-	-	-	-	-	-
20	International Organisations	-	-	-	-	-	-	-
21	Institutions	8	-	-	-	-	-	8
22	Corporates	3,272	8	57	87	13	17	3,454
23	of which: SME	1,492	1	51	65	10	15	1,634
24	Retail	3,741	-	-	-	-	-	3,741
25	of which: SME	593	-	-	-	-	-	593
26	Secured by mortgages on immovable property	-	-	-	-	-	-	-
27	of which: SME	-	-	-	-	-	-	-
28	Exposures in default	267	-	2	2	-	1	272
29	Items associated with particularly high risk	-	-	-	-	-	-	-
30	Covered bonds	-	-	-	-	-	-	-
31	Claims on institutions and corporates with a short-term credit assessment	-	-	-	-	-	-	-
32	Collective investments undertakings (CIU)	138	-	-	-	-	-	138
33	Equity exposures	2	-	-	-	-	-	2
34	Other exposures	542	-	-	-	-	-	542
35	<b>Total SA approach</b>	<b>17,500</b>	<b>22</b>	<b>159</b>	<b>155</b>	<b>307</b>	<b>21</b>	<b>18,164</b>
36	<b>Total</b>	<b>46,026</b>	<b>6,191</b>	<b>5,663</b>	<b>5,768</b>	<b>2,370</b>	<b>2,376</b>	<b>68,394</b>

**4. CREDIT RISK (CONTINUED)****EU CRB-C – Geographical breakdown of exposures (continued)**

		EU countries	Other European countries	United States of America	Other countries	Subtotal other countries	Total
1	Central governments or central banks	719	509	128	256	1,612	12,891
2	Institutions	1,902	1	21	12	1,936	2,292
3	Corporates	100	315	-	-	415	21,333
4	Of Which: Specialised Lending	88	55	-	-	143	3,778
5	Of Which: SME	-	-	-	-	-	10,586
6	Retail	37	12	7	7	63	17,632
7	Secured by real estate property	36	12	7	7	62	6,025
8	SME	-	-	-	-	-	402
9	Non-SME	36	12	7	7	62	5,623
10	Qualifying Revolving	-	-	-	-	-	-
11	Other Retail	1	-	-	-	1	11,607
12	SME	-	-	-	-	-	555
13	Non-SME	1	-	-	-	1	11,052
14	Equity	-	-	97	-	97	205
15	<b>Total IRB approach</b>	2,758	837	253	275	4,123	54,353
16	Central governments or central banks	2	1,139	-	-	1,141	7,640
17	Regional governments or local authorities	-	147	-	-	147	1,319
18	Public sector entities	162	-	-	-	162	2,498
19	Multilateral Development Banks	-	-	-	-	-	-
20	International Organisations	-	-	-	-	-	-
21	Institutions	173	3	-	-	176	184
22	Corporates	88	1,092	6	12	1,198	4,652
23	of which: SME	39	584	1	-	624	2,258
24	Retail	1,272	1,020	-	1	2,293	6,034
25	of which: SME	-	54	-	-	54	647
26	Secured by mortgages on immovable property	2	894	-	1	897	897
27	of which: SME	-	108	-	-	108	108
28	Exposures in default	8	13	3	-	24	296
29	Items associated with particularly high risk	-	-	-	-	-	-
30	Covered bonds	-	-	-	-	-	-
31	Claims on institutions and corporates with a short-term credit assessment	-	-	-	-	-	-
32	Collective investments undertakings (CIU)	-	-	-	-	-	138
33	Equity exposures	-	-	10	-	10	12
34	Other exposures	2	266	-	-	268	810
35	<b>Total SA approach</b>	1,709	4,574	19	14	6,316	24,480
36	<b>Total</b>	4,467	5,411	272	289	10,439	78,833



**4. CREDIT RISK (CONTINUED)****Table 15: EU CRB-D – Concentration of exposures by industry or counterparty types**

The maximum credit exposure to any client, except to the Republic of Croatia and the CNB as of 31 December 2018 is HRK 1,140 million (2017: HRK 1,267 million) before and after taking into account collateral and other credit enhancements.

		Public adminis- tration	Financial and insurance services	Mining	Information and communi- cation	Hotels and restaurants	Trade	Other service activities	Manufa- cturing	Agriculture and forestry	Transpor- tation	Subtotal
1	Central governments or central banks	12,460	342	-	67	-	-	-	-	-	-	12,869
2	Institutions	-	2,292	-	-	-	-	-	-	-	-	2,292
3	Corporates	-	48	129	293	2,948	4,840	389	4,670	1,016	903	15,236
4	of which: Specialised Lending	-	-	-	-	1,202	227	40	216	6	2	1,693
5	of which: SME	-	14	26	183	946	2,742	318	2,797	681	515	8,222
6	Retail	-	3	1	20	155	174	47	132	135	75	742
7	Secured by real estate property	-	1	-	6	75	71	20	60	64	17	314
8	of which: SME	-	1	-	6	75	71	20	60	64	17	314
9	of which: Non-SME	-	-	-	-	-	-	-	-	-	-	-
10	Qualifying Revolving	-	-	-	-	-	-	-	-	-	-	-
11	Other Retail	-	2	1	14	80	103	27	72	71	58	428
12	of which: SME	-	2	1	14	80	103	27	72	71	58	428
13	of which: Non-SME	-	-	-	-	-	-	-	-	-	-	-
14	Equity	-	64	-	2	-	-	97	-	-	-	163
15	<b>Total IRB approach</b>	<b>12,460</b>	<b>2,749</b>	<b>130</b>	<b>382</b>	<b>3,103</b>	<b>5,014</b>	<b>533</b>	<b>4,802</b>	<b>1,151</b>	<b>978</b>	<b>31,302</b>

## 4. CREDIT RISK (CONTINUED)

## EU CRB-D – Concentration of exposures by industry or counterparty types (continued)

		Public adminis- tration	Financial and insurance services	Mining	Information and communi- cation	Hotels and restaurants	Trade	Other service activities	Manufa- cturing	Agriculture and forestry	Transpor- tation	Subtotal
16	Central governments or central banks	719	6,561	-	-	-	-	-	-	-	-	7,280
17	Regional governments or local authorities	1,315	-	-	-	-	-	-	-	-	-	1,315
18	Public sector entities	16	162	-	2	-	-	7	-	36	5	228
19	Multilateral Development Banks	-	-	-	-	-	-	-	-	-	-	-
20	International Organisations	-	-	-	-	-	-	-	-	-	-	-
21	Institutions	-	184	-	-	-	-	-	-	-	-	184
22	Corporates	3	541	48	56	116	1,244	320	239	54	372	2,993
23	of which: SME	-	36	1	9	83	1,055	198	108	38	112	1,640
24	Retail	1	2	5	25	64	194	186	157	47	276	957
25	of which: SME	-	-	5	9	32	126	67	112	24	139	514
26	Secured by mortgages on immovable property	-	-	-	1	43	116	17	16	4	15	212
27	of which: SME	-	-	-	1	14	34	10	14	4	6	83
28	Exposures in default	-	-	-	38	5	75	7	22	67	7	221
29	Items associated with particularly high risk	-	-	-	-	-	-	-	-	-	-	-
30	Covered bonds	-	-	-	-	-	-	-	-	-	-	-
31	Claims on institutions and corporates with a short-term credit assessment	-	-	-	-	-	-	-	-	-	-	-
32	Collective investments undertakings (CIU)	-	-	-	-	-	-	-	-	-	-	-
33	Equity exposures	-	10	-	-	-	-	-	-	-	-	10
34	Other exposures	59	-	-	-	-	-	-	-	-	-	59
35	<b>Total SA approach</b>	<b>2,113</b>	<b>7,460</b>	<b>53</b>	<b>122</b>	<b>228</b>	<b>1,629</b>	<b>537</b>	<b>434</b>	<b>208</b>	<b>675</b>	<b>13,459</b>
36	<b>Total</b>	<b>14,573</b>	<b>10,209</b>	<b>183</b>	<b>504</b>	<b>3,331</b>	<b>6,643</b>	<b>1,070</b>	<b>5,236</b>	<b>1,359</b>	<b>1,653</b>	<b>44,761</b>

## 4. CREDIT RISK (CONTINUED)

## EU CRB-D – Concentration of exposures by industry or counterparty types (continued)

		Professional and scientific services	Energy	Constru- ction	Real estate and housing	Health and social services	Educa- tion	Private house- holds	Other	Art, entertain- ment and recreation	Exter- ritorial organis- ations	Subtotal	Total
1	Central governments or central banks	22	-	-	-	-	-	-	-	-	-	22	12,891
2	Institutions	-	-	-	-	-	-	-	-	-	-	-	2,292
3	Corporates	1,124	1,075	1,765	1,636	73	13	-	-	404	7	6,097	21,333
4	<i>of which: Specialised Lending</i>	125	542	263	1,148	-	-	-	-	7	-	2,085	3,778
5	<i>of which: SME</i>	517	84	1,145	324	70	13	-	-	211	-	2,364	10,586
6	Retail	72	3	76	13	30	15	16,675	-	6	-	16,890	17,632
7	<i>Secured by real estate property</i>	32	1	21	7	16	9	5,623	-	2	-	5,711	6,025
8	<i>of which: SME</i>	32	1	21	7	16	9	-	-	2	-	88	402
9	<i>of which: Non- SME</i>	-	-	-	-	-	-	5,623	-	-	-	5,623	5,623
10	<i>Qualifying Revolving</i>	-	-	-	-	-	-	-	-	-	-	-	0
11	<i>Other Retail</i>	40	2	55	6	14	6	11,052	-	4	-	11,179	11,607
12	<i>of which: SME</i>	40	2	55	6	14	6	-	-	4	-	127	555
13	<i>of which: Non-SME</i>	-	-	-	-	-	-	11,052	-	-	-	11,052	11,052
14	Equity	41	-	-	1	-	-	-	-	-	-	42	205
15	<b>Total IRB approach</b>	<b>1,259</b>	<b>1,078</b>	<b>1,841</b>	<b>1,650</b>	<b>103</b>	<b>28</b>	<b>16,675</b>	<b>-</b>	<b>410</b>	<b>7</b>	<b>23,051</b>	<b>54,353</b>

**4. CREDIT RISK (CONTINUED)****EU CRB-D – Concentration of exposures by industry or counterparty types (continued)**

		Professional and scientific services	Energy	Constru- ction	Real estate and housing	Health and social services	Educa- tion	Private house- holds	Other	Art, entertain- ment and recreation	Exter- ritorial organis- ations	Subtotal	Total
16	Central governments or central banks	-	-	-	-	-	-	-	360	-	-	360	7,640
17	Regional governments or local authorities	-	-	-	-	-	-	-	4	-	-	4	1,319
18	Public sector entities	-	-	1,987	-	274	1	-	8	-	-	2,270	2,498
19	Multilateral Development Banks	-	-	-	-	-	-	-	-	-	-	-	-
20	International Organisations	-	-	-	-	-	-	-	-	-	-	-	-
21	Institutions	-	-	-	-	-	-	-	-	-	-	-	184
22	Corporates	75	423	220	443	52	5	-	316	122	3	1,659	4,652
23	of which: SME	58	141	88	1	14	1	-	287	25	3	618	2,258
24	Retail	66	56	105	18	33	5	4,794	-	-	-	5,077	6,034
25	of which: SME	24	30	58	10	10	1	-	-	-	-	133	647
26	Secured by mortgages on immovable property	6	7	15	3	44	1	609	-	-	-	685	897
27	of which: SME	6	7	8	3	-	1	-	-	-	-	25	108
28	Exposures in default	4	-	3	3	-	-	65	-	-	-	75	296
29	Items associated with particularly high risk	-	-	-	-	-	-	-	-	-	-	-	-
30	Covered bonds	-	-	-	-	-	-	-	-	-	-	-	-
31	Claims on institutions and corporates with a short-term credit assessment	-	-	-	-	-	-	-	-	-	-	-	-
32	Collective investments undertakings (CIU)	-	-	-	-	-	-	-	138	-	-	138	138
33	Equity exposures	-	-	-	-	-	-	-	2	-	-	2	12
34	Other exposures	-	-	-	-	-	-	-	751	-	-	751	810
35	<b>Total SA approach</b>	<b>151</b>	<b>486</b>	<b>2,330</b>	<b>467</b>	<b>403</b>	<b>12</b>	<b>5,468</b>	<b>1,579</b>	<b>122</b>	<b>3</b>	<b>11,021</b>	<b>24,480</b>
36	<b>Total</b>	<b>1,410</b>	<b>1,564</b>	<b>4,171</b>	<b>2,117</b>	<b>506</b>	<b>40</b>	<b>22,143</b>	<b>1,579</b>	<b>532</b>	<b>10</b>	<b>34,072</b>	<b>78,833</b>

**4. CREDIT RISK (CONTINUED)****Exposure categories according to remaining maturity**

DISCLOSURE REQUIREMENTS COVERED: ART. 442 (f) CRR

**Table 16: EU CRB-E – Maturity of exposures**

		On demand	<= 1 year	> 1 year <= 5 years	> 5 years	No stated maturity	Total
1	Central governments or central banks	-	3,699	8,307	885	-	12,891
2	Institutions	49	1,963	139	141	-	2,292
3	Corporates	48	8,726	4,414	8,145	-	21,333
4	of which: Specialised Lending	-	117	920	2,741	-	3,778
5	of which: SME	39	5,093	1,938	3,516	-	10,586
6	Retail	6	2,121	3,599	11,906	-	17,632
7	Secured by real estate property	-	59	324	5,642	-	6,025
8	of which: SME	-	46	114	242	-	402
9	of which: Non-SME	-	13	210	5,400	-	5,623
10	Qualifying Revolving	-	-	-	-	-	-
11	Other Retail	6	2,062	3,275	6,264	-	11,607
12	of which: SME	1	234	211	109	-	555
13	of which: Non-SME	5	1,828	3,064	6,155	-	11,052
14	Equity	23	182	-	-	-	205
15	<b>Total IRB approach</b>	<b>126</b>	<b>16,691</b>	<b>16,459</b>	<b>21,077</b>	<b>-</b>	<b>54,353</b>
16	Central governments or central banks	2,922	4,077	284	-	357	7,640
17	Regional governments or local authorities	1	344	616	358	-	1,319
18	Public sector entities	-	321	159	2,017	1	2,498
19	Multilateral Development Banks	-	-	-	-	-	-
20	International Organisations	-	-	-	-	-	-
21	Institutions	119	27	2	-	36	184
22	Corporates	449	2,443	1,265	466	29	4,652
23	of which: SME	393	1,277	432	156	-	2,258
24	Retail	643	2,748	2,411	232	-	6,034
25	of which: SME	6	59	524	58	-	647
26	Secured by mortgages on immovable property	70	59	348	420	-	897
27	of which: SME	5	35	62	6	-	108
28	Exposures in default	158	51	78	9	-	296
29	Items associated with particularly high risk	-	-	-	-	-	-
30	Covered bonds	-	-	-	-	-	-
31	Claims on institutions and corporates with a short-term credit assessment	-	-	-	-	-	-
32	Collective investments undertakings (CIU)	-	-	-	-	138	138
33	Equity exposures	9	-	-	-	3	12
34	Other exposures	262	62	381	-	105	810
35	<b>Total SA approach</b>	<b>4,633</b>	<b>10,132</b>	<b>5,544</b>	<b>3,502</b>	<b>669</b>	<b>24,480</b>
36	<b>Total</b>	<b>4,759</b>	<b>26,823</b>	<b>22,003</b>	<b>24,579</b>	<b>669</b>	<b>78,833</b>

#### 4. CREDIT RISK (CONTINUED)

##### 4.1. USE OF THE IRB APPROACH TO CREDIT RISK

###### EU CRE - DISCLOSURE REQUIREMENTS COVERED: ART. 452 (a) CRR

Based on the Bank request from 17 May 2011, for issuance of approval for implementation of the internal rating-based approach for calculation of the credit risk weighted exposure amount, in accordance with the Article 166 para 2 of the Decision on the Capital Adequacy of Credit Institutions (Official Gazette No. 1/09, 75/09, 2/10), the Governor of the Croatian National Bank approved, pursuant to the Article 43 para 2 item 9 of the Croatian National Bank Act (Official Gazette No. 75/08), the Article 128 para 1, item 1 and the Article 135 para 1, 4 and 6 of the Credit Institutions Act (Official Gazette No. 117/08, 74/09, 153/09) and the Article 166 para 3 of the Decision on the Capital Adequacy of Credit Institutions, implementation of the internal ratings model method for the following exposure categories:

1. Founding IRB approach ("FIRB") for exposures towards:

- central governments and central banks,
- institutions and in relation to subcategories of the institution exposures: banks, public government bodies and financial institutions to which the CNB issued approval for making business operations and which meet the same prudential requirements as credit institutions,
- corporations and
- equity shares – simple risk weight approach.

2. Advanced IRB approach ("AIRB") for exposure towards retail customers.

3. Gradual IRB approach implementation approval is given to:

- the Bank for the category of exposure towards institutions, the exposure subcategory of local and regional self-management authority,
- the entities within the Group of institutions in the Republic of Croatia: Erste Factoring d.o.o. and Erste bank a.d. Podgorica.

4. Permanent exemption or implementation of standardized approach is approved for:

- subcategories of exposure: non-profit public companies which do not meet requirements set for public government entities; leasing companies; insurance companies; investment companies; all other unclassified exposures,
- exposures towards counterparty credit risk,
- exposures towards equity shares in companies whose credit commitments meet the requirements set for the 0% risk weight based on the standardized approach.

