HALKBANK A.D., BEOGRAD

Financial Statements
Year Ended December 31, 2017 and
Independent Auditors' Report

Translation of the Auditors' Report issued in the Serbian language

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Translation of the Auditors' Report issued in the Serbian language

INDEPENDENT AUDITORS' REPORT

To the Shareholders and Management of Halkbank A.D., Beograd

We have audited the accompanying financial statements of Halkbank A.D., Beograd (hereinafter: the "Bank") enclosed on pages 2 to 97, which comprise the statement of the financial position as of December 31, 2017 and the related income statement, statement of other comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes

Management's Responsibility for the Unconsolidated Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the International Financial Reporting Standards, as well as for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with the Law on Audit and standards on auditing applicable in the Republic of Serbia. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of Halkbank A.D., Beograd as at December 31, 2017, and its financial performance and cash flows for the year then ended in accordance with the International Financial Reporting Standards.

Report on Other Legal and Regulatory Requirements

Management is responsible for preparation of the annual business report in accordance with the requirements of the Law on Accounting of the Republic of Serbia. In accordance with the Law on Audit of the Republic of Serbia and Decision on Amendments and Supplements to the Decision on External Audit of Banks, it is our responsibility to express an opinion on the compliance of the Bank's annual business report for the year 2017 with the financial statements for the same financial year. In our opinion, the financial information disclosed in the Bank's annual business report for 2017 is consistent with its audited financial statements for the year ended December 31, 2017.

Other Matter

The Bank's financial statements as of and for the year ended December 31, 2016 were audited by another auditor, whose report dated March 6, 2017 expressed an unqualified opinion.

Belgrade, March 21, 2018

Deloitte d.o.o. BEOGRAD IV

Nataša Milojević

Nataša Milojević
Certified Auditor

STATEMENT OF FINANCIAL POSITION
As of December 31, 2017
(Thousands of RSD)

	Note	December 31, 2017	*Audited by another auditor* December 31, 2016
ASSETS			
Cash and balances held with the central bank	3.10, 14	4,839,851	4,090,612
Pledged financial assets	15a	-	90,000
Financial assets at fair value through profit and loss, held for trading	3.9.3, 15b	24,758	23,984
Financial assets available for sale	3.9.4, 15c	4,359,850	3,177,595
Financial assets held to maturity	3.9.2, 15d	472,892	1,353,325
Loans and receivables due from banks and other financial institutions	3.9.1, 16	1,524,613	1,018,760
Loans and receivables due from customers	3.9.1, 17	28,894,906	23,997,783
Intangible assets	3.7, 18a	98,947	73,976
Property, plant and equipment	3.5, 18b, 18c	817,842	818,446
Investment property	3.6, 18d	127,727	126,337
Deferred tax assets	3.12, 13c	62,393	62,393
Other assets	19	225,398	152,600
Total assets		**41,449,177**	**34,985,811**
LIABILITIES			
Deposits and other liabilities due to banks, other financial institutions and the central bank	20	6,277,751	2,938,019
Deposits and other liabilities due to customers	21	28,762,098	25,878,046
Provisions	2.7, 22	39,343	42,466
Other liabilities	23	250,278	243,695
Total liabilities		**35,329,470**	**29,102,226**
EQUITY			
Issued (share) capital	3.14, 24	4,248,483	4,248,483
Retained earnings	24	194,631	138,153
Reserves	3.14, 24	1,676,593	1,496,949
Total equity	24	**6,119,707**	**5,883,585**
Total liabilities and equity		**41,449,177**	**34,985,811**

Notes on the following pages form
an integral part of these financial statements.

These financial statements were adopted by the Executive Board of Halkbank A.D., Beograd on February 28, 2018.

Vesna Petrović	Erturk Sumer	Kenan Bozkurt
Head of the Financial Management and Planning Division	Member of the Executive Board	Chairman of the Executive Board

AKCIONARSKO DRUŠTVO HALKBANK II BEOGRAD

Translation of the Auditors' Report issued in the Serbian language

INCOME STATEMENT
Year Ended December 31, 2017
(Thousands of RSD)

	Note	2017	*Audited by another auditor* 2016
Interest income	3,1, 4a	1,754,993	1,604,833
Interest expenses	3,1, 4b	(265,688)	(259,871)
Net interest income		**1,489,305**	**1,344,962**
Fee and commission income	3,2, 5a	710,404	663,889
Fee and commission expenses	3,2, 5b	(106,059)	(87,333)
Net fee and commission income		**604,345**	**576,556**
Net gains on the financial assets held for trading	3,3, 6	2,015	11,646
Net gains on the financial assets available for sale	3,3, 7	4,270	-
Net foreign exchange gains and positive currency clause effects	3,4, 8	25,238	498
Other operating income	9	25,111	20,995
Net losses from impairment of financial assets and credit risk-weighted off-balance sheet assets	3.9.5, 10a	(269,765)	(389,289)
TOTAL OPERATING INCOME, NET		**1,880,519**	**1,565,368**
Staff cost	3.12, 11	(648,765)	(584,536)
Amortization and depreciation charge	3.5, 3.6, 3.7, 18	(151,567)	(106,915)
Other expenses	12	(885,556)	(737,837)
PROFIT BEFORE TAXES		**194,631**	**136,080**
Current income expenses	3.12, 13	-	-
Deferred tax benefits/(expenses)	3.12, 13	-	-
RESULT FOR THE YEAR – PROFIT	24	**194,631**	**136,080**
Basic/diluted earnings per share	24	**1,070**	**748**

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AKCIONARSKO DRUŠTVO
HALKBANK
II
BEOGRAD

Vesna Petrović	Erturk Sumer	Kenan Bozkurt
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STATEMENT OF OTHER COMPREHENSIVE INCOME
Year Ended December 31, 2017
(Thousands of RSD)

	2017	*Audited by another auditor* 2016
PROFIT FOR THE YEAR	**194,631**	**136,080**
Components of other comprehensive income which cannot be reclassified to profit or loss:		
Decrease in revaluation reserves arising from intangible investments and fixed assets	-	(3,206)
Actuarial (losses)/gains	(990)	4,146
Components of other comprehensive income which can be reclassified to profit or loss:		
Gains on changes in the fair value of financial assets available for sale	46,747	4,683
Reclassification from OCI to Profit and Loss in the moment of sale of available for sale securities	(4,270)	-
Total positive other comprehensive income for the year	**41,487**	**5,623**
TOTAL POSITIVE COMPREHENSIVE INCOME FOR THE YEAR	**236,118**	**141,703**

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AKCIONARSKO DRUŠTVO HALKBANK BEOGRAD

STATEMENT OF CHANGES IN EQUITY
Year Ended December 31, 2017
(Thousands of RSD)