The Bank started with the application of IRB approach with the reporting date as of 30 September 2011.

#### 4.1. USE OF THE IRB APPROACH TO CREDIT RISK (CONTINUED)

##### The structure of internal rating systems and relations between internal and external ratings

DISCLOSURE REQUIREMENTS COVERED: ART. 452 (b) CRR

##### EU CRD

Rating is used for measurement and assessment of level of risk that the client will not settle their obligations towards the Bank, and for every rating probability of default ("PD") within one year is calculated. The Bank has a developed system for rating assignment to the clients, whereby, according to the asset class that client belongs to, applies different rating. Rating R is assigned to the defaulted clients, independently of the asset class where a client belongs to, as defined in Basel III guidelines and regulations of the CNB. CNB and ESB rating is assigned to each client.

CNB ratings are determined in accordance with CNB decision in risk groups, depending on the assessed level of risk and classify in relevant stage, as follows:

- risk group A1 = exposures without significant increase in credit risk since initial recognition and classify in stage 1
- risk group A2 = exposures with significant increase in credit risk since initial recognition and classify in stage 2
- risk group B = partially recoverable exposures and classify in stage 3
- risk group C = completely unrecoverable exposures and classify in stage 3

Each client rating has to be assigned according to their asset class. Rating is awarded by a certain rating method which is, in principle, in line with the class or sub-class of assets where the different asset classes are distinguished with the aim of meaningful differentiation of risk and consistent estimates of risk parameters. Within the system for the rating assignment different rating systems are applied, depending on the asset class and sub-segment in which the client is classified. Risk Management Division develops rating methods for certain categories of exposure independently or in cooperation with Erste Group Bank AG. Each of the rating system is covered by a specific tool that is used to determine the rating. Some tools are used for multiple sub-segments.

**Table 17: Display of rating categories, depending on the asset class**

Asset class	Sub-classes	Number of rating categories for non-defaulted clients	Number of rating categories for defaulted clients
Retail	Retail	8	5
SME		13	5
Corporate	Specialized Lending	13	5
	Other	13	5
Institutions	Local authorities	13	5
	Other	13	5
Sovereign		13	5

#### 4.1. USE OF THE IRB APPROACH TO CREDIT RISK (CONTINUED)

##### The structure of internal rating systems and relations between internal and external ratings (continued)

Rating is revised and updated:

- after processing of every new client's credit application
- after each change of client's asset class if a different method or different rating criteria within the expert opinions is prescribed in the new class
- monthly, based on client's behavior on all of his/her active accounts in the Bank (Behavioral scoring) for clients which belong to Retail asset class
- after occurrence of the default
- annually, with the annual review
- annually, after receiving financial data
- whenever the new information arises which might have an impact on the rating.

Rating needs to be updated at least once a year even though it has not changed in relation to the currently valid rating.

The assigned rating directly affects the level of decision making, provision allocation, pricing and in certain cases the maximum maturity for each product and setting limits. Consequently, the use of rating systems influences the overall risk management of the Bank.

For the purpose of monitoring of overall life process of rating model and calculation parameters of risk, the Bank has established a system of organization with departments in charge of the development and validation of models, system and process monitoring, credit risk control, the collection and storage of relevant data and the establishment of IT systems.

All ratings are designed so that the probability of default ("PD") following rating categories is always greater than the PD of the previous one while avoiding large concentration of clients in each rating category.

The annual validation is also carried out in the framework of Erste Group Bank AG ("EGB") thus ensuring the independence of validation. For the initiation of the model development and the coordination and analysis of the results of the annual model validation Quantitative research department ("QRD") within Risk management division is in charge. If the annual validation shows that some of the models are inadequate, QRD proposes changes or re-development of the model. The Bank also compares its rating models with ratings of foreign credit institutions and in case an external rating exists, it can be taken into account when determining the internal rating.



#### 4.1. USE OF THE IRB APPROACH TO CREDIT RISK (CONTINUED)

**Table 18: Mapping of internal rating and the rating of external rating agencies**

	Agencies	Group	
Investment grade	Aaa/AAA	1	Extremely strong
	Aa1/AA+	2	Very strong
	Aa2/AA		
	Aa3/AA-	3	Strong
	A1/A+		
	A2/A	4a	Medium Grade
	A3/A-	4b	
	Baa1/BBB+		
	Baa2/BBB	4c	
	Baa3/BBB-		
Speculative grade	Ba1/BB+	5a	Speculative
	Ba2/BB	5b	
	Ba3/BB-	5c	
	B1/B+	6a	Vulnerable
	B2/B	6b	
	B3/B-	7	Special Mention
	Caa, Ca CCC, CC	8	Substandard
Default	D	R	Default

#### **4.1. USE OF THE IRB APPROACH TO CREDIT RISK (CONTINUED)**

##### **Internal rating assignment process**

The process of the internal rating involves exposure types, definitions, methods and data for estimation and validation of PDs and loss given default ("LGD") and conversion factors ("CCF"), including assumptions used in estimating the above parameters and descriptions of material deviations from the definition of the status of default.

##### **Usage of internal estimates for other purposes than calculation of risk weighted assets in accordance with CRR part III, Title II, Chapter 3**

The Bank makes use of the internal rating system and applies the results in different areas of business for the purpose of quality portfolio management from both risk management perspective and perspective of optimizing portfolio and creating competitive advantage.

The results of the rating system at the Bank level are used in determining the risk appetite, determination of limits on the portfolio level, but also on an individual basis, pricing products and others. Risk appetite sets and defines the limits that are important for the daily operations of the Bank/Group. Results of the rating system are applied in the form of indicators defined in the risk appetite statement, which is among other things related to risk-weighted assets, the solvency ratio, risk earnings ratio etc.

The business strategy of the Bank limits possibility of high concentration and ensures diversification of the portfolio, which is in addition ensured with establishment of decision-making process and risk management lending process already controlled by limits for individual segments of exposure. This is implemented through the aforementioned risk appetite, which is defined in the form of qualitative and quantitative indicators, taking into account the strategy of the Bank, liquidity, risk and capital plans. The risk appetite is an important input parameter in the planning process and is part of the strategy of the Bank in the form of limits, target values and principles. The maximum lending limit is the way to carry out the supervision and management of the risk inherent in individual clients or groups of connected customers. The concept of the maximum lending limit is based on a calculated maximum lending limit ("CMLL"), which represents the absolute upper limit for any exposure to an individual client or group of connected customers for the Group arising from the Group's capacity to take risks and to operating lending limit ("OLL") that does not exceed CMLL's/RbLL and the need to maintain the prevailing standards of loan approval, policy and standards for risk management and risk appetite. The essence of the CMLL is to ensure that the impact of the unexpected fulfillment of the obligations of the client with a large exposure to be in the zone, which will not substantially adversely affect the solvency. In order to make the limits risk sensitive, rating based lending limit is introduced ("RbLL") under which the limit for each rating grade is calculated. The starting point is the CMLL for each asset class, which represents RbLL for the best rating category, while to the poor rating categories lower limit is joined gradually.

Certain categories of exposure, with a focus on credit risk, are monitored through various reports.

#### 4.1. USE OF THE IRB APPROACH TO CREDIT RISK (CONTINUED)

The reporting system includes a number of indicators of risk in the terms of the loan portfolio and strategy as well as specific information related to models like days past due, non-performing loans, risk costs, NPL coverage, portfolio distribution per ratings and industries, migration matrix, default rates and development of other risk parameters etc.

Even during stress testing exercise internal assessment is used as an impact of stress scenarios on key risk parameters.

Internal assessment is also used in determining the price of the product and monitoring the profitability of a loan and risk margin taking into account the expected risk cost. The profitability monitoring system faces earnings on the individual customer on the one hand and the cost of funding, the cost of capital to cover the risk and risk cost on the other. The Bank uses risk parameters that are calculated within the IRB approach. The effect of the rating migration is taken into account through risk costs and is also reflected in the change of EVA ("Economic Value Added").

##### **Explanation and review of control mechanisms of rating systems, including a description of independence, accountability and rating system checks**

The internal rating system of the Bank is implemented in the central operating system and automated as far as possible with precisely defined rules for determining the rating of the client, depending on its characteristics. For maintenance, control and validation of the internal rating system and the implementation of changes and upgrades to the internal rating system of the Bank, organizational units within the Risk Management Division, i.e. Risk Control functions are responsible, with clear separation of responsibilities and independent of the sales activities and operational decision-making on individual loan. Central governments, central banks, insurance companies and investment funds ratings are calculated in conjunction with the EGB. Central governments and central banks ratings are differently calculated for industrial development in relation to developing countries. Scoring contains basic indicators and sub-indicators that are mostly based on the growth and development of the national economy and the financial stability of the country.

Rating for banks, also in cooperation with EGB is calculated on the basis of quantitative indicators of financial statements, additional quantitative factors and a number of criteria for country risk in which the financial institution is located while the rating for local governments is calculated on the basis of quantitative and qualitative indicators that include selected financial data from the financial statements and the "soft facts" customer information.

Rating for companies is calculated on the basis of selected financial data and "soft facts" of customer information. Small and medium-sized enterprises include the behavior of the client at all active accounts that the client has with the Bank in calculation of rating in addition to selected financial data and "soft fact" information, and it has a bigger impact on the final rating for the company with lower turnover and less impact on businesses with higher turnover. In rating calculation for specialized financing special circumstances and risk profile of the loan that is used as the basis of special projects are taken into account.

#### **4.1. USE OF THE IRB APPROACH TO CREDIT RISK (CONTINUED)**

Rating for retail clients is based on the scoring of the client's creditworthiness on the basis of selected socio-demographic and financial data. At the same time, the rating is updated after processing each new loan application of the client on the basis of the latest data of the client (aka Application scoring) and also on the basis of customer behavior on all active accounts that the customer has with the bank (aka Behavioral scoring). The final rating of the client is obtained as a time-weighted average of the results of the Application and Behavioral scoring, where Application scoring becomes less influential on the final rating over time.

#### **Description of factors that impacted realized losses during the previous period**

##### **DISCLOSURE REQUIREMENTS COVERED: ART. 452 (h) CRR**

Favorable macroeconomic conditions in Croatia continues to have an impact on the portfolio of the EBC Group in the form of improved portfolio distribution, the NPL ratio decrease and keeping the average probability of default at the same levels. The default rate in corporate segment and small and medium-sized enterprises showed a continuous trend of decrease compared to the previous period reaching the level below the long-term average. The default rate in retail banking recorded a keeping of the default rate at the same levels with previous year and it is at the border level with long-term average. The significant decrease in partially recoverable and completely recoverable placements rate is recorded at the total portfolio as a consequence of portfolio optimization, accompanied by a favorable macroeconomic situation.

The level of non-performing loans coverage also shows a slight increase and is at a comfortable level beyond 100%.

#### **Assessment of the institution with respect to the actual values within a longer time frame**

##### **DISCLOSURE REQUIREMENTS COVERED: ART. 452 (i) CRR**

Following the regulatory requirements regarding IFRS 9 validation, a well-defined credit risk assessment and measurement process contains an effective model validation process to ensure that the credit risk assessment and measurement models are able to generate accurate, consistent and unbiased predictive estimates, on an ongoing basis. This includes establishing policies and procedures which set out the accountability and reporting structure of the model validation process, internal rules for assessing and approving changes to the models, and reporting of the outcome of the model validation. The IFRS9 validation for EBC is performed by the Erste Group, i.e. Risk Cost Governance and Validation unit.

Following the regulatory requirements, IFRS 9 validation procedure can be separated into the 3 main chapters:

1. Model input:
  - a) Credit institutions should have internally established quality and reliability standards on data (historical, current and forward-looking information) used as model inputs.
  - b) Data used to estimate ECL allowances should be relevant to the credit institutions' portfolios and, as far as possible, accurate, reliable and complete.

#### **4.1. USE OF THE IRB APPROACH TO CREDIT RISK (CONTINUED)**

2. Model design:
  - a) IFRS 9 validation should assess that the underlying theory of the model is conceptually sound, recognized and generally accepted for its intended purpose.
  - b) From a forward-looking perspective, validation should also assess the extent to which the model, at the overall model and individual risk factor level, can take into consideration changes in the economic or credit environment, as well as changes to portfolio business profile or strategy, without significantly reducing model robustness.
3. Model output:
  - a) Credit institutions should have internally established standards for acceptable model performance.
  - b) Where performance thresholds are significantly breached, remedial actions up to the extent of model re-calibration or re-development should be taken.

**4.1. USE OF THE IRB APPROACH TO CREDIT RISK (CONTINUED)****Table 19: EU CR9 – IRB approach – Backtesting of PD per exposure class (Central governments and central banks)**

Exposure class	PD range	External rating equivalent	Weighted average PD	Arithmetic average PD by obligors	Number of obligors		Defaulted obligors in the year	Of which new obligors	Average historical annual default rate
					End of previous year	End of the year			
Central governments and central banks	0.00 to <0.008	Extremely strong	0.01%	0.01%	-	1	-	-	na
Central governments and central banks	0.008 to <0.015	Very Strong	0.01%	0.01%	1	1	-	-	na
Central governments and central banks	0.015 to <0.020	Strong	0.02%	0.02%	1	2	-	-	na
Central governments and central banks	0.020 to <0.035	Upper Medium Grade	0.03%	0.03%	-	1	-	-	na
Central governments and central banks	0.035 to <0.060	Medium Grade	0.06%	0.06%	1	1	-	-	na
Central governments and central banks	0.060 to <0.15	Lower Medium Grade	0.12%	8.54%	-	14	-	-	na
Central governments and central banks	0.15 to <0.30	Speculative	0.29%	0.29%	11	1	-	-	na
Central governments and central banks	0.30 to <1.50	Very Speculative	1.11%	1.11%	2	1	-	-	na
Central governments and central banks	10.00 to <100.00	Substandard	0.29%	4.89%	5	1	-	-	na

## 4.1. USE OF THE IRB APPROACH TO CREDIT RISK (CONTINUED)

Table 20: EU CR9 – IRB approach – Backtesting of PD per exposure class (Institutions)

Exposure class	PD range	External rating equivalent	Weighted average PD	Arithmetic average PD by obligors	Number of obligors		Defaulted obligors in the year	Of which new obligors	Average historical annual default rate
					End of previous year	End of the year			
Institutions	0.10 to <0.15	Strong	0.14%	0.14%	24	25	-	-	na
Institutions	0.15 to <0.19	Upper Medium Grade	0.17%	0.17%	11	6	-	-	na
Institutions	0.19 to <0.25	Medium Grade	0.20%	0.20%	7	5	-	-	na
Institutions	0.25 to <0.30	Lower Medium Grade	0.29%	0.29%	7	6	-	-	na
Institutions	0.30 to <0.50	Speculative	0.40%	0.40%	8	5	-	-	na
Institutions	0.50 to <0.70	More Speculative	0.60%	0.60%	1	3	-	-	na
Institutions	0.70 to <1.00	Very Speculative	0.00%	0.00%	-	-	-	-	na
Institutions	1.00 to <2.00	Vulnerable	1.83%	1.83%	4	5	-	-	na
Institutions	2.00 to <5.00	Very Vulnerable	3.96%	3.96%	4	4	-	-	na
Institutions	5.00 to <25.00	Special Mention	10.24%	10.24%	2	6	-	-	na
Institutions	25.00 to <100.00	Substandard	29.00%	29.00%	20	11	-	-	na

## 4.1. USE OF THE IRB APPROACH TO CREDIT RISK (CONTINUED)

Table 21: EU CR9 – IRB approach – Backtesting of PD per exposure class (Retail)

Exposure class	PD range	External rating equivalent	Weighted average PD	Arithmetic average PD by obligors	Number of obligors		Defaulted obligors in the year	Of which new obligors	Average historical annual default rate
					End of previous year	End of the year			
Total Retail	na	na	9.88%	13.85%	334,684	348,019	6,044	496	na
Of which: secured by real estate property	na	na	10.62%	11.07%	18,449	18,421	223	8	na
Of which: Retail	0.00 to<0.15	na	0.22%	0.22%	28,485	30,582	67	-	0.35%
	0.15 to<0.20	na	0.27%	0.27%	41,432	45,483	138	-	0.42%
	0.20 to<0.40	na	0.36%	0.36%	64,054	67,230	349	-	0.46%
	0.40 to<0.80	na	0.77%	0.78%	50,019	51,865	564	-	0.85%
	0.80 to<1.90	na	1.74%	1.75%	30,673	27,099	760	-	1.84%
	1.90 to<4.50	na	2.21%	2.21%	14,808	13,875	476	-	2.26%
	4.50 to<10.50	na	8.23%	8.23%	8,757	7,607	602	-	8.13%
	10.50 to<100.00	na	23.51%	23.51%	47,102	53,873	2,631	-	23.70%
Of which: Oneway bookkeeping	100.00	na	100.00%	100.00%	27,316	26,445	-	479	100.00%
	0.00 to<1.53	na	1.59%	1.59%	142	172	1	-	0.21%
	1.53 to<2.00	na	1.59%	1.59%	274	280	2	-	0.59%
	2.00 to<2.20	na	1.84%	1.84%	192	153	2	-	0.73%
	2.20 to<3.00	na	2.32%	2.32%	251	249	2	-	1.28%
	3.00 to<4.00	na	3.27%	3.27%	404	416	4	-	2.28%
	4.00 to<5.00	na	4.52%	4.52%	373	385	4	-	3.29%
	5.00 to<7.00	na	6.21%	6.21%	358	372	3	-	5.48%
	7.00 to<12.00	na	10.68%	10.68%	318	393	16	-	10.34%
	12.00 to<22.00	na	16.10%	16.10%	44	40	6	-	24.50%
	22.00 to<100.00	na	25.60%	25.60%	302	282	23	-	21.75%
	100.00	na	100.00%	100.00%	709	523	-	6	100.00%