	Share capital	Share premium	Reserves from profit and other reserves	Revaluation reserves	Retained earnings	Accumulated losses	Total equity
(2016 Audited by Another Auditor)							
Opening balance at January 1, 2016	**2,421,160**	**1,827,323**	**1,359,741**	**317,052**	**-**	**(185,467)**	**5,739,809**
Actuarial gains/(losses)	-	-	-	4,146	(1,133)	-	**3,013**
Profit for the year	-	-	-	-	136,080	-	**136,080**
Loss absorption	-	-	(185,467)	-	-	185,467	**-**
Sales of property, plant and equipment	-	-	-	(3,206)	3,206	-	**-**
Other comprehensive income:							
Gains on the fair value adjustment of financial assets available for sale	-	-	-	4,683	-	-	**4,683**
Disposal of property, plant and equipment	-	-	-	(3,206)	3,206	-	**-**
Actuarial losses	-	-	-	4,146	(1,133)		**3,013**
Balance at December 31, 2016	**2,421,160**	**1,827,323**	**1,174,274**	**322,675**	**138,153**	**-**	**5,883,585**
Opening balance at January 1, 2017	**2,421,160**	**1,827,323**	**1,174,274**	**322,675**	**138,153**	**-**	**5,883,585**
Actuarial losses, net	-	-	-	(990)	-	-	**(990)**
Profit for the year	-	-	-	-	194,631	-	**194,631**
Profit distribution	-	-	138,153	-	(138,153)	-	**-**
Other	-	-	4	-	-	-	**4**
Other comprehensive income							
Gains on the fair value adjustment of financial assets available for sale	-	-	-	42,477	-	-	**42,477**
Actuarial losses	-	-	-	(990)	-	-	**(990)**
Balance at December 31, 2017	**2,421,160**	**1,827,323**	**1,312,431**	**364,162**	**194,631**	**-**	**6,119,707**

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AKCIONARSKO DRUŠTVO HALKBANK BEOGRAD II

Translation of the Auditors' Report issued in the Serbian language

STATEMENT OF CASH FLOWS
Year Ended December 31, 2017
(Thousands of RSD)

	2017	*Audited by another auditor* 2016
Cash inflows from operating activities	**2,334,414**	**2,103,275**
Interest receipts	1,615,643	1,433,910
Fee and commission receipts	712,474	662,217
Receipts of other operating income	5,538	4,004
Dividend receipts and profit sharing	759	3,144
Cash outflows from operating activities	**(1,907,513)**	**(1,769,790)**
Interest payments	(245,085)	(283,866)
Fee and commission payments	(121,289)	(80,365)
Payments to, and on behalf of employees	(651,930)	(650,582)
Taxes, contributions and other duties paid	(142,180)	(122,546)
Payments for other operating expenses	(747,029)	(632,431)
Cash inflows from changes in loans, deposits received and other liabilities	**6,135,293**	**5,545,204**
Cash inflow from changes in financial assets initially recognized at fair value through profit or loss, financial assets held for trading and other securities not intended for investment	-	511,788
Cash inflow from changes in deposits and other liabilities due to banks, other financial institutions, central bank and customers	6,135,293	5,033,416
Cash outflows from changes in loans, deposits received and other liabilities	**(6,333,081)**	**(2,105,951)**
Cash outflows from changes in loans and receivables due from banks, other financial institutions, central bank and customers	(6,332,272)	(2,105,951)
Cash outflows from financial assets initially recognized at fair value through profit or loss, financial assets held for trading and other securities not intended for investment	(809)	-
Net cash generated by operating activities before profit tax	**229,113**	**3,772,738**
Cash inflows from investing activities	**3,539,514**	**5,126,244**
Inflow from investments in investment securities	3,510,981	5,099,045
Inflow from sales of investments in subsidiaries and associates and joint ventures	-	20,109
Inflow from sale of intangible assets, property, plant and equipment	28,533	7,090
Cash outflows from investing activities	**(3,775,070)**	**(5,781,285)**
Outflow from investments in investment securities	(3,619,533)	(5,463,125)
Outflow from purchases of intangible assets, property, plant and equipment	(155,537)	(318,160)
Net cash used in investing activities	**(235,556)**	**(655,041)**
Cash inflows from financing activities	**2,427,371**	**-**
Inflows from borrowings	2,427,371	-
Cash outflows from financing activities	**(1,909,824)**	**(2,762,096)**
Outflows per subordinated borrowings	-	(1,842,216)
Outflows for repayment of borrowings	(1,909,824)	(919,880)
Net cash generated/(used in) by financing activities	**517,547**	**(2,762,096)**
TOTAL CASH INFLOWS	**14,436,592**	**12,774,723**
TOTAL CASH OUTFLOWS	**(13,925,488)**	**(12,419,122)**
NET INCREASE IN CASH	**511,104**	**355,601**
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE YEAR	**2,883,213**	**2,509,121**
Foreign exchange gains	**88,644**	**110,946**
Foreign exchange losses	**(180,227)**	**(92,455)**
CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR	**3,302,734**	**2,883,213**

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NOTES TO THE FINANCIAL STATEMENTS
December 31, 2017
All amounts expressed in thousands of RSD, unless otherwise stated.

1. BANK'S ESTABLISHMENT AND ACTIVITY

1.1.1. Establishment

Halkbank a.d. Beograd, formerly known as Čačanska banka, has been operating since July 1, 1956, and during its operations and development it has changed its legally-registered name and organizational form several times. As part of the overall restructuring of the Yugoslav banking system in 1990, the Bank was reorganized into a shareholding entity. In accordance with the Law on Banks and Other Financial Institutions and Decision of National Bank of Yugoslavia on Establishment of Banks, the Bank was registered as Beogradska banka Čačanska banka d.d., Čačak with the Commercial Court in Kraljevo on December 28, 1990. On July 13, 1995, the Bank's Shareholder Assembly adopted the Statute of Beogradska banka Čačanska banka, and thereby aligned its bylaws and enactments with the provisions of the Law on Banks and Other Financial Institutions. Pursuant to its Statute, Beogradska banka, Čačanska banka was formed as a legal entity with rights, obligations and responsibilities defined by the Law and its Articles of Association.

During 1999 and until the end of October 2000, the Bank operated as a branch office of Beogradska banka a.d., Beograd, after the merger and acquisition conducted under the Decision of the Commercial Court in Belgrade dated April 8, 1999. Based on the Court Decision dated November 2, 2000, the registration of the status change of merger and acquisition was found null and void and was deleted *ex officio*. From July 23, 2001, the Bank was registered and operated under the name of Čačanska banka a.d., Čačak.

In May 2015, Turkiye Halk Bankasi AS became the majority owner of Čačanska banka. The change of ownership caused the change of the Bank's name and headquarters. The new name of the Bank is Halkbank a.d. Beograd (hereinafter: the "Bank").

During 2017, there were further significant changes in the structure of equity of Halkbank a.d. Belgrade. On August 24, 2017 the majority owner, Turkiye Halkbankasi AS purchased on the Stock Exchange,18,200 ordinary Bank's shares, and then through the Share Takeover Bid, approved by the Securities Commission, in the period from September 7 to September 27, 2017, acquired additional 6,118 ordinary Bank's shares. After the completed Share Takeover Bid, on November 15, 2017, the majority shareholder conducted the squeeze-out purchase of shares from the remaining shareholders, so that on December 31, 2017, it owned 99.88% of ordinary shares, i.e., 99.89% of the Bank's total share capital (December 31, 2016: 76.75% of ordinary shares, or 82.47% of the Bank's total share capital).

The Bank was registered with the Serbian Business Registers Agency under number BD 54244 as of September 13, 2005.

1.1.2. Activities

The Bank is registered in the Republic of Serbia for payment, credit and deposit activities in the country and abroad and it operates in accordance with the Law on Banks.

The Bank's head office is in Belgrade, at the address of no. 9e, Milutina Milankovica Street, as registered with the Business Registers Agency under number BD 82129/2016 on October 19, 2016.

As of December 31, 2017, the Bank's network consisted of 23 branches (2016: 20 branches), as follows: Belgrade (7 branches), Čačak (2 branches), Jagodina, Gornji Milanovac, Kraljevo, Užice, Kragujevac, Kruševac, Aranđelovac, Valjevo, Šabac, Niš, Novi Sad, Pančevo, Novi Pazar, and Subotica. The Bank also had 9 sub-branches (2016: 8 sub-branches) in Paraćin, Požega, Topola, Ivanjica, Vrnjačka Banja, Leskovac, Mladenovac, Čačak and Tutin.

During 2017 the Bank opened three new branches, in Belgrade (in Makedonska Street), in Zemun (in Gospodska Street) and in Subotica (in Štrosmajerova Street) and one sub-branch in Tutin.

As at December 31, 2017 the Bank had 435 employees (2016: 411 employees). The Bank's tax identification number is 100895809.

2. BASIS OF PREPARATION AND PRESENTATION OF THE FINANCIAL STATEMENTS AND ACCOUNTING CONVENTION

2.1. Basis of Preparation and Presentation of Financial Statements

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

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

These financial statements were prepared at historical cost principle, except for the measurement of the following significant balance sheet items:

- financial assets available for sale stated at fair value;
- derivative financial instruments stated at fair value; and
- financial assets and liabilities held for trading stated at fair value.

Historical cost is generally based on the fair value of consideration paid in exchange for goods and services.

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

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

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

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

The Bank's financial statements are stated in thousands of dinars unless it is otherwise stated. Dinar (RSD) is the official presentation currency in the Republic of Serbia.

2. BASIS OF PREPARATION AND PRESENTATION OF THE FINANCIAL STATEMENTS AND ACCOUNTING CONVENTION (Continued)

2.2. Initial Application of New Amendments to the Existing Standards Effective for the Current Reporting Period

The following new amendments to the existing standards issued by the International Accounting Standards Board (IASB) have been effective over the current reporting period:

- Amendments to IAS 7 “Statement of Cash Flows” – Disclosure Initiative (effective for annual periods beginning on or after January 1, 2017);
- Amendments to IAS 12 “Income Taxes” - Recognition of Deferred Tax Assets for Unrealized Losses (effective for annual periods beginning on or after January 1, 2017); and
- Amendments to IFRS 12 due to “Improvements to IFRSs (cycle 2014-2016)” resulting from the annual improvement project of IFRS (IFRS 1, IFRS 12 and IAS 28) primarily with a view to removing inconsistencies and clarifying wording (amendments to IFRS 12 are to be applied for annual periods beginning on or after January 1, 2017).

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

2.3. New Standards and Amendments to the Existing Standards in Issue not yet Adopted

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

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

2. BASIS OF PREPARATION AND PRESENTATION OF THE FINANCIAL STATEMENTS AND ACCOUNTING CONVENTION (Continued)

2.3. New Standards and Amendments to the Existing Standards in Issue not yet Adopted (Continued)

The Bank's management has elected not to adopt these new standards, amendments to existing standards and new interpretations in advance of their effective dates. The management anticipates that the adoption of these standards, amendments to existing standards and new interpretations will have no material impact on the Bank's financial statements in the period of initial application except for the impact of the first-time adoption of IFRS 9, as disclosed in Note 2.7. Furthermore, the quantitative effects of application of IFRS 16 will be determined in 2018.

2.4. Comparative Information

Comparative information in the accompanying financial statements comprise the data from the Bank's financial statements for 2016.

The Bank presented borrowings obtained from the International Financial Institutions in 2017 (from GGF and EFSE), which were not approved with mediation of the National Bank of Serbia (hereinafter: the "NBS") within the line item of deposits and other liabilities due to banks, other financial institutions and the central bank. In this respect, and for comparability of the 2016 figures, all the borrowings received directly from the International Financial Institutions without mediation of NBS, were reclassified from the item of deposits and other liabilities due to customers to deposits and other liabilities due to banks, other financial institutions and the central bank in the total amount of RSD 223,006 thousand.

2.5. Statement of Compliance

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

2.6. First-Time Adoption of IFRS 9

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

The Bank did not apply provision of IFRS 9 to the earlier financial reporting periods. Effects of adjustments of the financial assets and liabilities' carrying values as of the Standard's first-time adoption date were recognized within retained earnings as the 2018 opening balance adjustment.

(a) Classification of Financial Assets and Liabilities

In accordance with IFRS 9 classification and measurement of financial assets depend on the following two main criteria:

- Business model based on which the Bank manages a financial asset; and
- Characteristics of the contractual cash flows of a financial assets (the so-called SPPI criterion).

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

2. BASIS OF PREPARATION AND PRESENTATION OF THE FINANCIAL STATEMENTS AND ACCOUNTING CONVENTION (Continued)

2.6. First-Time Adoption of IFRS 9 (Continued)

(a) Classification of Financial Assets and Liabilities (Continued)

- Hold to collect cash flows,
- Hold to collect cash flows and to sell, and
- Other business models (e.g. hold for sales).

Financial assets may be reclassified only as a result of change in business model. Reclassification is made prospectively, from the date of reclassification, i.e., as of the first day of the reporting period following the change in a business model. The Bank does not expect frequent changes of its business models.