#### 4.1. USE OF THE IRB APPROACH TO CREDIT RISK (CONTINUED)

##### EU CR9 – IRB approach – Backtesting of PD per exposure class (Retail continued)

Exposure class	PD range	External rating equivalent	Weighted average PD	Arithmetic average PD by obligors	Number of obligors		Defaulted obligors in the year	Of which new obligors	Average historical annual default rate
					End of previous year	End of the year			
Total Retail	na	na	9.88%	13.85%	334,684	348,019	6,044	496	na
Of which: double bookkeeping	0.00 to<1.00	na	0.95%	0.95%	102	109	-	-	0.13%
	1.00 to<1.20	na	1.13%	1.13%	331	394	2	-	0.30%
	1.20 to<1.90	na	1.45%	1.45%	348	350	2	-	0.83%
	1.90 to<2.50	na	2.09%	2.09%	418	436	7	-	1.24%
	2.50 to<3.50	na	3.03%	3.03%	664	710	6	-	2.29%
	3.50 to<5.00	na	4.53%	4.53%	616	626	14	-	3.46%
	5.00 to<7.80	na	7.24%	7.29%	456	469	10	-	6.75%
	7.80 to<12.00	na	11.01%	11.34%	440	466	26	-	10.79%
	12.00 to<22.00	na	21.07%	21.29%	46	58	7	-	27.90%
	22.00 to<100.00	na	35.63%	35.63%	14,243	16,382	320	-	36.66%
	100.00	na	100.00%	100.00%	1,005	694	-	11	100.00%

## 4.1. USE OF THE IRB APPROACH TO CREDIT RISK (CONTINUED)

Table 22: EU CR9 – IRB approach – Backtesting of PD per exposure class (Corporate)

Exposure class	PD range	External rating equivalent	Weighted average PD	Arithmetic average PD by obligors	Number of obligors		Defaulted obligors in the year	Of which new obligors	Average historical annual default rate
					End of previous year	End of the year			
Total Corporate	na	na	14.85%	21.80%	5,299	5,476	53	8	na
Of which: specialised lending	na	na	14.90%	17.45%	240	278	4	-	na
Of which: Corporate without specialised lending	0.00 to<0.60	Extremely Strong	0.48%	0.48%	224	269	-	-	0.17%
	0.60 to<0.85	Very Strong	0.69%	0.69%	183	234	2	-	0.32%
	0.85 to<1.14	Strong	1.06%	1.05%	206	225	1	-	0.69%
	1.14 to<1.39	Upper Medium Grade	1.06%	1.06%	305	314	2	-	0.65%
	1.39 to<2.10	Medium Grade	1.79%	1.78%	365	378	4	-	1.55%
	2.10 to<3.10	Lower Medium Grade	2.58%	2.56%	276	324	3	-	2.11%
	3.10 to<5.00	Speculative	3.98%	3.91%	206	219	4	-	3.72%
	5.00 to<7.00	More Speculative	6.14%	5.74%	163	161	2	-	6.28%
	7.00 to<9.06	Very Speculative	8.60%	8.03%	77	95	-	-	9.64%
	9.06 to<10.00	Vulnerable	9.32%	8.75%	70	84	3	-	10.28%
	10.00 to<12.00	Very Vulnerable	10.44%	10.38%	100	100	4	-	9.86%
	12.00 to<17.00	Special Mention	15.65%	15.70%	85	80	4	-	13.34%
	17.00 to<100.00	Substandard	22.87%	22.95%	2,081	2,132	20	-	20.44%
	100.00	Default	100.00%	100.00%	718	583	-	8	100.00%

#### 4.1. USE OF THE IRB APPROACH TO CREDIT RISK (CONTINUED)

##### EU CR9 – IRB approach – Backtesting of PD per exposure class (Corporate continued)

Exposure class	PD range	External rating equivalent	Weighted average PD	Arithmetic average PD by obligors	Number of obligors		Defaulted obligors in the year	Of which new obligors	Average historical annual default rate
					End of previous year	End of the year			
Total Corporate	na	na	14.85%	21.80%	5,299	5,476	53	8	na
Of which: SME	0.00 to<0.60	Extremely Strong	0.48%	0.48%	217	257	-	-	0.17%
	0.60 to<0.85	Very Strong	0.69%	0.69%	175	213	2	-	0.32%
	0.85 to<1.14	Strong	1.06%	1.06%	192	215	1	-	0.69%
	1.14 to<1.39	Upper Medium Grade	1.06%	1.05%	280	282	1	-	0.65%
	1.39 to<2.10	Medium Grade	1.79%	1.79%	334	326	4	-	1.55%
	2.10 to<3.10	Lower Medium Grade	2.58%	2.56%	249	282	3	-	2.11%
	3.10 to<5.00	Speculative	3.98%	3.92%	182	200	4	-	3.72%
	5.00 to<7.00	More Speculative	6.17%	5.97%	135	141	2	-	6.28%
	7.00 to<9.06	Very Speculative	8.65%	8.46%	67	80	-	-	9.64%
	9.06 to<10.00	Vulnerable	9.42%	9.24%	54	63	3	-	10.28%
	10.00 to<12.00	Very Vulnerable	10.41%	10.38%	71	54	3	-	9.86%
	12.00 to<17.00	Special Mention	15.65%	15.68%	79	72	4	-	13.34%
	17.00 to<100.00	Substandard	22.86%	22.91%	1,657	1,736	15	-	20.44%
	100.00	Default	100.00%	100.00%	630	512	-	6	100.00%

**4.1. USE OF THE IRB APPROACH TO CREDIT RISK (CONTINUED)**

DISCLOSURE REQUIREMENTS COVERED: ART. 452 (h) CRR

**Table 23: Specific credit risk adjustments in the preceding period for each exposure class in IRB approach**

Exposure categories	Losses as of 31 December 2017		Losses as of 31 December 2016		Changes in Value adjustment in %
	Expected loss (EL)	Value adjustment	Expected loss (EL)	Value adjustment	
	in HRK million	in HRK million	in HRK million	in HRK million	
Exposure to central governments or central banks	10	19	9	4	375%
Exposure to institutions	1	4	1	1	400%
Exposure to corporate	1,139	1,400	1,395	2,013	(30%)
Exposure to retail	1,145	1,218	1,099	1,087	12%
There of exposure to SME	116	106	139	143	(26%)
Exposure to retail customers secured by real estate	465	458	452	411	11%
Other exposure to retail	680	760	647	676	12%
Exposure to equity investments	3	-	3	-	-
Other	-	-	-	-	-
<b>TOTAL</b>	<b>2,298</b>	<b>2,641</b>	<b>2,507</b>	<b>3,105</b>	<b>(15)%</b>

**Area of application and usage of external credit ratings**

DISCLOSURE REQUIREMENTS COVERED: ART. 444 (a) - (d) CRR

The Bank uses the IRB approach for determining minimum capital requirements according to Basel III regulation. Standardized approach ("STD") is applied for certain asset classes for which the Bank has an approval for permanent partial usage in accordance with the CNB decision (No. ERODB-1-020/11-ŽJ-ŽR). Further, certain legal provisions can cause application of STD approach.

**4.1. USE OF THE IRB APPROACH TO CREDIT RISK (CONTINUED)**

External ratings are partially used for certain asset classes for RWA calculation in STD approach. If the external rating is available, the risk weight has to be determined according to Option 2<sup>3</sup>, otherwise Option 1 is applied.

Following external ratings are used:

**OECD external sovereign rating**

OECD external sovereign rating is applied for following exposure categories:

- Central governments and Central banks
- Institutions where Option 1 is applied for exposures towards institutions for country of domicile (in accordance with Article 121, paragraph 1 of CRR). In such cases, the rating is determined dependent on credit worthiness of the country of domicile of the counterparty.

**Standard & Poor's rating**

External ratings issued by Standard & Poor's ("S&P") rating agency are applied on certain portfolios. More specifically, the S&P external ratings of issuers of securities are used for determining the acceptability of financial collateral (bonds) and to calculate the impairment of volatility in accordance with Article 244 paragraph 1 of the Regulation. If the issuer of the security is at the same time the borrower whose exposure is subject to STD approach and if the risk assessment is available from S&P and of the OECD, then the worse score is taken into account.

**Table 24: Mapping of risk ratings with credit quality grades**

Standard & Poors	OECD country risk rating	Credit quality grade
AAA to AA-	0 to 1	1
A+ to A-	2	2
BBB+ to BBB-	3	3
BB+ to BB-	4 to 5	4
B+ to B-	6	5
CCC+ and below	7	6

**Table 25: Mapping of risk weights in accordance with the credit quality grade and exposure classes**

CQS	Central governments and Central banks	Institutions (Option 1)	Institutions (Option 2) Long term	Institutions (Option 2) Short term	Corporate
1	0%	20%	20%	20%	20%
2	20%	50%	50%	20%	50%
3	50%	100%	50%	20%	100%
4	100%	100%	100%	50%	100%
5	100%	100%	100%	50%	150%
6	150%	150%	150%	150%	150%

<sup>3</sup> In STD approach, 2 different approaches for RW determination for institutions can be applied: Option 1, in which the RW is assigned in a way that the RW for the institutions is 1 rating category worse than the RW of a domicile country of the institution( in accordance with Art.121 CRR)

Option 2, RW is based on the external rating (in accordance with Art.120 CRR).

#### 4.1. USE OF THE IRB APPROACH TO CREDIT RISK (CONTINUED)

Breakdown of exposures under the standardized approach by asset class and risk weight

**Table 26: EU CR5 – Standardized approach**

DISCLOSURE REQUIREMENTS COVERED: ART. 444 (e) CRR

Exposures post conversion factor and post risk mitigation techniques:

	Exposure classes	Risk weight												Total
		0%	2%	4%	10%	20%	35%	50%	70%	75%	100%	150%	250%	
1	Central governments or central banks	6,369	-	-	-	-	-	-	-	-	1,139	-	132	7,640
2	Regional governments or local authorities	-	-	-	-	639	-	-	-	-	474	-	-	1,113
3	Public sector entities	18	-	-	-	163	-	-	-	-	53	-	-	234
4	Multilateral Development Banks	5	-	-	-	-	-	-	-	-	-	-	-	5
5	International Organisations	-	-	-	-	-	-	-	-	-	-	-	-	-
6	Institutions	-	-	-	-	154	-	24	-	-	10	-	-	188
7	Corporates	-	-	-	-	-	-	-	-	-	3,178	-	-	3,178
8	Retail	-	-	-	-	-	-	-	-	4,534	-	-	-	4,534
9	Secured by mortgages on immovable property	-	-	-	-	-	637	260	-	-	-	-	-	897
10	Exposures in default	-	-	-	-	-	-	-	-	-	141	138	-	279
11	Items associated with particularly high risk	-	-	-	-	-	-	-	-	-	-	-	-	-
12	Covered bonds	-	-	-	-	-	-	-	-	-	-	-	-	-
13	Claims on institutions and corporates with a short-term credit assessment	-	-	-	-	-	-	-	-	-	-	-	-	-
14	Collective investment undertakings	-	-	-	-	-	-	-	-	-	138	-	-	138
15	Equity	-	-	-	-	-	-	-	-	-	10	-	2	12
16	Other items	202	-	-	-	-	-	-	-	-	640	-	-	842
17	<b>Total</b>	<b>6,594</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>956</b>	<b>637</b>	<b>284</b>	<b>-</b>	<b>4,534</b>	<b>5,783</b>	<b>138</b>	<b>134</b>	<b>19,060</b>

**4.1. USE OF THE IRB APPROACH TO CREDIT RISK (CONTINUED)****Table 27: Exposure category amounts (according to FIRB or AIRB approach)**

DISCLOSURE REQUIREMENTS COVERED: ART.452 (d) CRR

Exposure category	Exposure category amount according to FIRB approach	Exposure category amount according to AIRB approach
Exposure to central governments or central banks	12,910	-
Exposure to institutions	2,296	-
Exposure to corporates	22,733	-
Exposure to retail	-	18,850
Equity exposures	205	-
Securitization	-	-
Other exposures	2,800	-
<b>TOTAL</b>	<b>40,944</b>	<b>18,850</b>

**Table 28: EU CR10 – IRB (specialised lending)**

Regulatory categories	Remaining maturity	On-balance-sheet amount	Off-balance-sheet amount	Risk weight	Exposure amount	RWAs	Expected losses
Category 1	Less than 2.5 years	141	33	50%	155	74	-
	Equal to or more than 2.5 years	1,767	197	70%	1,922	1,326	8
Category 2	Less than 2.5 years	32	11	70%	35	24	-
	Equal to or more than 2.5 years	942	208	90%	1,098	968	9
Category 3	Less than 2.5 years	9	-	115%	9	10	-
	Equal to or more than 2.5 years	153	6	115%	158	174	4
Category 4	Less than 2.5 years	26	3	250%	27	68	2
	Equal to or more than 2.5 years	95	-	250%	95	224	8
Category 5	Less than 2.5 years	280	2	0%	282	-	141
	Equal to or more than 2.5 years	258	-	0%	258	-	129
<b>Total</b>	<b>Less than 2.5 years</b>	<b>488</b>	<b>49</b>		<b>508</b>	<b>176</b>	<b>143</b>
	<b>Equal to or more than 2.5 years</b>	<b>3,215</b>	<b>411</b>		<b>3,531</b>	<b>2,692</b>	<b>158</b>

**4.1. USE OF THE IRB APPROACH TO CREDIT RISK (CONTINUED)**

DISCLOSURE REQUIREMENTS COVERED: ART. 452 (e) and (j) CRR

**Table 29: EU CR6 – IRB approach – Credit risk exposures by exposure class and PD range (FIRB approach – Exposures to central governments or central banks)**

PD scale	Original on-balance-sheet gross exposures	Off-balance-sheet exposures pre-CCF	Average CCF	EAD post CRM and post CCF	Average PD	Number of obligors	Average LGD	Average maturity	RWAs	RWA density	EL	Value adjustments and provisions
0.00 to <0.15	12,277	35	82%	15,337	0.12%	19	45%	2.5	5,205	34%	8	
0.15 to <0.25	-	-	0%	-	0.00%	-	0%	-	-	0%	-	
0.25 to <0.50	73	-	50%	170	0.29%	2	45%	2.5	95	56%	0	
0.50 to <0.75	-	-	0%	-	0.00%	-	0%	-	-	0%	-	
0.75 to <2.50	438	-	0%	438	1.11%	1	45%	2.5	445	102%	2	
2.50 to <10.00	-	-	0%	-	0.00%	-	0%	-	-	0%	-	
10.00 to <100.00	87	-	0%	87	0.00%	1	0%	2.5	217	250%	-	
100.00 (Default)	-	-	0%	-	0.00%	-	0%	-	-	0%	-	
<b>Subtotal</b>	<b>12,875</b>	<b>35</b>	<b>80%</b>	<b>16,032</b>	<b>0.15%</b>	<b>23</b>	<b>45%</b>	<b>2.5</b>	<b>5,962</b>	<b>37%</b>	<b>10</b>	<b>19</b>
<b>Total (all portfolios)</b>	<b>48,298</b>	<b>8,491</b>	<b>36%</b>	<b>53,727</b>	<b>8.21%</b>	<b>353,566</b>	<b>40%</b>	<b>1.3</b>	<b>26,715</b>	<b>50%</b>	<b>2,295</b>	<b>2,641</b>



## 4.1. USE OF THE IRB APPROACH TO CREDIT RISK (CONTINUED)

Table 30: EU CR6 – IRB approach – Credit risk exposures by exposure class and PD range (FIRB approach – Exposures to institutions)

PD scale	Original on-balance-sheet gross exposures	Off-balance-sheet exposures pre-CCF	Average CCF	EAD post CRM and post CCF	Average PD	Number of obligors	Average LGD	Average maturity	RWAs	RWA density	EL	Value adjustments and provisions
0.00 to <0.15	1,721	6	65%	1,725	0.14%	25	5%	1.0	99	6%	-	
0.15 to <0.25	25	182	50%	122	0.17%	11	45%	2.5	69	57%	-	
0.25 to <0.50	187	-	0%	192	0.31%	11	45%	2.5	145	75%	1	
0.50 to <0.75	2	-	0%	2	0.60%	3	45%	2.5	2	104%	-	
0.75 to <2.50	21	-	0%	21	1.83%	5	11%	0.9	6	31%	-	
2.50 to <10.00	97	-	0%	97	3.96%	4	4%	0.5	10	10%	-	
10.00 to <100.00	55	-	0%	55	10.62%	17	2%	0.6	7	12%	-	
100.00 (Default)	-	-	0%	-	0.00%	-	0%	-	-	0%	-	
<b>Subtotal</b>	<b>2,108</b>	<b>188</b>	<b>51%</b>	<b>2,214</b>	<b>0.60%</b>	<b>76</b>	<b>11%</b>	<b>1.2</b>	<b>338</b>	<b>15%</b>	<b>1</b>	<b>5</b>
<b>Total (all portfolios)</b>	<b>48,298</b>	<b>8,491</b>	<b>36%</b>	<b>53,727</b>	<b>8.21%</b>	<b>353,566</b>	<b>40%</b>	<b>1.3</b>	<b>26,715</b>	<b>50%</b>	<b>2,295</b>	<b>2,641</b>

## 4.1. USE OF THE IRB APPROACH TO CREDIT RISK (CONTINUED)

Table 31: EU CR6 – IRB approach – Credit risk exposures by exposure class and PD range (FIRB approach – Exposures to corporates without specilased lending)