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

Based on the performed analysis of the business models and characteristics of the contractual cash flows, as from January 1, 2018 the Bank will classify all is financial assets into the following categories:

- Financial assets at amortized cost;
- Financial assets at fair value through other comprehensive income (FVTOCI); and
- Financial assets through profit or loss (FVTPL).

The Bank has had no changes in the manner of classification and measurement of financial liabilities under IFRS 9 against classification and measurement under IAS 39. Changes in classification of financial liabilities are not applicable for the Bank.

(b) Impairment of Financial Assets under IFRS 9

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

Expected credit losses are recalculated at each reporting date in order to reflect changes occurred in the credit risk since the initial recognition of the financial instrument. Such an approach results in earlier identification of credit losses as it is necessary to recalculate expected losses over a 12-month period for all credit risk exposures With no significant increase in credit risk since the initial recognition. It is necessary to recalculate lifetime expected credit losses for all exposures which show deterioration in creditworthiness since the initial recognition.

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

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

2. BASIS OF PREPARATION AND PRESENTATION OF THE FINANCIAL STATEMENTS AND ACCOUNTING CONVENTION (Continued)

2.6. First-Time Adoption of IFRS 9 (Continued)

(b) Impairment of Financial Assets under IFRS 9 (Continued)

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

- Stage 1 includes all new financial assets at initial recognition and instruments without significant credit quality deterioration since their initial recognition or instruments within the low credit risk category;
- Stage 2 includes financial instruments with significant credit quality deterioration since their initial recognition yet with no objective evidence of impairment;
- Stage 3 includes financial instruments where objective evidence of impairment exists at the reporting date, including Purchased or Originated Credit Impaired Assets (POCI) (asset impaired at initial recognition).

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

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

Identification of one or more of the following impairment triggers may indicate a significant credit risk deterioration:

- Continuous delay in settlement of 30 days as at the given date;
- Account blockade of 30 days without interruption as at the given date;
- FBE PE status;
- Indebtedness: aggregate liabilities (long-term + short-term)/equity >1 and simultaneous changes in sales, i.e., a fall of income of over 30%; and
- Indebtedness: aggregate liabilities (long-term + short-term)/equity >1 and simultaneous maturity mismatch (current assets - current liabilities) < 1 as well as inadequate cash flows (operating cash flows – short-term financial liabilities) <1.

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

Once an asset is designated as POCI it will remain POCI until the end of its life. Upon initial recognition of a POCI asset, the Bank does not record future expected credit losses given that they are reflected in the asset's fair value (at which such assets are initially recognized) as well as in the calculation of the credit-adjusted effective interest rate. Moreover, for the purposes of impairment allowance calculation, such assets will remain within Stage 3 over their entire life cycles, i.e., lifetime expected credit losses will be calculated.

Positive changes in the lifetime expected credit losses of the instrument are recognized as gains on the impairment of instruments if the expected credit loss in lower than the amount of expected credit losses included in the estimated cash flows upon initial recognition.

2. BASIS OF PREPARATION AND PRESENTATION OF THE FINANCIAL STATEMENTS AND ACCOUNTING CONVENTION (Continued)

2.6. First-Time Adoption of IFRS 9 (Continued)

(b) Impairment of Financial Assets under IFRS 9 (Continued)

Based on the analysis performed up to these financial statements' preparation date, the total estimated effect of the first-time adoption of IFRS 9 amounted to approximately RSD 125, 000 thousand as of January 1, 2018 as result of increase in impairment of the financial assets by the said amount.

Differences in the carrying amounts of the financial assets arising from the first-time adoption of IFRS 9 will be recognized within equity as of January 1, 2018.

The first-time adoption of IFRS 9 as of January 1, 2018 cannot have an effect on the capital adequacy ratio in terms of its decrease given that the Bank will adjust an item that is not included in the regulatory capital for the effects of the standard's first-time adoption. The capital adequacy ratio may slightly rise due to the consequent decrease in the risk-weighted assets and mild rise of the regulatory capital caused by reduced required reserve for estimated losses on the balance sheet assets and off-balance sheet items.

The above stated estimate is preliminary as activities on finalizing the standard's implementation are still ongoing throughout the Bank. The actual effect of IFRS 9 first-time adoption as of January 1, 2018 may vary from the estimated one due to the following facts:

- after becoming operational, the new system for provisioning calculation will require an expected stabilization period;
- new accounting policies, assumptions and estimates may be subject to certain modifications up to the time of completion of the Bank's next financial statements, which will include the date of IFRS 9 first-time adoption.

2.7. Significant Accounting Estimates and Judgments

Preparation and presentation of the financial statements requires the Bank’s management to make the best estimates and reasonable assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, as well as income and expenses for the reporting period.

These estimations and related assumptions are based on information available as of the preparation date of the financial statements.

The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are addressed below.

Impairment of Financial Assets

In accordance with its internal bylaws, the Bank assesses, at the end of each reporting period, whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is impaired, and impairment losses are incurred, if and only if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a “loss event“) and that loss event has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated. Concerning the loss assessment due to loan impairment, the Bank reviews its loan portfolio at least on a quarterly basis, in order to assess impairment.

In determining whether an impairment loss should be recorded in the income statement, the Bank makes judgments as to whether there is any reliable evidence indicating that there is a measurable decrease in estimated future cash flows from a loan portfolio before the decrease can be identified for individual loans in that portfolio.

The evidence could include available data indicating adverse changes in respect of the customer’s ability to settle its liabilities toward the Bank in a timely manner.

2. BASIS OF PREPARATION AND PRESENTATION OF THE FINANCIAL STATEMENTS AND ACCOUNTING CONVENTION (Continued)

2.7. Significant Accounting Estimates and Judgments (Continued)

Impairment of Financial Assets (Continued)

The Bank's management makes estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those of the portfolio, at the time of projecting its future cash flows. The methodology and assumptions used for estimating both the amount and timing of the future cash flows are reviewed on a regular basis in order to reduce any differences between the estimated and actual losses (Notes 10b, 16, 17).

Useful Lives of Intangible Assets, Property, Plant and Equipment

The determination of the useful lives of intangible assets, property and equipment is based on historical experience with similar assets as well as on any anticipated technological development and changes influenced by wide range of economic or industry factors. The appropriateness of the estimated useful lives is reviewed annually, or whenever there is an indication of significant changes in the underlying assumptions (Note 18).

Impairment of Non-Financial Assets

As of the reporting date, the Bank's management reviews the carrying amounts of the Bank's intangible assets and property, plant and equipment presented in the financial statements. If there is any indication that such assets have been impaired, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss. If the recoverable amount of an asset is estimated to be less than its carrying value, the carrying amount of the asset is reduced to its recoverable amount (Note 18).