PD scale	Original on-balance-sheet gross exposures	Off-balance-sheet exposures pre-CCF	Average CCF	EAD post CRM and post CCF	Average PD	Number of obligors	Average LGD	Average maturity	RWAs	RWA density	EL	Value adjustments and provisions
0.00 to <0.15	-	-	0%	-	0.00%	-	0%	-	-	0%	-	
0.15 to <0.25	-	-	0%	-	0.23%	1	45%	2.5	-	50%	-	
0.25 to <0.50	420	498	37%	593	0.48%	271	42%	2.5	310	52%	1	
0.50 to <0.75	767	585	44%	1,005	0.69%	238	41%	2.5	657	65%	3	
0.75 to <1.00	-	-	50%	-	0.75%	3	45%	2.5	-	4%	-	
1.0 to <2.50	3,842	3,211	29%	4,412	0.01	927	42%	2.5	3,739	85%	27	
2.50 to <3.50	2,488	890	41%	2,801	2.59%	331	40%	2.5	2,832	101%	30	
3.50 to <5.00	996	494	40%	1,136	3.99%	228	41%	2.5	1,244	110%	19	
5.00 to <7.00	668	235	38%	690	6.19%	155	40%	2.4	830	120%	17	
7.00 to <9.00	244	128	37%	290	8.62%	83	41%	2.5	374	129%	10	
9.00 to <10.00	300	213	67%	365	9.50%	66	39%	2.5	524	144%	13	
10.00 to <15.00	239	104	0.47	254	0.10	97	37%	2.5	330	130%	10	
15.00 to <30.00	228	196	0.29	280	0.20	2,196	38%	2.5	460	164%	21	
30.00 to <100.00	-	1	-	-	0.34	20	45%	2.2	-	233%	-	
100.00 (Default)	1,681	142	59%	1,617	100.00%	583	43%	-	-	0%	687	
<b>Subtotal</b>	<b>11,873</b>	<b>6,697</b>	<b>35%</b>	<b>13,443</b>	<b>14.83%</b>	<b>5,199</b>	<b>41%</b>	<b>2.2</b>	<b>11,300</b>	<b>84%</b>	<b>838</b>	<b>1,015</b>
<b>Total (all portfolios)</b>	<b>48,298</b>	<b>8,491</b>	<b>36%</b>	<b>53,727</b>	<b>8.21%</b>	<b>353,566</b>	<b>40%</b>	<b>1.3</b>	<b>26,715</b>	<b>50%</b>	<b>2,295</b>	<b>2,641</b>

## 4.1. USE OF THE IRB APPROACH TO CREDIT RISK (CONTINUED)

Table 32: EU CR6 – IRB approach – Credit risk exposures by exposure class and PD range (FIRB approach – Exposures to corporates, specialized lending)

PD scale	Original on-balance-sheet gross exposures	Off-balance-sheet exposures pre-CCF	Average CCF	EAD post CRM and post CCF	Average PD	Number of obligors	Average LGD	Average maturity	RWAs	RWA density	EL	Value adjustments and provisions
Category 1	1,907	230	73%	2,076	0.74%	87	50%	-	1,400	67%	8	
Category 2	974	220	73%	1,134	1.58%	68	50%	-	991	87%	9	
Category 3	162	6	75%	167	5.60%	19	50%	-	184	110%	5	
Category 4	121	3	43%	122	16.00%	44	50%	-	292	239%	10	
Category 5	538	2	100%	540	100.00%	60	50%	-	-	0%	269	
<b>Subtotal</b>	<b>3,702</b>	<b>461</b>	<b>73%</b>	<b>4,039</b>	<b>14.90%</b>	<b>278</b>	<b>50%</b>	<b>-</b>	<b>2,867</b>	<b>71%</b>	<b>301</b>	<b>386</b>
<b>Total (all portfolios)</b>	<b>48,298</b>	<b>8,491</b>	<b>36%</b>	<b>53,727</b>	<b>8.21%</b>	<b>353,566</b>	<b>40%</b>	<b>1.3</b>	<b>26,715</b>	<b>50%</b>	<b>2,295</b>	<b>2,641</b>

## 4.1. USE OF THE IRB APPROACH TO CREDIT RISK (CONTINUED)

Table 33: EU CR6 – IRB approach – Credit risk exposures by exposure class and PD range (AIRB approach – Exposures to retail (SME))

PD scale	Original on-balance-sheet gross exposures	Off-balance-sheet exposures pre-CCF	Average CCF	EAD post CRM and post CCF	Average PD	Number of obligors	Average LGD	Average maturity	RWAs	RWA density	EL	Value adjustments and provisions
0.00 to <0.15	-	-	0%	-	0.00%	-	0%	-	-	0%	-	
0.15 to <0.25	-	-	0%	-	0.00%	-	0%	-	-	0%	-	
0.25 to <0.50	-	-	0%	-	0.00%	-	0%	-	-	0%	-	
0.50 to <0.75	-	-	0%	-	0.00%	-	0%	-	-	0%	-	
0.75 to <1.00	5	8	70%	11	0.95%	109	47%	-	5	40%	-	
1.00 to <1.25	58	16	73%	70	1.13%	394	38%	-	25	36%	-	
1.25 to <1.50	52	11	72%	60	1.45%	350	39%	-	26	43%	-	
1.50 to <2.50	157	19	90%	174	1.93%	1,290	37%	-	79	45%	1	
2.50 to <3.50	149	27	92%	172	3.11%	1,126	38%	-	96	56%	2	
3.50 to <5.00	156	22	94%	177	4.53%	1,011	38%	-	118	67%	3	
5.00 to <10.00	116	18	92%	132	6.90%	840	40%	-	97	73%	4	
10.00 to <20.00	89	11	98%	101	11.00%	892	38%	-	85	84%	5	
20.00 to <50.00	30	1	99%	31	27.65%	16,730	36%	-	37	118%	3	
50.00 to <100.00	-	-	0%	-	0.00%	-	0%	-	-	0%	-	
100.00 (Default)	117	1	90%	118	100.00%	1,899	39%	-	19	16%	98	
<b>Subtotal</b>	<b>929</b>	<b>134</b>	<b>87%</b>	<b>1,046</b>	<b>15.78%</b>	<b>24,641</b>	<b>38%</b>	<b>0.0</b>	<b>587</b>	<b>56%</b>	<b>116</b>	<b>106</b>
<b>Total (all portfolios)</b>	<b>48,298</b>	<b>8,491</b>	<b>36%</b>	<b>53,727</b>	<b>8.21%</b>	<b>353,566</b>	<b>40%</b>	<b>1.3</b>	<b>26,715</b>	<b>50%</b>	<b>2,295</b>	<b>2,641</b>

## 4.1. USE OF THE IRB APPROACH TO CREDIT RISK (CONTINUED)

Table 34: EU CR6 – IRB approach – Credit risk exposures by exposure class and PD range (AIRB approach – Exposures to retail)

PD scale	Original on-balance-sheet gross exposures	Off-balance-sheet exposures pre-CCF	Average CCF	EAD post CRM and post CCF	Average PD	Number of obligors	Average LGD	Average maturity	RWAs	RWA density	EL	Value adjustments and provisions
0.00 to <0.15	-	-	0%	-	0.00%	-	0%	-	-	0%	-	
0.15 to <0.25	1,423	266	12%	1,456	0.22%	30,582	31%	-	206	14%	1	
0.25 to <0.35	2,906	304	13%	2,947	0.27%	45,483	33%	-	510	17%	3	
0.35 to <0.50	4,326	266	14%	4,363	0.36%	67,229	35%	-	975	22%	6	
0.50 to <0.75	-	-	0%	-	0.00%	-	0%	-	-	0%	-	
0.75 to <1.00	3,366	93	16%	3,380	0.77%	51,858	37%	-	1,216	36%	10	
1.00 to <2.00	1,696	35	39%	1,710	1.74%	27,092	36%	-	874	51%	11	
2.00 to <2.50	813	7	28%	815	2.21%	13,873	36%	-	446	55%	7	
2.50 to <10.00	-	-	0%	-	0.00%	-	0%	-	-	0%	-	
10.00 to <100.00	913	3	10%	913	15.74%	61,470	36%	-	919	101%	51	
100.00 (Default)	1,368	2	41%	1,369	100.00%	25,762	35%	-	514	38%	940	
<b>Subtotal</b>	<b>16,811</b>	<b>976</b>	<b>15%</b>	<b>16,953</b>	<b>9.52%</b>	<b>323,349</b>	<b>35%</b>	<b>0.0</b>	<b>5,660</b>	<b>33%</b>	<b>1,029</b>	<b>1,112</b>
<b>Total (all portfolios)</b>	<b>48,298</b>	<b>8,491</b>	<b>36%</b>	<b>53,727</b>	<b>8.21%</b>	<b>353,566</b>	<b>40%</b>	<b>1.3</b>	<b>26,715</b>	<b>50%</b>	<b>2,295</b>	<b>2,641</b>

## 5. CREDIT RISK ADJUSTMENTS

### EU CRB-A - DISCLOSURE REQUIREMENTS COVERED: ART. 442 (a) and (b) CRR

The receivables arising from the contractual relationship, and that the borrower has not settled within the agreed period are considered due but unpaid receivables of the Bank. "Due" means the amount of principal, interest and other receivables which the counterparty has not settled at the contractual maturity date.

Impairment of investments (impairment) is carried out for placements:

- for which there is evidence of losses arising from credit risk, on an individual basis
- for non-identified losses on an individual basis and for these placements impairment is carried out on a group basis.

An impairment loss is measured as the difference between the gross book value of assets and its recoverable amount and is recognized in the income statement in the period in which it is established. Impairment of financial assets is carried out if the recoverable amount, i.e. the present value of expected future cash flows of financial assets discounted by "original" effective interest rate of these assets is less than its book value.

The general principles and standards for credit risk allowances within the Bank follow the Central National Bank's ("CNB") procedures and IFRS are described in internal policies. The Bank, in line with regulatory and accounting standards, evaluates the need and allocates credit risk allowances for expected losses in accordance with IFRS9.

The process of provisioning for credit losses includes the default on the customer level and impairment identification and the type of assessment (individual or collective). Customer level means, if one of the customer's exposures is classified as defaulted then all of that customer's exposures are classified as defaulted.

During the process the Bank distinguishes between:

- Credit loss allowances for identified losses that are allocated to exposure to performing clients ie. those that are not in the default status or stage 1 and stage 2 provisions. Expected credit loss estimation is applied on collective basis and the expected credit losses (ECL) are calculated. For them, the methodology of expected credit loss is equal to the sum of the multiplication exposure and probability of default (PD) and loss given default (LGD) that are discounted to the present value. Depending on whether exposure is classified into stage 1 or stage 2, the time range of the expected credit loss is different. For exposures classified in stage 1, the expected credit loss is calculated in the twelve-month period until the exposure to stage 2 is calculated by calculating the lifetime expected credit loss.
- Credit loss allowances for identified losses that are allocated to exposure of client in default or stage 3 provisions and are calculated on an individual or collective basis. In the case of individually non-significant clients, the collective assessment (so-called Rule-based approach) is applied while individual approach is applied to individually significant clients. In case of ECL on financial assets of individually significant customers in default, estimates of expected future cash flows are based on more than one scenario to ensure the unbiased and probability weighted result.

## 5. CREDIT RISK ADJUSTMENTS (CONTINUED)

Other information regarding Restructured Exposure for Disclosure purposes in accordance with Article 442 (a) and (b) of the Regulation is published in the Annual Report for 2017 on the Bank's website within the Note 43.4.

The calculation of specific allowances is performed either on an individual basis (in case of significant customers) or on collective basis rule-based (for homogeneous groups of exposures of similar credit risk). In case of significant customers, expected cash flows are estimated individually by the Collection and Work-out Division and the Credit Risk Management Division. A customer is considered as significant if the total exposure defined as the sum of all on balance and off balance sheet exposures exceeds a determined materiality limit proscribed in internal acts and respecting regulation of Croatian National Bank. Otherwise, the customer is considered as insignificant and a rule-based approach is used for the calculation of the allowance. Under this approach, specific allowances are calculated as a multiplication of the carrying amount and the loss given default ("LGD"), where LGD reflects time in default or the stage of workout process.

For the calculation of credit loss allowances the risk parameters for the probability of default (PD) and loss given default (LGD) are used. The PD represents the likelihood of a borrower defaulting on its financial obligation (as per definition of default below), either over next 12 month (1Y PD) or over remaining lifetime (LT PD). LT PD is developed through observation of historical defaults from initial recognition through the lifetime of the loans. It is assumed to be same across all assets in the same portfolio and rating band. Which of the risk parameters, one year or lifetime, will be used depends on the stage of the specific exposure.

LGD represents the Group's expectation of the extent of loss on a defaulted exposure. LGD varies by type of counterparty, type and seniority of claim and availability of collateral or other credit support. LGD is expressed as a percentage loss per unit exposure at the time of default (EAD).

Parameters are determined to reflect the risk as a "point-in-time" measure and with consideration of forward-looking information ("FLI"), which resulted in introducing a baseline forecast and a number of alternative scenarios for selected macroeconomic variables. These are derived, together with their probabilities of occurrence, as a deviation from baseline forecasts, where the baseline forecasts are, with a few exceptions, internally determined by Erste Group's research department. Given multiple scenarios, the "neutral" PDs (and also LGDs, with a few exceptions) are adjusted through macro models which link relevant macroeconomic variables with risk drivers. Same macro-shift models as for external and internal stress test are employed. Forward looking information is incorporated for first three years of ECL measurement.

## 5. CREDIT RISK ADJUSTMENTS (CONTINUED)

DISCLOSURE REQUIREMENTS COVERED: ART. 442 (g) CRR

**Table 35: EU CR1-A: Credit quality of exposures by exposure classes and instruments**

		Gross carrying values of		Specific credit risk adjustment	General credit risk adjustment	Accumulated write-offs	Credit risk adjustment charges of the period	Net values
		Defaulted exposures	Non-defaulted exposures					(a+b-c-d)
1	Central governments or central banks	-	12,910	19	-	-	(1)	12,891
2	Institutions	-	2,296	4	-	-	22	2,292
3	Corporates	2,362	20,371	1,400	-	655	172	21,333
4	Of Which: Specialised Lending	540	3,624	386	-	182	74	3,778
5	Of Which: SME	972	10,334	720	-	338	52	10,586
6	Retail	1,488	17,362	1,218	-	14	36	17,632
7	Secured by real estate property	604	5,879	458	-	2	15	6,025
8	SME	63	392	53	-	-	(6)	402
9	Non-SME	541	5,487	405	-	2	21	5,623
10	Qualifying Revolving	-	-	-	-	-	-	-
11	Other Retail	884	11,483	760	-	12	21	11,607
12	SME	55	553	53	-	2	(7)	555
13	Non-SME	829	10,930	707	-	10	28	11,052
14	Equity	-	205	-	-	-	-	205
15	Total IRB approach	3,850	53,144	2,641	-	669	229	54,353



## 5. CREDIT RISK ADJUSTMENTS (CONTINUED)

### EU CR1-A: Credit quality of exposures by exposure classes and instruments (continued)

		Gross carrying values of		Specific credit risk adjustment	General credit risk adjustment	Accumulated write-offs	Credit risk adjustment charges of the period	Net values
		Defaulted exposures	Non-defaulted exposures					(a+b-c-d)
		a	b	c	d	e	f	
16	Central governments or central banks	-	7,651	11	-	-	(11)	7,640
17	Regional governments or local authorities	-	1,324	5	-	-	(1)	1,319
18	Public sector entities	-	2,600	102	-	-	(18)	2,498
19	Multilateral Development Banks	-	-	-	-	-	-	-
20	International Organisations	-	-	-	-	-	-	-
21	Institutions	-	184	-	-	-	-	184
22	Corporates	634	4,754	518	-	456	110	4,870
23	Of which: SMEs	258	2,286	248	-	117	11	2,296
24	Retail	308	6,123	319	-	115	(6)	6,112
25	Of which: SMEs	21	650	14	-	-	2	657
26	Secured by mortgages on immovable property	-	922	25	-	-	-	897
27	Of which: SMEs	-	115	7	-	-	-	108
28	Exposure in default	-	-	-	-	557	73	-
29	Items associated with particularly high risk	-	-	-	-	-	-	-
30	Covered bonds	-	-	-	-	-	-	-
31	Claims on institutions and corporates with a short-term credit assessment	-	-	-	-	-	-	-
32	Collective investments undertakings	-	138	-	-	-	-	138
33	Equity exposures	-	12	-	-	-	-	12
34	Other exposures	-	810	-	-	-	-	810
35	<b>Total standardised approach</b>	<b>942</b>	<b>24,518</b>	<b>980</b>	<b>-</b>	<b>571</b>	<b>74</b>	<b>24,480</b>
36	<b>Total</b>	<b>4,792</b>	<b>77,662</b>	<b>3,621</b>	<b>-</b>	<b>1,240</b>	<b>303</b>	<b>78,833</b>
37	Of which: Loans	4,619	55,596	3,490	-	1,240	267	56,725
38	Of which: Debt securities	-	9,801	37	-	-	3	9,764
39	Of which: Off-balance-sheet exposures	173	12,265	94	-	-	33	12,344

## 5. CREDIT RISK ADJUSTMENTS (CONTINUED)

Table 36: EU CR1-B – Credit quality of exposures by industry or counterparty types