Provisions, Contingent Liabilities and Contingent Assets

Provisions are recognized if, as a result of a past event, the Bank has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. In order to be maintained, the best possible estimates are considered, determined and, if necessary, adjusted at each reporting date.

When the outflow of the economic benefits is no longer probable in order to settle legal or constructive liabilities, provisions are reversed through profit and loss. Provisions are monitored per type and they can be used only for the expenses they were initially recognized for. Provisions are not recognized for future operating losses.

Contingent liabilities are not recognized in the financial statements. Contingent liabilities are disclosed in the notes to the financial statements, unless the probability of an outflow of resources containing economic benefits is very remote (Note 22).

Contingent assets are not recognized in the financial statements. Contingent assets are disclosed in the notes to the financial statements, when an inflow of economic benefits is probable.

Provisions for Litigations

The Bank is involved in a number of legal proceedings arising from daily operations that relate to commercial, contractual and labor disputes, which are resolved and considered in the course of regular business activities. The Bank regularly estimates the probability of negative outcomes of these matters, as well as the amounts of probable or reasonably estimated losses.

Reasonable estimates include judgments made by management, after considering information including notifications, settlements, estimates performed by the Legal Department, available facts, identification of other potentially responsible parties and their ability to contribute as well as prior experience.

2. BASIS OF PREPARATION AND PRESENTATION OF THE FINANCIAL STATEMENTS AND ACCOUNTING CONVENTION (Continued)

2.7. Significant Accounting Estimates and Judgments (Continued)

Provisions for Litigations (Continued)

A provision for litigation is recognized when it is probable that an obligation exists and a related outflow of resources will occur (probability of a negative outcome higher than 50%), for which a reliable estimation can be made. Accordingly, when there is an expectation that the outcome of the dispute may be negative for the Bank, a provision is made in the amount of the estimated expenditure required to settle the obligation as of the statement date. Provisions are estimated on quarterly basis. The required provision may change in the future due to occurrence of new events or obtaining additional information.

Deferred Tax Assets

Deferred tax assets are recognized for unused tax losses to the extent that it is probable that expected future taxable profit will be available against which the unused tax losses can be utilized. The Bank's management necessarily makes significant estimates in order to determine the amount of deferred tax assets that can be recognized, based on the period of occurrence, the amount of future taxable profit and strategy of tax planning policy.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

3.1. Interest Income and Expenses

Interest income and expenses, including penalty or default interest and other income and other expenses from interest bearing assets, as well interest bearing liabilities are calculated and recognized in the income statement on an accrual basis using effective interest method.

For all interest-bearing financial instruments, except those financial instruments at fair value through profit or loss, interest income and expenses are recognized within the income statement using the effective interest rate method. Interest income and interest expenses include calculated discount/premium for financial instruments held to maturity and available for sale.

The loan origination fee, which are charged, collected or paid on a one-time basis in advance, are deferred and amortized over the life of the loan using the effective interest method.

In accordance with its accounting policies, the Bank ceases to recognize income from accrued regular interest in the following cases:

- when a decision has been made on instigation of a bankruptcy procedure over the borrower;
- when a decision on instigation of court proceedings for collection of receivables from the borrower has been made;
- when decision on derecognition of income from accrued interest has been made by the Bank's competent board or when other circumstances, which aggravate the collection of receivables, have been identified;
- when the borrower, a legal entity or an entrepreneur, is over 150 days past due in liability settlement.

After identification of objective evidence of impairment and the recognition of the impairment, interest income on these receivables is calculated by applying the effective interest rate to the net basis, i.e., by applying the rate of interest used to discount future cash flows for the purpose of measurement of impairment losses.

In order to determine the full amount of interest receivables, the Bank continues to calculate interest, however thus calculated interest is not recognized as interest income but recorded as an off-balance sheet item.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.1. Fee and Commission Income and Expenses

Fees and commissions originating from banking services are generally recognized as per the matching principle, on an accrual basis, at the time of occurrence or maturity for collection, except for fees and commissions for approval of guarantees and other warranties, which are initially recognized as deferred income and subsequently transferred to P&L on a proportional basis which is aligned with the stipulations of the guarantees, warranties and letter of credit agreements.

Fee and commission income mainly comprises fees for services rendered in the domestic and international payment transfers, issue of guarantees and letters of credit and other banking services.

Fee and commission expenses mostly relate to fees for transactions of domestic and international payment operations and other services and are recorded upon service rendering.

3.2. Dividend Income

Dividend income from investments in equity instruments is recognized as income when the shareholder's right to receive payment is established, i.e., at the moment when the dividend is received.

3.3. Foreign Exchange Translation

Transactions denominated in foreign currencies are translated into dinars at the official middle exchange rate of the National Bank of Serbia effective as at the transaction date.

Assets and liabilities denominated in foreign currencies at the reporting date are translated into dinars at the official middle exchange rate of the National Bank of Serbia effective as at the reporting date.

Net foreign exchange effects arising upon performance of transactions in foreign currencies and upon translation of the assets and liabilities denominated in foreign currencies are recognized as foreign exchange gains or losses, in accordance with IAS 21 – "The Effects of Changes in Foreign Exchange Rates".

Gains and losses arising from embedded derivatives in financial assets or liabilities, in cases of annuity is connected for the dinar exchange rate to foreign currency are recognized as income or expenses from change in fair value.

Commitments and contingent liabilities denominated in foreign currencies are translated into dinars at the official middle exchange rate of the National Bank of Serbia effective as at the reporting date.

3.4. Property, Plant and Equipment

Building property is initially measured at cost or at purchase price. Cost includes expenditure that is directly attributable to the acquisition of assets.

Subsequent costs are included in the asset's carrying amount or are recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Bank and the cost of the item can be measured reliably. All other repairs and maintenance costs are recognized as expenses in the income statement of the financial period in which they are incurred.

Valuation of buildings after the initial recognition is performed using the revaluation model stipulated by IAS 16 – "Property, Plant and Equipment", buildings are stated at revalued amounts less any subsequent accumulated depreciation and subsequent accumulated impairment losses.

Assessment of revalued amounts and useful life of buildings is carried out at least once every three years by an independent certified appraiser (expert valuer in civil engineering).

Assessment of the building property market value/impairment was performed by an independent certified appraiser as of December 31, 2015.

NOTES TO THE FINANCIAL STATEMENTS
December 31, 2017
All amounts expressed in thousands of RSD, unless otherwise stated.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.4. Property, Plant and Equipment (continued)

Plant and equipment are initially measured at cost, less accumulated depreciation and impairment losses and subsequently measured at cost less accumulated depreciation and impairment losses, if any.