		Gross carrying values of		Specific credit risk adjustment Defaulted exposures	General credit risk adjustment	Accumulated write-offs	Credit risk adjustment charges of the period	Net values
		Defaulted exposures	Non-defaulted exposures					(a+b-c-d)
		a	b	c	d	e	f	g
1	Agriculture, forestry and fishing	151	1,283	75	-	13	17	1,359
2	Mining and quarrying	19	179	15	-	-	4	183
3	Manufacturing	532	5,098	394	-	132	32	5,236
4	Energy and water supply	66	1,571	73	-	1	27	1,564
5	Construction	410	4,226	465	-	396	38	4,171
6	Trade	891	6,202	450	-	433	99	6,643
7	Transportation	58	1,656	61	-	18	19	1,653
8	Hotels and restaurants	323	3,211	203	-	27	21	3,331
9	Information and communication	54	463	13	-	5	(22)	504
10	Financial and insurance services	2	10,255	48	-	-	25	10,209
11	Real estate and housing	208	2,078	169	-	1	11	2,117
12	Professional and scientific services	364	1,177	131	-	58	-	1,410
13	Other service activities	86	1,064	80	-	30	4	1,070
14	Public administration	-	14,591	18	-	-	(13)	14,573
15	Education	-	41	1	-	-	-	40
16	Health and social services	1	522	17	-	-	-	506
17	Art, entertainment and recreation	6	538	12	-	2	-	532
18	Private households	1,621	21,918	1,396	-	124	43	22,143
19	Exterritorial organisations	-	10	-	-	-	(3)	10
20	Other	-	1,579	-	-	-	4	1,579
21	<b>Total</b>	<b>4,792</b>	<b>77,662</b>	<b>3,621</b>	<b>-</b>	<b>1,240</b>	<b>303</b>	<b>78,833</b>
22	<i>of which: loans</i>	<i>4,619</i>	<i>55,596</i>	<i>3,490</i>	<i>-</i>	<i>1,240</i>	<i>267</i>	<i>56,725</i>
23	<i>of which: debt securities</i>	<i>-</i>	<i>9,801</i>	<i>37</i>	<i>-</i>	<i>-</i>	<i>3</i>	<i>9,764</i>
24	<i>of which: off-balance-sheet</i>	<i>173</i>	<i>12,265</i>	<i>94</i>	<i>-</i>	<i>-</i>	<i>33</i>	<i>12,344</i>

## 5. CREDIT RISK ADJUSTMENTS (CONTINUED)

**Table 37: EU CR1-C – Credit quality of exposures by geography**

	Gross carrying values of		Specific credit risk adjustment Defaulted exposures	General credit risk adjustment	Accumulated write-offs	Credit risk adjustment charges of the period	Net values
	Defaulted exposures	Non-defaulted exposures					(a+b-c-d)
	a	b	c	d	e	f	
CROATIA	4,661	67,142	3,409	-	1,054	297	68,394
Regional Department West	3,108	45,107	2,189	-	963	193	46,026
Regional Department Central Croatia	459	5,578	374	-	46	13	5,663
Regional department Slavonia	205	2,346	175	-	16	20	2,376
Regional Department Rijeka	372	6,089	270	-	22	44	6,191
Regional Department South	394	5,657	283	-	4	25	5,768
Regional Department Istra	123	2,365	118	-	4	2	2,370
EU COUNTRIES	22	4,470	25	-	-	-	4,467
OTHER EUROPEAN COUNTRIES	104	5,481	174	-	31	-	5,411
LATIN AMERICA	-	1	-	-	-	-	1
UNITED STATES OF AMERICA	5	269	2	-	-	-	272
OTHER COUNTRIES	-	299	11	-	155	6	288
<b>Total</b>	<b>4,792</b>	<b>77,662</b>	<b>3,621</b>	<b>-</b>	<b>1,240</b>	<b>303</b>	<b>78,833</b>

**Table 38: EU CR1-D – Ageing of past-due exposures**

Analysis of accounting on-balance-sheet past-due exposures regardless of their impairment status:

Gross carrying values		a	b	c	d	e	f
		≤ 30 days	> 30 days ≤ 60 days	> 60 days ≤ 90 days	> 90 days ≤ 180 days	> 180 days ≤ 1 year	> 1 year
1	Loans	858	48	110	116	164	2,422
2	Debt securities	-	-	-	-	-	-
3	Total exposures	858	48	110	116	164	2,422

## 5. CREDIT RISK ADJUSTMENTS (CONTINUED)

Table 39: EU CR1-E – Non-performing and forborne exposures

		Gross carrying values of performing and non-performing exposures							Accumulated impairment and provisions and negative fair value adjustments due to credit risk				Collaterals and financial guarantees received	
			Of which performing but past due > 30 days and <= 90 days	Of which performing forborne	Of which non-performing				On performing exposures		On non-performing exposures		On non-performing exposures	Of which forborne exposures
						Of which defaulted	Of which impaired	Of which forborne		Of which forborne		Of which forborne		
010	Debt securities	10,047	-	-	1	1	1	-	(37)	-	(1)	-	-	-
020	Loans and advances	58,651	708	270	4,729	4,661	4,661	1,455	(557)	(24)	(2,932)	(556)	873	420
030	Off-balance-sheet exposures	12,150	-	-	173	173		-	(63)	-	(31)	-	96	-

**5. CREDIT RISK ADJUSTMENTS (CONTINUED)**

DISCLOSURE REQUIREMENTS COVERED: ART. 442 (i) CRR

**Table 40: EU CR2-A: Changes in the stock of general and specific credit risk adjustments**

		a
		Accumulated specific credit risk adjustment
<b>1</b>	<b>Opening balance</b>	<b>4,297</b>
1a	Restatement of opening balance - effects of changes in accounting policies	123
2	Increases due to amounts set aside for estimated loan losses during the period	301
3	Decreases due to amounts reversed for estimated loan losses during the period	(397)
4	Decreases due to amounts taken against accumulated credit risk adjustments	(1,050)
5	Transfers between credit risk adjustments	375
6	Impact of exchange rate differences	-
7	Business combinations, including acquisitions and disposals of subsidiaries	-
8	Other adjustments	(28)
<b>9</b>	<b>Closing balance</b>	<b>3,621</b>
10	Recoveries on credit risk adjustments recorded directly to the statement of profit or loss	3,621
11	Specific credit risk adjustments recorded directly to the statement of profit or loss	(101)

**Table 41: EU CR2-B: Changes in the stock of defaulted and impaired loans and debt securities**

		a
		Gross carrying value defaulted exposures
<b>1</b>	<b>Opening balance</b>	<b>5,839</b>
2	Loans and debt securities that have defaulted or impaired since the last reporting period	990
3	Returned to non-defaulted status	(701)
4	Amounts written off	(546)
5	Other changes	(747)
<b>6</b>	<b>Closing balance</b>	<b>4,835</b>

## 6. LEVERAGE RATIO

### DISCLOSURE REQUIREMENTS COVERED: ART. 451 CRR

The leverage ratio represents the relationship between Tier 1 and the leverage exposure pursuant to Article 429 CRR. Essentially, the leverage exposure represents the sum of unweighted on balance sheet and off balance sheet positions considering valuation and risk adjustments as defined in the CRR.

As of 31 December 2018, the leverage ratio for the Group amounted to 11.58%. The calculation is based on the Delegated Regulation (EU) 2015/62 of 10 October 2014, which was published in the Official Journal of the European Union on 17 January 2015. As such, the ratio is calculated on period-end values as of 31 December 2018, while the Tier 1 capital is determined based on fully loaded Basel III definitions, i.e. not including any transitional provisions.

### Leverage exposure breakdown and reconciliation

**Table 42: LRSum form: Summary reconciliation of accounting assets and leverage ratio exposures:**

	in HRK million
Total assets as per published financial statements	69,691
Adjustment for entities which are consolidated for accounting purposes but are outside the scope of regulatory consolidation	(34)
(Adjustment for fiduciary assets recognised on the balance sheet pursuant to the applicable accounting framework but excluded from the leverage ratio total exposure measure in accordance with Article 429(13) of Regulation (EU) No 575/2013)	-
Adjustments for derivative financial instruments	105
Adjustments for securities financing transactions "SFTs"	-
Adjustment for off balance sheet items (i.e., conversion to credit equivalent amounts of off balance sheet exposures)	878
(Adjustment for intragroup exposures excluded from the leverage ratio total exposure measure in accordance with Article 429(7) of Regulation (EU) No. 575/2013)	-
(Adjustment for exposures excluded from the leverage ratio total exposure measure in accordance with Article 429(14) of Regulation (EU) No. 575/2013)	-
Other adjustments	-
<b>Total leverage ratio exposure</b>	<b>70,640</b>

## 6. LEVERAGE RATIO (CONTINUED)

The following table provides a breakdown of the total leverage exposure measure into its main parts as well as the calculation of the period-end leverage ratio as of 31 December 2018.

The disclosure table has been aligned with the table proposed by the Implementing Technical Standards (EBA/ITS/2014/04rev1) published by the EBA on 15 June 2015.

Line items that were not relevant to the Group were omitted; therefore, the numbering of lines in the table is not consecutive.

**Table 43: LRCom form: Leverage ratio common disclosure**

	in HRK million
<b>On balance sheet exposures (excluding derivatives and SFTs)</b>	
1. On balance sheet items (excluding derivatives, SFTs and fiduciary assets, but including collateral)	67,668
2. (Asset amounts deducted in determining Tier 1 capital)	(364)
3. Total on balance sheet exposures (excluding derivatives, SFTs and fiduciary assets) (sum of lines 1 and 2)	67,304
<b>Derivative exposures</b>	
4. Replacement cost associated with all derivatives transactions (i.e. net of eligible cash variation margin)	33
5. Add on amounts for PFE associated with all derivatives transactions (mark to market method)	105
6. Total derivative exposures (sum of lines 4 and 5)	138
<b>Securities financing transaction exposures</b>	
7. Gross SFT assets (with no recognition of netting), after adjusting for sales accounting transactions	1,956
8. Counterparty credit risk exposure for SFT assets	-
9. Total securities financing transaction exposures (sum of line 7 and 8)	1,956
<b>Other off balance sheet exposures</b>	
10. Off balance sheet exposures at gross notional amount	3,087
11. (Adjustments for conversion to credit equivalent amounts)	(2,209)
12. Other off balance sheet exposures (sum of lines 10 and 11)	878
<b>Capital and total exposure measure</b>	
13. Tier 1 capital	8,141
14. Leverage ratio total exposure measure (sum of lines 3, 6, 9, 12)	70,276
<b>Leverage ratio</b>	
15. Leverage ratio	11.58%

## 6. LEVERAGE RATIO (CONTINUED)

### Obrazac LRQua: Free format text boxes for disclosure on qualitative items

#### Management of the risk of excessive leverage

Leverage ratio is one of the core risk metric included in the Group Risk Appetite Statement ("RAS"). The leverage ratio is planned as part of the annual forecasting and budgeting process. As a RAS metric, the development of the leverage ratio is regularly monitored by the Management Board and Supervisory Board and reported to relevant counterparties in Erste Holding. Leverage ratio is calculated quarterly.

#### Factors influencing the development of leverage exposure

The overall leverage exposure in the year 2018 increased by 0.82% comparing to the year 2017 to HRK 70,276 million. This change mostly refers to the increase of the on balance exposure.

Split-up of on balance sheet exposures (excluding derivatives and SFTs)

**Table 44: LRSpl form: Split-up of on balance sheet exposures (excluding derivatives, SFTs and exempted exposures)**

	in HRK million
EU-1. Total on balance sheet exposures (excluding derivatives, SFTs), of which:	69,624
EU-2. Trading book exposures	2,201
EU-3. Banking book exposures, of which:	67,423
EU-4. Covered bonds	-
EU-5. Exposures treated as sovereigns	20,468
EU-6. Exposures to regional governments, MDB, international organizations and PSE not treated as sovereigns	3,477
EU-7. Institutions	711
EU-8. Secured by mortgages of immovable properties	6,874
EU-9. Retail exposures	14,711
EU-10. Corporate	16,712
EU-11. Exposure in default	276
EU-12. Other exposures (e.g. equity, securitizations, and other non-credit obligation assets)	4,194



## 7. MARKET RISK EXPOSURE

### EU MRA - DISCLOSURE REQUIREMENTS COVERED: ART. 445 CRR

Market risk is the risk from the potential impacts that external events can have on the valuation of the assets, liabilities and off balance sheet positions of the Bank and it is caused by the price changes respectively the changes in the financial markets and as such is divided into:

- Interest rate risk,
- FX Risk,
- Equities risk.

Management and the control of the market risk exposures and setting the limits are defined within the internal regulation, policies and procedures issued by Risk management division. Measurement and the control of the exposure to market risk is conducted throughout the Value at Risk limits system as well as sensitivities system ("PVBP", "FX Delta" and "Stop loss limits").

For the purposes of the capital charges Bank is using the standardized approach.

**Table 45: EU MR1 – Market risk under the standardized approach**

		RWAs	Capital requirements
	Outright products		
1	Interest rate risk (general and specific)	46	4
2	Equity risk (general and specific)	-	-
3	Foreign exchange risk	10	1
4	Commodity risk	-	-
	Options		
5	Simplified approach	-	-
6	Delta-plus method	-	-
7	Scenario approach	-	-
8	Securitisation (specific risk)	-	-
9	<b>Total</b>	<b>56</b>	<b>5</b>

In the reporting period, the Group had stable capital requirements for market risk arising primarily from transactions with customers (interest rate risk) and own fund requirements for foreign exchange risk based on the calculation of total net foreign exchange position.

## 7. MARKET RISK EXPOSURE (CONTINUED)

### Value at Risk

Value at Risk ("VaR") describes what level of losses may be expected as a maximum at a defined probability – the confidence level – within a certain holding period of the positions under normal market conditions and based on historical experience. Basic idea behind this historical model is taking into calculation the current portfolio and re-pricing its market value based on the previous market prices, VaR calculates maximum loss within the given confidence level which a Bank can endure in a predefined time period.

According to the VaR limits structure, at a confidence level of 99%, daily VaR limits are set, on the total trading book as well as the separate limits on the money market portfolio, fixed income portfolio, fx portfolio and shares. VaR limits are also introduced on fixed income corporates, money market banking book, money market trading book and fixed income securities in the banking and in the trading book. Limit utilization is monitored daily.

**Table 46: Var limits and utilization split by portfolio**

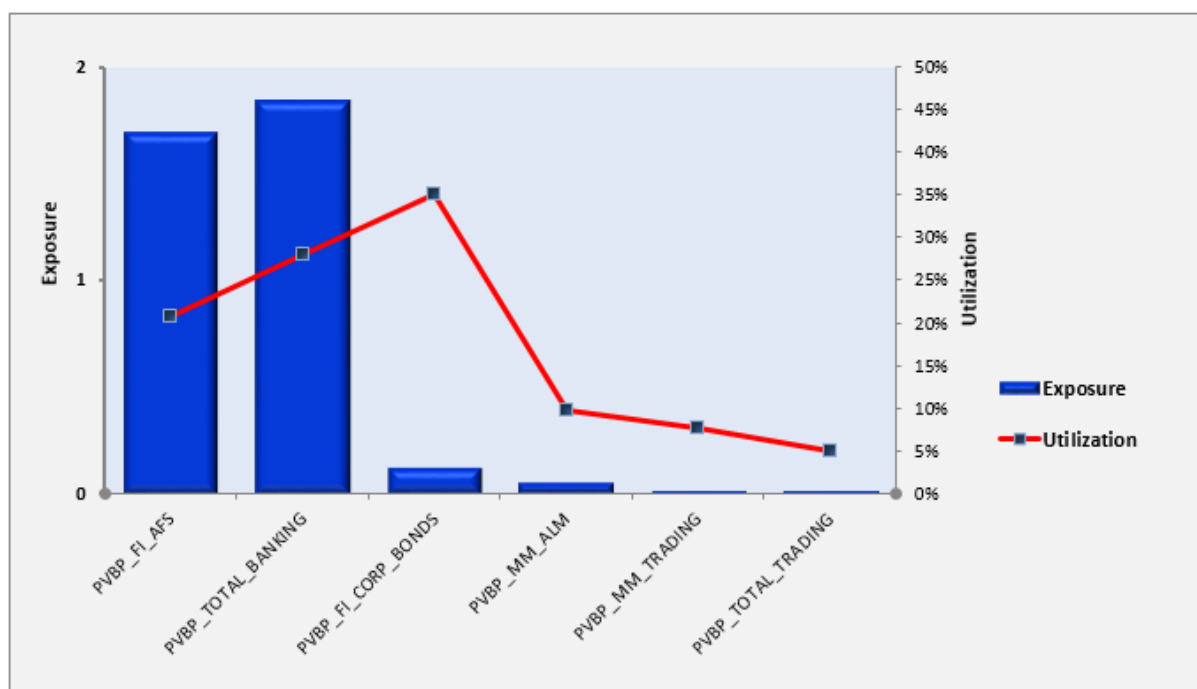
VaR limits and Utilization	Limit (HRK)	Exposure	Maximum	Minimum
Banking book – fixed income securities	74.2	16.4	17	11
Banking book – fixed income corporates	5.2	0.7	1.7	0.3
Banking book - Foreign exchange	4.5	0.1	0.2	-
Banking book - Money market	22	6.8	10	1.5
Trading book – fixed income trading	1.1	-	-	-
Trading book – Money market	2.2	0.06	0.8	-

**Price Value of a Basis Point ("PVBP")** is the sensitivity limit that limits the risk of change in the portfolio value caused by parallel shift of the interest rate curve by one basis point.

For the purposes of the effective control of the Trading Book and separate positions in the Banking Book PVBP limits are set up separately for the money market portfolio as well as for the fixed income portfolio. Furthermore, PVBP limits for the separate desks are set up; Fixed income desk, Money market desk and FX desk. PVBP limits for corporate securities are set up, as well.

## 7. MARKET RISK EXPOSURE (CONTINUED)

Picture 3: Sensitivities for the interest rate curve move by one basis point



**FX Delta** measures the price sensitivity and presents the delta exposure (spot plus delta position for the options) to the currency risk. Based on that assumption, the Bank has implemented FX Delta limits for all the significant currencies as well as for the total FX position of the Bank.

**Stop Loss** calculation shows the maximum loss for separate portfolios which the Bank can tolerate on monthly and yearly basis. The Bank, in this context, has established monthly and annual Stop loss limits individually for money market, fixed income securities and foreign currency business.

### Net interest income simulation

Net interest income simulation of the Group for the year 2019 shows that in case of increase of interest rates for 1% net interest income will increase for 4% or HRK 63 million. The cause of this effect is assets that has shorter period of changes in interest rates than the period watched. Internal net interest income limit was 6% which is bellow limit of 15%.

## 7. MARKET RISK EXPOSURE (CONTINUED)

**Table 47: Simulation of net interest income in the year 2019 on the basis of the data for 31 December 2018:**

	EUR	USD	HRK	CHF	TOTAL	in %
immediate parallel shock plus 200 bp	99	2	17	8	126	8%
immediate parallel shock plus 100 bp	50	1	10	2	63	4%
immediate parallel shock minus 100 bp	(80)	(4)	(22)	1	(105)	(6%)
immediate parallel shock minus 200 bp	(171)	(10)	(58)	(3)	(242)	(15%)
Internal net interest income limit	(52)	(10)	(38)	3	(97)	(6%)

## 8. EXPOSURE TO INTEREST RATE RISK ON POSITIONS NOT INCLUDED IN THE TRADING BOOK

### DISCLOSURE REQUIREMENTS COVERED: ART. 448 CRR

Under the interest rate risk in the banking book, there are following subtypes present within the context of the interest rate risk:

- 1) Gap risk; the risk to the which a credit institution is exposed to due to the maturity mismatching in the maturity date (for fixed interest rates) and revaluing of interest rates (for variable interest rates) positions in the banking book, can be subdivided into parallel repricing and yield-curve risk,
- 2) Basis risk; the risk to the which a credit institution is exposed to due to the difference in the reference interest rates for the instruments with similar characteristics in relation with maturity or time period before the next interest rate change,
- 3) Optionality risk; the risk to which a credit institution is exposed to due to the options incorporated within the interest-sensitive positions (i.e. possible early repayment of loans, possible early withdrawal of deposits etc.). It can be further subdivided into automatic option risk and behavioral option risk.

The term interest rate risk management implies the implementation of measures and decisions with the goal to minimize the negative effect of the balance sheet items sensitive to interest rate changes on the Bank's business stability i.e. the optimization of the overall Bank's interest income (short-term aspect). Moreover, the influence of the interest rate movement on the assumed economic value of the Bank's capital (long-term aspect) is monitored.

The interest rate risk within the Bank's business activities may be dually monitored:

- a. through the structured exposure of the bank to the interest rate risk
- b. through the positions in the interest-sensitive instruments on the currency, cash and bond market, i.e. the interest rate risk exposure of its trading book positions.

## 8. EXPOSURE TO INTEREST RATE RISK ON POSITIONS NOT INCLUDED IN THE TRADING BOOK (CONTINUED)

The following parameters influence on the Bank's interest rates definition:

- funding spread that includes all regulatory costs (obligatory reserves, currency of the paid obligatory reserves, the rate of minimum required foreign currency claims of banks relative to their foreign currency liabilities etc.),
- market interest rate movements for HRK and all relevant world currencies,
- refinancing risk / credit risk of the Bank,
- refinancing risk / credit risk of the country,
- remaining maturity of banking book,
- maturity mismatch in the banking book items,
- market competitiveness,
- Bank's strategy,
- currency,
- legal regulations (acting in accordance with the proscribed instruments of insurance),
- other.

Exposure of the Group to the interest rate risk in the banking book related to the regulatory capital, according to Croatian National Bank Decision on the management of interest rate risk in banking book (NN120/2016) and updated guidelines of the European Banking Authority ("EBA") on "Technical aspects of the management of interest rate risk arising from non-trading activities under the supervisory review process" ("EBA/GL/2015/08"), was as follows:

**Table 48: Exposure of the Group to the interest rate risk in the banking book related to the regulatory capital**

<b>Currency in HRK million</b>	<b>Standard shock</b>
HRK	(335)
EUR	(253)
USD	(21)
OTHER	34
<b>CHANGE IN THE ECONOMIC VALUE</b>	<b>575</b>
<b>REGULATORY CAPITAL</b>	<b>9,154</b>
<b>(CHANGE IN THE ECONOMIC VALUE / REGULATORY CAPITAL)*100</b>	<b>6.3%</b>

## 9. LIQUIDITY RISK

### DISCLOSURE REQUIREMENTS COVERED: ART. 435 (1) (a-d) CRR

In accordance with the EBA guidelines on LCR disclosure to complement the disclosure of liquidity risk management under Article 435 of Regulation (EU) No 575/2013 (EBA/GL/2017/1), disclosure requirements for the Bank are:

- **DISCLOSE RISK MANAGEMENT OBJECTIVES AND POLICIES FOR LIQUIDITY RISK**

#### **Strategies and processes in the management of the liquidity risk**

The liquidity risk is defined in line with the principles set by the Basel Committee on Banking Supervision and the Croatian National Bank. Accordingly, a distinction is made between:

- Market liquidity risk, which is the risk that the Bank cannot easily offset or eliminate a position at the market price because of inadequate market depth or market disruption, and
- Funding liquidity risk, which is the risk that the Bank will not be able to meet efficiently both expected and unexpected current and future cash flow and collateral needs without affecting either daily operations or the financial condition. Funding liquidity risk is further divided into insolvency risk and structural liquidity risk. The former is the short-term risk that current or future payment obligations cannot be met in full, on time in an economically justified way, while structural liquidity risk is the long-term risk of losses due to a change in the Bank's own refinancing cost or spread.

The governance is related to the defining main responsibilities for managing liquidity risk of all the involved stakeholders within the Bank as well as to the main documents which define principles and practices for the managing of the liquidity risk. The three setup of the governance incorporates the following key principles:

**Conservatism** - Measurement shall always be based on conservative estimations and assumptions. For example, an estimate of future cash flows should be based on the remaining maturity period, using the latest possible settlement date for inflows and the earliest possible settlement date for the outflows;

**Granularity** - In the specification of any liquidity risk measure the entities shall always strive to define sufficiently granular data for the calculation which enables reasonable analysis on the dynamics of the results and sufficient drill-down capability to identify key risk drivers.

**Timeliness** - The Bank shall make effort to define input data and to set the frequency of reporting so that the information of the results is not outdated.

The Bank defines, through the risk strategy, inter alia, the risk appetite for liquidity risk as a part of the risk appetite statement. Accordingly, key liquidity principles are defined to ensure that processes are in place to manage the liquidity risk profile and the strategic limits are set in the risk strategy. These are further translated into operating limits and liquidity risk management.

## 9. LIQUIDITY RISK (CONTINUED)

### Structure and organisation of the liquidity risk management function (authority, statute, other arrangements)

Organizational units involved in the liquidity risk management:

Asset and Liability Management Division (ALM) is in charge of liquidity management in co-operation with the Trading Department, responsible for adopting a liquidity and financing strategy and establishing short- and long-term financing plans for the Bank and the Group, respecting regulatory and internal liquidity risk limits. The ALM consists of two groups - Liquidity and Investment Group and Analysis and FTP System Group.

Risk Management Division is responsible for the implementation of methods and models of control and liquidity risk management, measurement, monitoring, internal and regulatory reporting, participation in the determination of the limits and monitors all relevant limit usage. Initiate appropriate steps (escalation) in case of limit violation. Comprehensive and up-to-date documenting the models used for liquidity risk analysis and assessing liquidity risk materiality.

Internal Audit Division is tasked with periodically reviewing overall liquidity management framework as well as checking compliance with the applicable legal and regulatory framework.

Asset and Liability Management Committee ("ALCO") is responsible for adopting and implementing strategies and methodologies for liquidity risk management as well as all necessary documentation, approval of the structure and limits, breaches, and action plan for settling within the limits. In crisis periods, approving liquidity enhancing actions. It is responsible for approving all new liquidity measuring tools implemented in the Bank in accordance with local regulations.

Management and Supervisory Board are responsible for the development of strategies, policies and practices for liquidity risk management and to ensure that the bank maintains sufficient liquidity to meet its obligations at all times.

Operating Liquidity Committee ("OLC") is responsible for continuous market and liquidity monitoring, action plans and measures proposal, crisis management and communication.

### Scope and nature of liquidity risk reporting and measurement systems

In accordance with best market practices, exposure to liquidity risk is determined through regulatory prescribed measures and regular reports.

The monitoring of key liquidity risk indicators is performed from intraday to quarterly, and individual reports are processed and more frequently than defined if needed. Reporting is defined through regulatory reports (such as LCR, NSFR, ALMM, asset encumbrance, financing plans), internal reports (such as survival period analysis, structural liquidity gap's, monthly report) and public disclosure (such as Annual Report, Pillar 3 Disclosure report).

The Risk Management Division is responsible for continuously and quickly identifying and measuring liquidity risk assessment and liquidity risk reporting. All regulatory requirements are reported at a solo level, while for the needs of internal reporting and liquidity monitoring, and within the definition and management of risk appetite statement, some liquidity indicators are monitored at a consolidated level as well. Comprehensive reporting of liquidity measures is covered by monthly ALCO reports. In addition, for the purposes of Erste Group liquidity risk management, the Bank fully consolidated and reports on the liquidity coverage ratio.

## 9. LIQUIDITY RISK (CONTINUED)

### **Policies for hedging and mitigating the liquidity risk and strategies and processes for monitoring the continuing effectiveness of hedges and mitigants**

The starting point for liquidity risk management is the definition and identification of various types of liquidity risk through liquidity risk management, risk assessment and the product approval process.

The risk appetite is part of the risk appetite statement and contains binding business activity limits in terms of liquidity considerations, supplementing the key principles of liquidity risk management and translated into operational liquidity risk limits included in everyday risk management procedures.

Management of short-term and long-term liquidity, including liquidity buffers, is the responsibility of the Asset and Liability Management Division. It includes setting a liquidity strategy and establishing a regular funding plan, as well as the development of contingency funding plans and the implementation of related early warning systems with respect to detecting the type and severity of liquidity stress events as early as possible.

The Bank has established a robust liquidity risk management framework that ensures it maintains sufficient liquidity, including a cushion of unencumbered, high quality liquid assets, to withstand a range of stress events, including those involving the loss or impairment of both unsecured and secured funding sources.

Stress testing is a key tool at the Bank's level of the risk management, reflecting portfolio characteristics and to ensure that current exposures remain in accordance with a bank's established liquidity risk tolerance. Liquidity risk is also considered in a number of different types of stress testing exercises, including comprehensive stress testing, recovery planning and survival period analysis.

Risk tolerance defined in accordance with business plans, strategy adopted, overall risk appetite statement and the role of credit institution in the financial system has been defined.

### **A declaration approved by the management body on the adequacy of liquidity risk management arrangements of the institution providing assurance that the liquidity risk management systems put in place are adequate with regard to the institution's profile and strategy**

Liquidity risk management is satisfactory, i.e. liquidity risk is managed in an adequate manner, effective limits, control systems and reporting lines, strategies and plan in case of crisis situations are established.

The liquidity risk assessment is carried out within the Market and Liquidity Risk Management Department, and the ALM and the Financial Markets Division. Continuous consideration of the adequacy of the methodologies used and the possibility of improving the overall process. Once a year during the audit documentation, the necessary changes are made as a result of changes in business practices, risk strategies etc. An internal audit is carried out by the competent organizational unit of the Bank, which can also detect certain weaknesses and deficiencies and make certain suggestions to improve the process, which are taken into account by the Risk Management Division. Liquidity risk is also considered in a number of different types of stress testing exercises including comprehensive stress testing, recovery plan, and survival period analysis. The key tool to measure insolvency risk is a survival period analysis, using a dynamic stress testing methodology.



## 9. LIQUIDITY RISK (CONTINUED)

**A concise liquidity risk statement approved by the management body succinctly describing the institution's overall liquidity risk profile associated with the business strategy. This statement shall include key ratios and figures (other than those already covered in Annex II of these guidelines) providing external stakeholders with a comprehensive view of the institution's management of liquidity risk, including how the liquidity risk profile of the institution interacts with the risk tolerance set by the management body**

The Bank has defined and implemented the Group Risk Strategy, which is approved by the Management Board and the Supervisory Board on an annual basis. The Group Risk Strategy defines, inter alia, the Risk Appetite for liquidity risk as a part of the Risk appetite statement. In line with the Risk appetite statement, key liquidity principles are defined to ensure that processes are in place to manage the liquidity risk profile and the strategic limits are set in the Group Risk Strategy that are further translated into operating limits and liquidity risk management policies, and represent the key objectives to be met for the next years and demonstrate that the Bank is committed to further develop its liquidity risk management framework.

The liquidity risk profile of the institution approved by the management body is defined by the Risk appetite statement, which defines the minimum required level of the LCR ratio - the regulatory ratio to measure the exposure liquidity risk of a credit institution. The 2018 Risk appetite statement defined "green" (normal) zone above 120%, "amber" (warning zone) between 105% - 120% and "red" (crisis zone) below 105%.

The 2018 liquidity management strategy, approved by the bank's management body, based on the plan of the bank's balance sheet development for the next five business years, was the projection of the LCR regulatory ratio and for all of the projected years over the minimum defined ratio accepted by the Risk appetite statement:

**Table 49: Projection of the LCR regulatory ratio**

Projection	2018	2019	2020	2021	2022
LCR	199,93%	160,79%	137,24%	145,87%	151,68%

The Bank also defines liquidity management in a local Group, and defined principles should be fulfilled in the liquidity management process of a local Group involving Erste Bank Podgorica, Erste Card Club, Erste Factoring and S-Leasing. ALM coordinates liquidity management in the local Group, while Group ALM is responsible for liquidity management in the Holding and throughout the Erste Group.

## 9. LIQUIDITY RISK (CONTINUED)

Table 50: Disclosure level and components of the LCR

Scope of consolidation (solo)		Total unweighted value (average)				Total weighted value (average)			
Currency and units (HRK million)									
Quarter ending on		31 March 2018	30 June 2018	30 September 2018	31 December 2018	31 March 2018	30 June 2018	30 September 2018	31 December 2018
Number of data points used in the calculation of averages		12	12	12	12	12	12	12	12
HIGH-QUALITY LIQUID ASSETS									
1	Total high-quality liquid assets (HQLA)					11,180	11,312	12,280	13,251
CASH-OUTFLOWS									
2	Retail deposits and deposits from small business customers, of which:	28,444	28,635	29,068	29,799	2,367	2,375	2,407	2,468
3	Stable deposits	10,147	10,319	10,527	10,728	507	516	526	536
4	Less stable deposits	18,297	18,316	18,542	19,071	1,859	1,859	1,880	1,932
5	Unsecured wholesale funding	11,896	12,288	12,737	13,220	4,726	4,947	5,179	5,321
6	Operational deposits (all counterparties) and deposits in networks of cooperative banks	7,058	7,405	7,832	8,276	1,489	1,565	1,661	1,761
7	Non-operational deposits (all counterparties)	4,760	4,858	4,879	4,944	3,159	3,356	3,492	3,560
8	Unsecured debt	78	25	25	-	78	25	26	-
9	Secured wholesale funding					-	-	-	-
10	Additional requirements	3,860	3,917	3,978	4,044	534	638	710	727
11	Outflows related to derivative exposures and other collateral requirements	197	305	374	382	197	305	374	382
12	Outflows related to loss of funding on debt products	-	-	-	-	-	-	-	-
13	Credit and liquidity facilities	3,662	3,612	3,603	3,662	336	333	336	345
14	Other contractual funding obligations	553	545	526	516	126	156	192	229
15	Other contingent funding obligations	2,455	2,584	2,650	2,700	123	129	119	102
16	TOTAL CASH OUTFLOWS					7,875	8,245	8,607	8,846
CASH-INFLOWS									
17	Secured lending (e.g. reverse repos)	2,236	2,115	2,340	2,629	73	86	105	146
18	Inflows from fully performing exposures	1,887	1,821	1,676	1,449	1,538	1,478	1,308	1,104
19	Other cash inflows	155	238	292	299	155	239	292	299

**9. LIQUIDITY RISK (CONTINUED)****Disclose level and components of the LCR (CONTINUED)**

EU-19a	(Difference between total weighted inflows and total weighted outflows arising from transactions in third countries where there are transfer restrictions or which are denominated in non-convertible currencies)					-	-	-	-
EU-19b	(Excess inflows from a related specialised credit institution)					-	-	-	-
20	<b>TOTAL CASH INFLOWS</b>	4,279	4,175	4,309	4,377	1,767	1,803	1,705	1,550
EU-20a	<i>Fully exempt inflows</i>	-	-	-	-	-	-	-	-
EU-20b	<i>Inflows Subject to 90% Cap</i>	-	-	-	-	-	-	-	-
EU-20c	<i>Inflows Subject to 75% Cap</i>	4,279	4,175	4,309	4,377	1,767	1,803	1,705	1,550
TOTAL ADJUSTED VALUE									
21	<b>LIQUIDITY BUFFER</b>					11,180	11,312	12,280	13,251
22	<b>TOTAL NET CASH OUTFLOWS</b>					6,109	6,422	6,903	7,297
23	<b>LIQUIDITY COVERAGE RATIO (%)</b>					184%	177%	178%	181%

## 9. LIQUIDITY RISK (CONTINUED)

- **DISCLOSE FURTHER EXPLANATION OF THE ITEMS INCLUDED IN THE LCR DISCLOSURE TEMPLATE**

### **Concentration of funding and liquidity sources**

Concentration of funding occurs when the resource structure makes the Bank vulnerable to an individual event or individual factor, such as a significant and sudden withdrawal of funding or inadequate access to new funding sources.