Depreciation is calculated on a straight-line basis to the cost or revalued amount of each part of an item of property, plant and equipment in order to fully write off the cost of assets over their estimated useful lives in accordance with the Bank's Rulebook on Amortization of Intangible Assets and Depreciation of Property, Equipment and Investment Property.

At each year-end, the Bank internally reviews the carrying amounts of its buildings in order to determine if there are indications that there have been any impairment losses. If there are such indications, the Bank assesses the recoverable amounts of such assets in order to determine impairment loss amounts, if any.

The following depreciation rates were used in 2017 and were not changed compared to the rates used in 2016:

Buildings	2.50%
Investment property	2.50%
Leasehold improvements	16.67% - 20.00%
Computer equipment	20.00%
Furniture and other equipment	16.67% - 33.33%

3.5. Investment Property

Investment property is property held by the Bank for the purpose of lease and it is accounted for in accordance with IAS 40 – "Investment Property".

Investment property is initially measured at cost or purchase price. After initial recognition, the Bank measures its investment property at cost less the accumulated depreciation.

Depreciation of investment property is calculated using the straight-line method over an estimated life of investment property, in accordance with the Bank's internal bylaws. Depreciation of investment property is carried out over the period of 40 years, using a depreciation rate of 2.5%.

At each year-end, the Bank internally reviews the carrying amounts of its investment properties in order to determine if there are indications that there have been any impairment losses. If there are such indications, the Bank assesses the recoverable amounts of such assets in order to determine impairment loss amounts, if any.

3.6. Intangible Assets

As at December 31, 2017, the Bank's intangible assets were stated at cost less accumulated amortization and accumulated impairment losses. Such items are subsequently carried at cost less any accumulated depreciation and amortization and impairment losses. Intangible assets comprise licenses, patents and software.

Amortization is calculated using the straight-line method to the cost of intangible assets over the agreed period of use of such assets or their estimated useful lives unless a period of use is agreed. Most commonly those are periods from 3 to 5 years.

3.7. Leases

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards associated with ownership of that asset. In other cases, the Bank has operating lease arrangements.

The Bank appears both as the lessor and lessee (only in operating leases).

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.7. Leases (Continued)

When the Bank is an operating lease lessor, the leased asset continues to be recognized in the Bank's books and depreciation is calculated during its estimated useful life.

Income from the leased asset is recognized as other income on a straight-line basis over the period of the lease.

When the Bank appears as a operating lessee, the Bank does not recognize the asset leased as an asset but recognizes the lease payments within other expenses, using a straight-line basis over the period of the lease.

3.8. Financial Instruments

All financial instruments are initially recognized at fair value increased by transaction costs directly attributable to the acquisition or issue of a financial asset or liability, except for financial assets and financial liabilities at fair value through profit or loss.

Financial assets and financial liabilities are recorded in Bank's statement of financial position at the date upon which the Bank becomes a party to the contractual provisions of a specific financial instrument. All purchases and sales of financial assets are recognized on the settlement date, which is the date the asset is delivered to the counterparty.

Derecognition of Financial Assets and Financial Liabilities

Financial Assets

A financial asset (or, where applicable, part of a financial asset or part of a group of similar financial assets) is derecognized when:

- the rights to receive cash flows from the asset have expired; or
- the Bank has transferred its rights to receive cash flows from the asset or has assumed an obligation to pay the received cash flows in full without material delay to a third party under a pass-through arrangement; and
- either the Bank has transferred substantially all the risks and benefits of the asset, or has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

When the Bank has transferred its rights to receive cash flows from an asset or has entered into a pass-through arrangement, and has neither transferred nor retained substantially all the risks and rewards of the asset, nor transferred control of the asset, the asset is recognized to the extent of the Bank's continuing involvement in the asset. Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Bank could be required to repay.

Financial Liabilities

A financial liability is derecognized when the obligation underlying the liability is discharged or cancelled or has expired. Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognized in the profit or loss.

3.9.1 Loans and Receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.9. Financial Instruments (Continued)

3.9.1 Loans and Receivables (Continued)

All loans and receivables originated by the Bank are recognized in the statement of financial position in the amount of gross amortized cost less the individual allowances for impairment. Gross amortized costs represent total receivables from the Bank's customers (including principal outstanding, nominal interest, penalty interest, receivables for fees and other receivables) adjusted by the amount of unamortized fees.

Individual allowances for impairment and provisions represent decreased value of assets (collectable amounts) below the carrying amounts, caused by increase in the credit risk of such assets, leading to negative changes in expected cash flows from such assets.

By recording individual allowance for impairment as an expense, the Bank indirectly decreases the value of loans and receivables when there is objective evidence of uncertainty of collection, as a result of one or more events (loss event) that occurred after the initial recognition of an investment, and such a loss event affects the estimated future cash flows.

Loss events may be identified at the moment when:

- the borrower is over 90 days past due or
- another loss event has occurred.

RSD loans and receivables with contracted currency clause, are revalued in accordance with the particular contract executed for each loan. The difference between the nominal value of the outstanding principal and the revalued amount is recorded within the underlying financial instrument.

The Bank performs accounting write-off of balance sheet assets of low recoverability and general release of debt as follows:

Accounting write-off of balance sheet assets of low recoverability entails transfer of the balance sheet assets to the off-balance sheet items, where the balance sheet assets represent non-performing loans and other doubtful receivables. The accounting write-off does not entail the Bank's waiver of its legal and contractual rights and collection of these receivables, but merely an accounting procedure of write-off from the balance sheet assets, with the continued recording of such loans and receivables within the Bank's off-balance sheet items and continued collection activities undertaken by the Bank. The Bank performs the accounting write-off balance sheet assets of low recoverability when the calculates impairment of such loans and receivables calculated and credited by the Bank to impairment allowance equals 100% of the gross carrying amount of such loans and receivables, i.e., if they are fully impaired. Accounting write-off is carried out at least quarterly.

General release of debt may be performed in the event that the Bank permanently waives collection of and releases receivables due from a debtor based on the settlement (agreement) with the debtor/co-debtors, final court ruling, writ of execution (court ruling or decision), decision of the Bank's competent body or based on assignment of debts causing termination of rights to further collection. In such instances, all the Banks' receivables are derecognized from the Bank's on-balance and off-balance item records. Before general debt release the Bank may but need not perform write-off of such loans and receivables.

3.9.2 Financial Assets Held to Maturity

Held-to-maturity assets are non-derivative financial assets with fixed or determinable payments and fixed maturity that the Bank has intention to hold to maturity quoted on an active market (except for assets classified as loans and receivables).