Pursuant to Article 22 of the Commission Delegated Regulation (EU) 2015/61 Bank calculates liquidity outflows by multiplying the remaining balances of the different categories or types of liabilities and off-balance sheet liabilities with rates at which outflow or withdrawal is expected.

During whole observed period unweighted value of cash outflows shows high share, on average 60%, of retail deposits and deposits from small business customers in total sources followed by unsecured wholesale funding with average share of 26%. The structure changes after the application of the corresponding rates at which this sources of funds are expected to run off or be drawn down in the next 30 days period in a way that largest share changes in favor of unsecured wholesale funding, in particular non-operative deposits of financial clients, since they are considered as less stable funding sources compared to, for example, Retail deposits.

Also, in accordance with Article 9 of the Commission Delegated Regulation (EU) 2015/61 Bank uses market value of its liquid assets which is, if necessary, reduced by the given corrective factors in order to calculate the liquidity coverage ratio. Such weighted value of the liquidity buffer was at a high levels, in average HRK 12,006 million, of which HRK 11,844 million or 99% relates to extremely high liquidity and credit quality assets or Level 1 assets. Out of this L1 assets, the largest share refers to the exposures to the central government followed by coins and banknotes, withdrawable central bank reserves and assets representing claims on or guaranteed by the multilateral developments banks and international organizations. This structure of the liquidity buffer enables Bank to maintain high level of the net outflows coverage during a 30-day stress period which should allow the conversion of liquid assets into cash without relying on the liquidity from central bank or government funds.

### **Derivative exposures and potential collateral calls**

The Bank included outflows from derivatives as well as impact of an adverse market scenario on derivatives, financing transactions and other contracts in outflows related to derivative exposures and other collateral requirements.

The Bank take into account the outflows and inflows provided for period of 30 calendar days from the exposure to derivative transactions on a net basis in accordance with Article 21 of the Commission Delegated Regulation (EU) 2015/61. During observed period, outflows from derivatives in average amounted HRK 234 million.

## **9. LIQUIDITY RISK (CONTINUED)**

From 1 March 2017 the Bank is obliged to exchange collateral for OTC derivative transactions that are not settled by the Central Counterparty on (EMIR).

EMIR has mandated transparent reporting of OTC derivatives regulators, that regulators within the EU could monitor and, if necessary, investigate transactions that have not been concluded in accordance with legal regulations.

Contracting parties that are liable to apply the EMIR shall exchange collateral if they exceed the defined threshold and monitor the exposure and calculation of the collateral required for the use of a Group web application that supports all regulatory and strategic collateral management needs.

Consequently, it is apparent that the Bank monitors and evaluates collateral daily, showing only the amount of required collateral. Additionally, the LCR reports an additional outflow that meets the collateral requirements that would arise from the impact of the adverse market scenario on the Historical Look-Back Approach (HLBA). The mentioned outflow in the observed period in average amounted HRK 81 million.

### **Currency mismatch in the LCR**

The Bank also insures the currency adjustment of its liquid assets and its net liquid outflows to prevent excessive currency mismatch endangering the Bank's ability to use liquidity buffers to fulfilling liquidity outflows in a particular currency during the stress period. The Bank fully secures currency adjustment, which is visible through the LCR ratio, in total, as well as for individual currencies, maintaining the same above the required regulatory level without additional restrictions on the LCR ratio or the share of net liquid outflows for individual currencies.

### **A description of the degree of centralization of liquidity management and interaction between the Group's units**

The Bank fully cooperates with the Group in the implementation of methodologies and regulations, thereby ensuring compliance with the Group. The Bank's approach is to collect data from a different data sources in entities and combine them with the centralized data to respond to liquidity reporting requirements. Also, this information is sent to the Holding as well, but the Bank independently compiles all regulatory and internal liquidity reports. Classification and aggregation rules of cash flows are implemented through internal systems and tools.

### **Other items in the LCR calculation that are not captured in the LCR disclosure template but that the institution considers relevant for its liquidity profile**

The bank fully compliance the regulatory defined LCR ratio and is within the defined limit. Although the Bank's monthly reports on the LCR, the Bank daily monitors and compliance the regulatory LCR, both in total and in all significant currencies. In addition to the ratio itself, the Bank regularly monitors the composition of the liquidity buffer by asset level, meeting all defined limits within the Commission Delegated Regulation (EU) 2015/61.

## 10. OPERATIONAL RISK

Operational risk is a risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. Operational risk definition includes legal risk and excludes strategic and reputational risk.

The Bank assesses reputational risk for assessment purposes due to the strong links with the operational risk (e.g. most of operational risk events have a strong impact in terms of reputation).

The operational risk management system includes the following:

1. the operational risk management strategy,
2. policy and other internal acts which define general rules or principles, procedures and methods for operational risk management,
3. an organizational structure and resources for the operational risk management,
4. the operational risk management process which includes:
  - identification of operational risk,
  - assessment, mitigation and acceptance of operational risk,
  - quantification of operational risk,
  - monitoring, controlling and reporting of operational risk.
5. business continuity management,
6. identification and maintenances of the capital requirement for operational risk.

### Operational Risk Management Process

The Bank identifies inherent and residual operational risk in all material activities processes and systems. Operational risk is influenced by a large variety of factors which have to be considered when determining the operational risk exposure for the Bank. These factors can be grouped into categories, such as e.g. economic and business environment, processes and systems etc.

When determining the operational risk exposure for the Bank, both qualitative and quantitative instruments are applied.

The quantitative analysis of operational risk includes collection of internal and external loss event data where particular emphasis is put on the data classification and quality necessary for quantifying operational risk.

For the qualitative analysis methodology for operative risk and control self-assessments is performed on a regular basis and for all identified high risks, for which internal controls are not adequate or efficient, corrective measures by relevant organizational unit have to be implemented, in order to mitigate identified operational risk.

An objective in the identification of operational risk is establishing key risk indicators which are measured and give a timely indication regarding changes in the operational risk profile.

In order to involve management of the Bank in the change management process, it is ensured that there is an approval process that fully assesses operational risk for all new products, activities, processes and systems. This process has to also cover recent significant corporate events (such as mergers, acquisitions, disposals and restructuring) or new markets.

## 10. OPERATIONAL RISK (CONTINUED)

In addition to the loss data collection, scenario analysis are implemented to analyze possible future losses which the Bank has not yet experienced.

Managing operational risk is conducted for all identified operational risk in all activities, products and processes of the Bank. Managing operational risk implies preventive and corrective activities or methods, criteria and procedures with the goal of approval, avoidance, mitigation or transfer of identified risk;

- **Avoidance** implies non-undertaking of certain activities with the intent to prevent the operational risk arising from the concerned activities.
- **Mitigation and controlling** implies the improvement of business processes and practices and/or introduction of control to reduce the operational risk.
- **The transfer** implies the transfer of operational risk to third parties via insurance or other specific financial instruments.
- **Acceptance** implies a formal decision on operational risk acceptance by responsible decision body.

The overall accepted level of operational risk is managed by using the operational risk scaling matrix which is a combination of probability and impact of operational risk, and risk decision, in particular, the decision on mitigation or acceptance of operational risk identified through the specific instruments or in any decision which involves operational risk. Any decision on accepting operational risk should be based on adequately balanced risk, costs of mitigation and benefits.

The monitoring of the operational risk exposure implies a regular result analysis of identification and measurement (assessment) of operational risk and information on the operational risk control activities.

The Bank's Management Board is informed on operational risk through Quarterly Report on Operational Risk and Local Operational Conduct Committee is held at minimum on a quarterly basis.

Business Continuity Management ensures that selected critical business processes for the Bank are continuously available, also in case of emergency or crisis through measures, planned for these situations including required acts of preparing and preventively measures for avoidance of risks to reduce their probability and consequences.

### Capital Requirement

The Bank is using the standardized approach ("TSA") for the capital requirement calculation, according to the Title III of CRR, Article 317, the Group Members Erste Card Club and S-Leasing have started to apply TSA, while other members apply Basic indicator approach ("BIA") in accordance to the Article 315 of the same Title of CRR. The Bank provides the operational risk capital requirement in such a way that, constantly and on the Bank's individual level, provides the capital requirement amount for the operational risk which is adequate to the type, range and complexity of its services as well as to its operational risk exposure or possible exposure within its scope of services.

## 11. EXPOSURES IN EQUITY NOT INCLUDED IN THE TRADING BOOK

DISCLOSURE REQUIREMENTS COVERED: ART. 447 CRR

**Table 51: EU CR10 - IRB (equities)**

Categories	On-balance sheet amount	Off-balance sheet amount	Risk weight	Exposure amount	RWA	Capital requirements
Exchange-traded equity exposures	40	-	190%	40	76	6
Private equity exposures, listed	2	-	290%	2	7	1
Other equity exposures	120	-	370%	120	443	35
<b>Total</b>	<b>162</b>	<b>-</b>		<b>162</b>	<b>526</b>	<b>42</b>

**Table 52: Equity exposures in the Banking book**

Equity investments in banking book	Comparison	
	On balance sheet amount	Market value
Investments in credit institutions	-	
Unlisted, in sufficiently diversified portfolios	-	
Investments in financial institutions	<b>159</b>	
Unlisted, in sufficiently diversified portfolios	158	
Listed	1	1
Investments in non-financial institutions	<b>44</b>	
Unlisted, in sufficiently diversified portfolios	44	
Listed	-	-
Investments in other institutions	-	
Unlisted, in sufficiently diversified portfolios	-	

Quoted equity instruments are measured at fair value on the basis of quoted prices, and fair value of unquoted equity instruments is estimated using adequate proportion of price and earnings, that is proportion of price and cash flows reflecting specific considerations of the issuer.

Accounting measurements and policies are shown within Annual report published on the Bank's website.



## 12. CREDIT RISK MITIGATION TECHNIQUES

### EU CRC - DISCLOSURE REQUIREMENTS COVERED: ART. 453 CRR

Collateral represents secondary source of payment, while the primary source of payment is customer cash payment, Collaterals also represent the credit risk protection.

Credit protection are collaterals pursuant to which the Bank has the right to act against the collateral issues in order to reduce the loss due to borrower is going into default (according to Manual of the internal system of clients and placements allocation) or the loss due to borrower not settling any other obligation toward the Bank. In process of origination and changes during loan approval collaterals must be collected in accordance with relevant procedures and decisions form high level management.

The following types of collaterals are accepted:

- Real estate (commercial and residential)
- Financial collateral (securities and cash deposits)
- Guarantees (given mostly by states, banks and companies, all guarantees must have a minimum credit rating which is reviewed annually).

Amount and type of collateral depends on the assessment of the counterparty credit risk. Eligible collateral are those that are in accordance with Basel III regulation and are appropriate to reduce the capital requirements in the calculation of the required own funds of the Bank. Basel III regulation lays down minimum requirements for each type of credit protection. In Collateral Catalog is indicated which minimum requirements has to be fulfilled for eligible collateral.

For reducing the capital requirements the Bank uses:

- Material credit protection - properties (collaterals) owned by the collateral issuer which can be held by the Bank or sold by the Bank in the case borrower went into default or the borrower not settling any other obligation towards the Bank, or in the case of insolvency or bankruptcy of the borrower,
- Non-material credit protection - the amount of credit protection priory agreed, which the collateral owner will pay to the Bank in the case borrower went into default or the borrower not settling any other obligation towards the Bank, or in the case of insolvency or bankruptcy of the borrower.

Collateral revaluation is done periodically and is automated as far as possible.

Collateral coverage is determined by collateral acceptable value where the valuation rate for collateral category used is defined in Bank's internal acts. Collateral management policy is the high level document which, among others, prescribes:

- Definition and the role of collateral,
- Competencies and responsibilities in the Collateral management process,
- Standards for collateral valuation,
- Definition of effective rate,
- Eligibility of collateral.

Methods and conversion factor for collateral valuation are results of empirical research and experience in the liquidation of the collateral in Collection and Work-out Division which are based on collected data on the proceeds from the realization of collateral. Conversion factors are checked regularly, at least once per year, and are aligned with the realized collateral recovery.

In the financial reports, acceptable value of collateral is capped by the exposure volume.

## 12. CREDIT RISK MITIGATION TECHNIQUES (CONTINUED)

Determining the value of collateral and their subsequent valuation, according to types of collateral, are carried out in accordance with the internal generated rules and in accordance with regulatory requirements. Collateral valuation is based on current market prices with an amount that can be recovered within a reasonable period being taken into account.

Collateral revaluation is done periodically and is automated as far as possible.

For residential real estate value monitoring is performed with statistical methods. Previously determined real estate value is adjusted to market value considering trends in real estate market.

For those real estate which cannot undergo statistical valuation, either due to nature of the real estate or because of significant deviation compared to previous valuation or significant exposure toward to the client valuation is done for each particular real estate by a licensed appraiser.

For residential real estate revaluation has to be performed by authorized valuers at least every three years when the loan amount secured by a mortgage exceeds HRK 20 million. Between revaluations, once a year, monitoring process is done (desktop analysis).

For commercial real estate revaluation has to be performed by authorized valuator at least every three years, in between revaluations, once a year monitoring process is done.

Licensed appraisers:

- have to have the required qualification, competences and experience for determining the value of real estate,
- should not be involved in the credit approval process, nor should they be involved in real estate market transactions,
- should not have any legal or business relation with the borrower, nor should they have their own interest concerning real estate appraisal value.

Bank's authorized valuers are considered to be licensed appraisers and expert witnesses at Erste nekretnine d.o.o. and real estate valuers that are on the list of official Erste nekretnine d.o.o.

Erste nekretnine d.o.o. monitors authorized valuers who are not their employees. Acceptance of instruments as collaterals is estimated in the Collection and Work-out Division and approved by Risk department.

Internal policies and procedures are prescribing rules for accepting collateral, effective weight and monitoring and recording collateral values.

## 12. CREDIT RISK MITIGATION TECHNIQUES (CONTINUED)

**Table 53: EU CR3 - Credit risk mitigation techniques – overview**

		Exposure unsecured- Carrying amounts	Exposure to be secured	Exposure secured by collateral	Exposure secured by financial guarantees	Exposure secured by credit derivatives
1	Total loans	53,404	13,774	10,782	2,992	-
2	Total debt securities	9,764	-	-	-	-
3	<b>Total exposure</b>	<b>66,077</b>	<b>15,556</b>	<b>12,340</b>	<b>3,216</b>	<b>-</b>
4	of which defaulted	1,692	158	49	109	-

**Table 54: EU CR4 - Standardized approach – credit risk exposure and Credit Risk Mitigation (CRM) effects**

	Asset classes	Exposures before CCF and CRM		Exposure post CCF and CRM		RWA and RWA density	
		On balance	Off balance	On balance	Off balance	RWA	RWA density
1	Central governments or central banks	7,639	1	7,640	-	1,469	7,71
2	Regional government or local authorities	988	331	987	126	602	3,16
3	Public sector entities	2,490	8	232	2	86	0,45
4	Multilateral development banks	-	-	5	-	-	-
5	International organisations	-	-	-	-	-	-
6	Institutions	158	26	161	27	53	0,28
7	Corporates	3,005	1,647	2,566	612	3,081	16,17
8	Retail	4,161	1,873	4,153	381	3,401	17,84
9	Secured by mortgages on immovable property	897	-	897	-	345	1,81
10	Exposures in default	276	20	276	3	348	1,83
11	Higher-risk categories	-	-	-	-	-	-
12	Covered bonds	-	-	-	-	-	-
13	Institutions and corporates with a short term credit assessment	-	-	-	-	-	-
14	Collective investment undertakings	138	-	138	-	138	0,72
15	Equity	12	-	12	-	15	0,08
16	Other items	810	-	842	-	640	3,36
17	<b>Total</b>	<b>20,574</b>	<b>3,906</b>	<b>17,909</b>	<b>1,151</b>	<b>10,178</b>	

### 13. ASSET ENCUMBRANCE

#### DISCLOSURE REQUIREMENTS COVERED: ART. 443 CRR

In 2018 median for the asset encumbrance ratio for the Group amounts 11.12%, and individually for the Bank amounts 11.71%. The majority of the encumbered assets is result of the Bank's obligatory reserve. The Bank in Croatia is a typical commercial bank (credit institution) which as the most significant source of financing uses base of client's deposits, then deposits and loans from other financial institutions and owners as well as equity. The Bank as well as the Bank's owners provide financing sources also for local subsidiaries. That is the main reason for low level of encumbered asset. Also, it's a good indicator how the Bank and the Group sufficiently manage the financing sources and liquidity position. The low level of encumbered asset is also an indicator that the Bank and the Group enjoys the confidence of the market and clients, so up to now there was no significant need to encumber asset in order to maintain existing financing lines and ensure new ones.

The main sources of encumbered asset is obligatory reserve, pledge of asset to provide favorable financing sources and repo transactions. Obligatory reserve is a mandatory according to the CNB decision. In last two cases, pledged asset consists mostly of government debt securities and loans placements to government. The difference is in transaction maturity profile. In transactions where the pledge is used to provide favorable financing sources the asset is encumbered for a longer period according the validity of the agreed financing line, while at repo activities, the asset is encumbered with goal to optimize short term liquidity position or with the purpose to participate in the inter-bank market in order to achieve additional income in the short run. This practice of asset encumbrance is a common for the Group, especially for the Bank as well as for the local financial market.

**Table 55: Asset encumbrance – Form A – Asset**

Form A - Asset		Carrying amount of encumbered assets	Fair value of encumbered assets	Carrying amount of non-encumbered assets	Fair value of non-encumbered assets
		010	040	060	090
<b>010</b>	<b>Assets of the reporting institution</b>	<b>7,757</b>		<b>60,194</b>	
030	Equity instruments	-	-	280	280
040	Debt securities	1,220	1,220	8,969	8,991
120	Other assets	6,833		50,967	

**Table 56: Asset encumbrance – Form B – Collateral received**

Form B – Collateral received		Fair value of encumbered collateral received or own debt securities issued	Fair value of collateral received or own debt securities issued available for encumbrance
		010	040
<b>130</b>	<b>Collateral received by the reporting institution</b>	<b>-</b>	<b>1,949</b>
150	Equity instruments	-	26
160	Debt securities	-	1,923
230	Other collateral received	-	-
<b>240</b>	<b>Own debt securities issued other than own covered bonds or ABSs</b>	<b>-</b>	<b>-</b>

### 13. ASSET ENCUMBRANCE (CONTINUED)

**Table 57: Asset encumbrance – Form C – Encumbrance asset/collateral received and related obligation**

Form C – Encumbrance asset/collateral received and related obligation		Matching liabilities, contingent liabilities or securities lent	Assets, collateral received and own debt securities issued other than covered bonds and ABSs encumbered
		010	030
<b>010</b>	<b>Carrying amount of selected financial liabilities</b>	<b>990</b>	<b>7,757</b>

**14. COUNTERCYCLICAL BUFFER REQUIREMENTS****DISCLOSURE REQUIREMENTS COVERED: ART. 440 CRR**

The Group calculates countercyclical buffer requirements at consolidated level. As of 31 December 2018 only a very small number of jurisdictions (Hong Kong, Norway, Sweden, Czech Republic, Slovakia, United Kingdom, Lithuania and Island) applied countercyclical buffer rates of more than 0%, resulting in an overall countercyclical rate for the institution of 0%. The table below sets out the geographical distribution of credit exposures relevant for the calculation of the countercyclical buffer as well as the institutions specific countercyclical buffer rate for the Group as of 31 December 2018. The table detailing the distribution of credit exposure has been simplified by listing individually only those countries which have communicated countercyclical buffer rates other than zero. Other countries are grouped.

**Table 58: Geographical distribution of credit exposures relevant for the calculation of the countercyclical buffer as well as the institutions specific countercyclical buffer rate**

	General credit exposure		Trading book exposure		Securitization exposure		Own funds requirements				Own funds requirements weights	Countercyclical capital buffer rate
	Exposure value-SA	Exposure value-IRB	Sum of long and short position of trading book	Value of trading book exposure for internal models	Exposure value for SA	Exposure value for IRB	Of which: General credit exposures	Of which: Trading book exposures	Of which: Securitization exposures	Total		
Republic of Croatia	6,468	37,934	15	-	-	-	2,167	1	-	2,168	0.90	0.00%
Other European countries	2,833	301	-	-	-	-	171	-	-	171	0.07	0.00%
EU countries	531	120	-	-	-	-	40	-	-	40	0.02	0.00%
United states of America	18	104	-	-	-	-	30	-	-	30	0.01	0.00%
Other countries	13	7	-	-	-	-	1	-	-	1	0.00	0.00%
Norway	-	13	-	-	-	-	-	-	-	-	0.00	2.00%
Sweden	3	2	-	-	-	-	-	-	-	-	0.00	2.00%
Czech Republic	-	1	-	-	-	-	-	-	-	-	0.00	1.00%
Slovakia	-	-	-	-	-	-	-	-	-	-	0.00	1.25%
Hong Kong	-	-	-	-	-	-	-	-	-	-	0.00	1.875%
United Kingdom	14	3	-	-	-	-	1	-	-	1	0.00	0.50%
Island	-	-	-	-	-	-	-	-	-	-	0.00	1.25%
Lithuania	-	-	-	-	-	-	-	-	-	-	0.00	0.50%
<b>TOTAL</b>	<b>9,880</b>	<b>38,485</b>	<b>15</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>2,410</b>	<b>1</b>	<b>-</b>	<b>2,411</b>		

#### 14. COUNTERCYCLICAL BUFFER REQUIREMENTS (CONTINUED)

**Table 59: Institutions specific countercyclical capital buffer rate**

Total risk exposure amount	30,146
Institutions specific countercyclical capital buffer rate	0.0%
Institutions specific countercyclical buffer requirement	-

#### 15. REMUNERATION POLICY

##### DISCLOSURE REQUIREMENTS COVERED: ART. 450 CRR

The 2018 Remuneration Policy of ("the Policy") of the Group was updated in March 2018 in alignment with Erste Group Remuneration Policy valid for 2018. The Policy of Group was adopted by the Bank's Management Board, Remuneration Committee and Banks Supervisory Board, and is applied to the Bank and to the Group (includes companies consolidated by the Bank). In relation to 2017 Policy, there were no significant changes of policies and practices related to managing remuneration. Some changes were related to the harmonization with Erste Group policy after the recommendations to the Erste Group by joint supervisory team and other to regular update of certain chapters without influence to remuneration practices being used within Group (e.g. clearer definition of proceedings in case of contract termination).

The Bank founded the Remuneration Committee, the body of the Supervisory Board in charge of the decisions related to the Remuneration Policy and other activities as mentioned in Article 8 of Decision on Remuneration. Institutions which are part of the Group and which are not specified as material, do not have Remuneration Committees. The decisions related to the payment of variable remuneration and other decisions related to the implementation of Remuneration policies are made by their Supervisory Boards. The Bank's Remuneration committee had three meetings during 2018 and one made per rollam and was in charge of making decisions which were then sent to the Supervisory Board for final approval. These decisions were related to the payment of variable remuneration, adoption of updated Remuneration Policy, adoption of company targets and targets of the Member of the Management Board, approval of list of identified staff and other relevant decision.

The Remuneration Policy of the Group defines a framework of fixed and variable remuneration of employees on consolidated and sub consolidated level. Each company consolidated by the Bank has its own Remuneration Policy which is harmonized with the Banks Remuneration Policy. There is no difference between the policies and practices of individual companies related to the way identified staff are treated as well as other staff in general.

## 15. REMUNERATION POLICY (CONTINUED)

Supervisory Board is adopting and maintaining the basic principles of the remuneration policy, as well as supervising its appropriate implementation. Responsibilities and duties of the Supervisory Board listed in the Policy are aligned with Article no.5 of the Decision on Remuneration of the Croatian National Bank.

Design and execution of the Remuneration policy of each company of the Group is coordinated by the Bank's Human Resources (HR), together with legal, risk, compliance and controlling of each company.

Process of Key Performance Index (KPI) setting, i.e. performance and development system is coordinated by the Bank's HR with close cooperation with controlling and risk (especially related to setting company targets, targets of the Management Board and top management) of the Bank and each individual companies.

Malus and claw-back decisions are taken generally on a case by case basis by the Management Board, Human Resources and Compliance in case of identified staff who are not Board members and by the Remuneration Committee and Supervisory Board, in case of Management Board Members.

The identification of employees who are material risk takers in the Bank and individual companies of the Group is coordinated by the Bank's Human Resources in cooperation with business, legal, compliance and risk management functions of the Bank and each individual company.

Implementation of the Remuneration Policy is subject to internal audit at least once a year in order to ensure alignment with regulation, policies and procedures adopted by Supervisory Board.

Variable payments are related to the business success and paid for sustainable performance on the level of individual institution, Group of institutions (the Bank and companies which the Bank consolidates) and individual performance of the each employee. Criteria for determining and payment of variable remuneration are connected with target achievement within the regular annual cycle of performance and development management, and are defined by separate decisions and variable schemes as well as employment contract of identified staff. Variable payments can be awarded and paid only if such a payment is sustainable related to the financial situation of the Bank and the Group and justified related to the business performance as well as individual performance. In case such a payment is not sustainable or does not reflect the good performance, it will not be paid or will be retained.

The payment of variable remuneration must be related to:

- risks, capital, liquidity, performance and the probability, as well as the time needed for realization of the profit of the respective institution;
- the performance of the consolidated and single entity (Group and each institution separately);
- the performance of the business unit (department, division, institution) concerned, and
- the performance of the individual consisting of the achievement of agreed targets and the way these business targets have been achieved, including the individual's risk behavior according to Erste Group and Group strategy and policies.



## 15. REMUNERATION POLICY (CONTINUED)

One of the roles of the Supervisory Board is to make a decision, upon the recommendation of the Remuneration committee, on criteria that will be applied for determining bonus pool for each business year, for separate categories of employees. Evaluation of those criteria (minimum criteria are related to performance and long term sustainability) influences the percentage of bonus pool eligible for payout for a certain business year. The decision on the percentage is made after the closure of each business year. Therefore, the bonus pool determined first at the beginning of a business year is revised after the evaluation period and can vary from 0% to 120%. Bonus pool can be divided in few parts and different criteria could be used for different segments of employees, with minimum criteria being:

- Financial results;
- Capital adequacy ratio;
- Fulfilment of the annual strategic indicators according to the strategy review and budget dialogues; and
- The risk, capital, liquidity and the probability as well as the time needed for the realization of the profit.

The Remuneration Policy also defines the types of variable schemes which can be used in the Bank or other company of Group for variable remuneration. All employees are eligible to variable payment, in accordance with criteria defined in particular schemes and other conditions stipulated in the Remuneration Policy. When creating variable remuneration schemes, the companies of Group must ensure that cash and/or non-cash forms of variable remuneration do not promote behavior through which the employees could place their interests or company interests to the detriment of consumers.

The performance, as a basis for the payment of variable remuneration is measured by quantitative and qualitative goals. Quantitative goals are financial goals and other business specific goals, whereas qualitative goals for example are customer satisfaction, operational quality, compliance and similar. All categories of employees, including top management, have goals related to Erste Group competences, i.e. goals which define expected behavior standards.

The evaluation of performance for material risk takers is taking into considerations period longer than one year, in order to ensure that the process of evaluation is based on long term success. In accordance with that, 40% of variable pay of identified staff is deferred for the period of 3 to 5 years. The deferral period for members of the Bank's Management Board is 5 years, and for other Identified staff, the deferral period is 3 years. In case variable payment exceeds the total amount of 150 thousand EUR, the deferred amount is increased to 60%. Variable payment is paid in cash, and variable payment of identified employees is paid in cash and in instruments. The instrument to which 50% of variable remuneration is bound, are phantom shares of Erste Group Bank AG, the value of which is determined according to the average share price during the business year for which variable remuneration is granted. Phantom shares must be kept during the retention period of 1 year, which is the same for all material risk takers.

Besides phantom shares, there are no other instruments used for variable remuneration in Group.

## 15. REMUNERATION POLICY (CONTINUED)

Neither the Bank nor any company of Group will pay variable remuneration, or transfer the rights from instruments, including the deferred part of already granted instalments, if such a payment is not sustainable or justified. Variable payments are considered as sustainable if, in the period from their award until their payment is due, the financial standing of the Bank and Group is not endangered, stays secure and stable. Variable payments are considered as justified if their payment is based on the success of Group, individual institution, business unit and specific employee.

If an event of loss or substantial decrease in business results occurs, variable payments will be decreased by applying one of the measures defined by Article 37 of the Decision on remuneration.

Variable payments are subject to full decrease by activating the provisions on malus and claw back up to the amount of 100%.

The Bank or any other company of Group can apply malus or claw-back of any variable remuneration granted or paid within the last five years. Criteria for activating the provisions on malus and claw back are aligned with Decision on remuneration from the Croatian National Bank.

In the Group long-term incentive plans or uncommon rewarding practices are not used.

Maximum amount of variable remuneration applied in Group amounts to 100% of total fixed remuneration for identified staff and also all other staff. In 2018, the General Assembly did not make any decisions related to higher ratio of variable / fixed remuneration.

## 15. REMUNERATION POLICY (CONTINUED)

**Table 60: Information on remuneration for all staff**

	Supervisory function	Management Board Function	Investment Banking	Retail Banking	Asset Management	Corporate Function	Independent Control Function	Total
Number of employees (Headcount)	32	18						50
Total number of staff (FTE)			277	1,430	-	1,101	249	3,056
Total amount of remuneration	0.29	32.66	66.30	227.62	-	215.94	51.32	594.13
of which: total amount of variable pay	-	11.49	12.46	34.09	-	23.09	5.12	86.25

**15. REMUNERATION POLICY (CONTINUED)****Table 61: Information on remuneration for Identified Staff (MRTs)**

	Supervisory function	Management Board Function	Investment Banking	Retail Banking	Asset Management	Corporate functions	Independent Control functions	Total
Number of Identified Staff (Headcount)	32	18						50
Total number of Identified Staff (FTE)			7	9	-	43	13	72
Number of Identified Staff in senior management positions			6	8	-	42	12	68
Total amount of fixed pay (in HRK mil.)	0.29	21.17	3.67	4.53	-	17.83	5.27	52.76
<i>of which in cash</i>	0.29	21.17	3.67	4.53	-	17.83	5.27	52.76
<i>of which: senior management</i>	0.29	21.17	3.37	4.19	-	17.60	4.86	51.48
<i>of which: other identifies staff</i>	-	-	0.30	0.34	-	0.23	0.41	1.28
<i>of which in shares and shares-related instruments</i>								0
<i>of which in other non-cash instruments</i>								0
Total amount of variable pay (in HRK mil.)	-	11.49	1.90	1.89	-	5.20	1.35	21.83
<i>of which in cash</i>	-	5.93	1.10	1.15	-	3.51	0.99	12.68
<i>of which: senior management</i>	-	5.93	1.03	1.08	-	3.48	0.90	12.42
<i>of which: other identifies staff</i>	-	-	0.07	0.07	-	0.03	0.09	0.26
<i>of which in shares and shares-related instruments</i>	-	5.56	0.80	0.74	-	1.69	0.36	9.15
<i>of which: senior management</i>	-	5.56	0.8	0.74	-	1.69	0.36	9.15
<i>of which: other identifies staff</i>	-	-	-	-	-	-	-	-
<i>of which in other non-cash instruments</i>								-
Total amount of variable deferred pay*	-	5.94	0.64	0.60	-	1.36	0.28	8.82
<i>of which in cash</i>	-	2.97	0.32	0.30	-	0.68	0.14	4.41
<i>of which in shares and shares-related instruments</i>	-	2.97	0.32	0.30	-	0.68	0.14	4.41
<i>of which in other non-cash instruments</i>	-	-	-	-	-	-	-	-

\* only Board members and senior managers have deferred variable pay

**15. REMUNERATION POLICY (CONTINUED)****Table 62: Additional information on the total amount of variable pay (MRTs)**

	Supervisory function	Management Board Function	Investment Banking	Retail Banking	Asset Management	Corporate functions	Independent Control functions	Total
Total amount of outstanding deferred variable remuneration granted in previous years	-	8.22	0.54	0.42	-	1.50	0.22	10.90
<i>Total amount of outstanding deferred variable remuneration granted in previous years -vested parts</i>	-	1.59	0.17	0.13	-	0.41	0.07	2.37
<i>Total amount of outstanding deferred variable remuneration granted in previous years - non vested parts</i>	-	6.63	0.37	0.29	-	1.09	0.15	8.53
<i>Reduction of deferred payments from previous years based on performance adjustments</i>	-	-	-	-	-	-	-	0
<i>Number of employees who received guaranteed variable payments (sign-on bonus)</i>	-	-	-	-	-	-	-	0
<i>Total amount of guaranteed variable payments (sign-on bonus)</i>	-	-	-	-	-	-	-	0
<i>Number of employees who received severance payments due to early termination</i>	-	-	-	-	-	-	-	0
<i>Total amount of severance payments due to early termination</i>	-	-	-	-	-	-	-	0
<i>Highest severance payment to a single person due to early termination</i>	-	-	-	-	-	-	-	0
<i>Number of employees who received discretionary pension payments</i>	-	-	-	-	-	-	-	0
<i>Total amount of discretionary pension payments awarded</i>	-	-	-	-	-	-	-	0
<i>Total amount of variable remuneration awarded for multi-year periods under programmes which are not revolved annually</i>	-	-	-	-	-	-	-	0

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## 18. ABBREVIATIONS

ALCO – Asset Liability Management Committee  
ALM – Asset Liability Management  
AQR – Asset Quality Review  
CCF – Credit Conversion Factor  
CMLL – Calculated Maximum Lending Limit  
CRD IV – Capital Requirements Directive 2013/36 EU  
CRO – Chief Risk Officer  
CRR – Capital Requirements Regulation 575/2013  
EBA – European Banking Authority  
ECB – European Central Bank  
EGB – Erste Group Bank AG  
EVA – Economic Value Added  
ICAAP – Internal Capital Adequacy Assessment  
IFRS – International Financial Reporting Standards  
LGD – Loss Given Default  
LIP – Loss Identification Period  
OLL – Operating Lending Limit  
PD – Probability of Default  
PVBP – Price Value of a Basis Point  
QRD – Quantitative Research Department  
RAS – Risk Appetite Statement  
RbLL – Rating based Lending Limit  
SKDD – Central Depository and Clearing Company