Financial assets held to maturity include Treasury bills of the Republic of Serbia and government bonds of the Republic of Serbia quoted on an active market. Shares cannot be classified in this category since these financial assets have no maturity date.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.9. Financial Instruments (Continued)

3.9.2 Financial Assets Held to Maturity (Continued)

Upon initial recognition, financial assets held to maturity which include fair value increased by transaction costs, are measured at amortized cost using the effective interest method. Transaction costs that may be attributable to the purchase of the financial asset are included in amortized cost by applying the effective interest method, i.e., they are amortized through the income statement over the instrument's life. The effective interest method entails calculation of amortized cost by applying the market effective interest rate and distribution of interest income over the relevant period.

Subsequent measurement of changes in the amortized cost of these assets is performed each day when interest for such assets is due, as determined by the relevant contract, as well as on the last day of each month during the year.

Gains and losses from the changes in value of financial assets arising from changes in RSD exchange rate (if the asset is denominated in a foreign currency or in RSD with a currency clause index) are also recognized in the income statement, as income and expenses.

3.9.3 Financial Assets at Fair Value through Profit or Loss Held for Trading

Financial assets at fair value through profit or loss represent assets that are classified as held for trading, which assumes that they were acquired for sale or repurchase in the near future, with the aim to earn a profit from short-term price fluctuations and/or dealer's margin.

Financial assets at fair value through profit or loss held for trading consist of bank and corporate shares continuously traded in the Belgrade Stock Exchange. Securities held for trading are measured at fair value at the reporting date, while the recognized gains or losses arising from the changes in the fair value of the financial assets are included in the net profit or loss. Fair value is the market value of a financial asset determined as of the reporting date on the stock exchange where the asset is traded.

Financial assets at fair value through profit or loss held for trading include derivatives as well. A derivative is a financial instrument or any other agreement with the following three characteristics:

- its value changes (as a result of changes in the defined/agreed interest rate or the price of the financial instrument or its stock exchange price or foreign exchange rate or price growth index or another variable);
- it does not require any initial net investment or it requires an initial net investment which is lower than that for other agreement types that are expected to show similar responses to the changes in market conditions; and
- it will be settled in the future.

Initial recognition of derivatives is carried out at the moment when the derivative agreement is concluded, when the notional amount of the derivative is record within off-balance sheet items. The initial positive or negative difference in the fair value of a derivative is recorded on-balance sheet as an asset or a liability. The positive fair value of the derivative is recognized as an asset and the negative fair value of the derivative as a liability. The derivative is derecognized at the moment when the contractual rights and obligations (exchange of cash flows) arising from the derivative expire, i.e., at the termination date. As of the termination date the carrying amount of an asset is derecognized.

3.9.4 Financial Assets Available for Sale

Financial assets available for sale are non-derivative financial assets designated as available for sale or assets not classified as loans and receivables, held-to-maturity assets and financial assets at fair value through profit or loss.

Assets available-for-sale are acquired to be sold within non-specified future period in order to realize a profit.

Upon initial recognition, financial assets available for sale are measured at fair value increased for transaction costs. These costs are initially capitalized rather than recognized as an expense in the income statement and they increase the carrying amount of the asset.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.9. Financial Instruments (Continued)

3.9.4 Financial Assets Available for Sale (Continued)

After initial recognition, the Bank measures available-for-sale financial assets at their fair value, recognizing gains and losses from changes in the fair value in revaluation reserves within equity. Within equity, gains and losses from the change in the value of a financial asset are not recognized if arising from RSD exchange rate fluctuations (if the asset is denominated in a foreign currency or subject to a foreign currency clause).

Subsequent valuation is recorded on a quarterly basis. On the sale date, the amount acquired through the sale of the asset closes the carrying amount of the asset and the revaluation reserve for that asset, and the difference is recognized as a gain or loss on sale/disposal.

3.9.5 Impairment of Financial Instruments

In accordance with IAS 39, a financial asset or a group of financial assets are impaired or impairment loss is reversed, only and only if, there is objective evidence of the uncertainty, due to one or more events, which have arisen after initial recognition of financial assets, and if such loss events have an impact on the estimated future cash flows from a financial asset or group of financial assets that can be measured reliably. Possible or expected future trends, which can cause losses in future, do not provide objective evidence of uncertainty.

3.10. Cash and Balances Held with the Central Bank

Cash and balances held with the central bank are comprised of cash in RSD and in foreign currencies, i.e., cash held on the Bank's gyro and current accounts, cash on hand and other cash in RSD and foreign currencies, gold and other precious metals and liquid surpluses deposited with the National Bank of Serbia.

For purposes of the cash flow statement, cash includes cash on hand in local and foreign currencies, balances on accounts held with other banks, as well as available funds held with the National Bank of Serbia.

3.11. Managed Funds

The funds that the Bank manages on behalf of and for the account of third parties for fees are disclosed within off-balance sheet items.

3.12. Taxes and Contributions

Current Income Taxes

Income tax is recognized and calculated in accordance with IAS 12 – "Income Taxes" and the Law on Corporate Income Tax.

Income tax represents the amount calculated by applying the statutory income tax rate of 15% to the profit before taxes, after deducting the effects of permanent differences that adjust the prescribed tax rate to the effective tax rate.

The final amount of income tax liability is calculated by applying the prescribed tax rate to the tax base determined in the tax statement.

The Law on Corporate Income Tax of the Republic of Serbia does not allow any tax losses of the current period to be used to recover taxes paid in previous periods. However, any current year losses disclosed in the tax statements up to 2009 may be used to reduce the taxable profits for future periods, but only for a period not longer than ten years. The losses in the tax statements for 2010 and thereafter may be used for reduction of the taxable profits for the ensuing periods, yet no longer than five years. Such tax losses, up to the amount of anticipated future taxable profit against which the tax losses can be offset, are recognized in the statement of the financial position as deferred tax assets.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.12. Taxes and Contributions (Continued)

Deferred Taxes

Deferred taxes are provided for using the balance sheet liability method on all temporary differences at the reporting date between the taxation-purpose amounts of assets and liabilities and their carrying amounts for financial reporting purposes. Tax rate enacted at the reporting date is used to determine the deferred tax amount.

Deferred tax liabilities are recognized for all taxable temporary differences, except where the deferred tax liability arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and in respect of taxable temporary differences associated with investments in subsidiaries, associates and joint ventures, where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not be reversed in the foreseeable future.

Deferred tax assets are recognized for all deductible temporary differences, unused portions tax credit and tax loss carryforwards to the extent that it is probable that taxable profits will be available against which the deductible temporary differences, and the unused tax credits and tax losses carried forward can be utilized, except where the deferred tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit, nor taxable profit or loss; and in respect of deductible temporary differences associated with investments in subsidiaries, associates and joint ventures, when deferred tax assets are recognized only to the extent that it is probable that the temporary differences will be reversed in the foreseeable future and that sufficient taxable profit will be available against which the temporary differences can be utilized.

The carrying amount of deferred tax assets is reviewed at each reporting date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or portion of the deferred tax assets to be utilized. Unrecognized deferred tax assets are reassessed at each reporting date and are recognized to the extent that it has become probable that future taxable profit will allow the deferred tax assets to be utilized.

Deferred tax assets and liabilities are calculated at tax rates that are expected to be effective in the year when the asset is realized or the liability is settled, based on tax rates and tax regulations enacted or substantively enacted at the reporting date.

Indirect Taxes and Contributions

Indirect taxes and contributions include property tax, value added tax, payroll taxes and contributions charged to the employer, as well as other taxes and contributions payable in accordance with the tax regulations of the Republic of Serbia and local municipal tax regulations. These taxes and contributions are presented within other expenses.

3.13. Fair Value

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction in the market at the measurement date under current market conditions.

Fair value of certain financial instruments measured at their nominal value corresponds to their carrying amount (cash, receivables and liabilities without agreed maturity, which can be collected/paid in short-term).

Other assets, liabilities and securities are adjusted to their fair values by discounting future cash flows using the current interest rates that do not depart significantly from the market interest rates.

For market-traded securities the rates of return from the secondary market of government securities are used in determination of fair value.

All amounts expressed in thousands of RSD, unless otherwise stated.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.13. Fair Value (Continued)

Considering that in Serbia there is no active market for derivatives, the fair value calculation uses observable and indirectly observable data or data derived from interest rates (swap points). Swap points represent the difference between forward and spot exchange rates and are indicative of the interest rate spread between the two currencies in which a foreign exchange swap is contracted.

The Bank's business policy is to disclose information on the fair value of assets or liabilities for which there are official market information or information arising from alternative valuation techniques when the fair value varies significantly from the carrying amount.

Assets and liabilities that are measured at fair value or for which fair value is disclosed are categorized according to the inputs used to measure fair values, as follows:

1) Level 1: Valuation using quoted market price (unadjusted) in an active market for an identical instrument;
2) Level 2: Valuation using observable inputs other than quoted prices, either directly (i.e. as prices) or indirectly (i.e. derived from prices); and
3) Level 3: Valuation using significant unobservable inputs to the extent that market information on value is not directly or indirectly accessible.

3.14. Equity and Reserves

Equity represents the Bank's assets in excess of all its liabilities. Equity is not assessed and measured separately. Equity consists of the Bank's issued (share) capital, reserves and retained earnings. The Bank makes reserves from by allocation of funds from retained earnings.

3.15. Employee Benefits

Long-Term Employee Benefits – Retirement Benefits

The Bank does not have its own pension funds or share-based payment options and consequently had no liabilities recognized in this respect as of December 31, 2017.

As of December 31, 2017, the Bank made provisions for retirement benefits and unused annual leaves based on the assessment carried out by a certified actuary.

Provisions were made based of the following assumptions:

Average salary for November 2017 paid in Republic of Serbia	in RSD	65,609.00
Discount rate		3.75%
Salary growth rate		4.00%
Employee turnover rate		6.00%

Short-Term Employee Benefits – Taxes and Contributions for Social Security

Pursuant to the regulations effective in the Republic of Serbia, the Bank has an obligation to pay personal income tax contributions to various state social security funds. This obligation involves the payment of the tax and contributions on behalf of the employee, by the employer, in amounts calculated by applying the specific, legally prescribed rates. The Bank is also legally obligated to withhold the tax amount and contributions from gross salaries to employees, and to transfer the withheld portions on their behalf directly to the appropriate government funds. These taxes and contributions payable on behalf of the employee and employer are charged to expenses in the period in which they arise.

Short-Term Compensated Absences

Accumulating compensated absences (annual vacation leaves) may be carried forward and used in future periods if the current period's entitlement is not used in full. Expenses for compensated absences are recognized at the amount the Bank expects to pay as a result of the unused entitlement that has accumulated at the reporting date. In the case of non-accumulating compensated absences, an obligation or expense is recognized when the absences occur.

NOTES TO THE FINANCIAL STATEMENTS
December 31, 2017
All amounts expressed in thousands of RSD, unless otherwise stated.

4. INTEREST INCOME AND EXPENSES

a) INTEREST INCOME

	Year Ended December 31, 2017	Year Ended December 31, 2016
Loans in RSD:		
Banks	413	997
Public companies	1,942	-
Corporate customers	644,093	672,067
Entrepreneurs	125,085	123,270
Public sector	31,726	16,613
Individuals	600,597	453,759
Other customers	69,254	86,749
	1,473,110	1,353,455
Loans in foreign currencies:		
Corporate customers	38,593	48,949
Entrepreneurs	99	368
Individuals	114	135
Other customers	103	93
	38,909	49,545
Deposits in RSD:		
Banks	27,985	24,355
	27,985	24,355
Deposits in foreign currencies:		
Banks	99	53
Non-residents	1,478	1,379
	1,577	1,432
Interest income on securities:		
In RSD	198,265	151,369
In foreign currency	14,731	24,088
	212,996	175,457
Interest income from other investments:		
In RSD	416	385
In foreign currencies	-	204
	416	589
TOTAL:	**1,754,993**	**1,604,833**

Recognized interest income on impaired loans for the year ended December 31, 2017 totaled RSD 166,645 thousand (2016: RSD 184,310 thousand).

NOTES TO THE FINANCIAL STATEMENTS
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3. INTEREST INCOME AND EXPENSES (Continued)

b) INTEREST EXPENSES

	Year Ended December 31, 2017	Year Ended December 31, 2016
Loans in RSD:		
Banks	1,784	4,439
	1,784	4,439
Loans in foreign currencies:		
Public sector	49,082	66,788
Banks	37,289	38,182
	86,371	104,970
Deposits in RSD:		
Banks	17,603	17,270
Public companies	1,976	3,874
Corporate customers	26,903	18,639
Entrepreneurs	59	41
Public sector	8,672	1,111
Individuals	26,313	12,850
Other customers	17,265	13,178
	98,791	66,963
Deposits in foreign currency:		
Banks	439	-
Corporate customers	19,948	20,539
Entrepreneurs	6	23
Individuals	55,097	61,621
Other customers	3,252	1,316
	78,742	83,499
TOTAL:	**265,688**	**259,871**

4. FEE AND COMMISSION INCOME AND EXPENSES

a) FEE AND COMMISSION INCOME

	Year Ended December 31, 2017	Year Ended December 31, 2016
Fee and commission income in RSD:		
Banks and other financial institutions	36,805	48,344
Public companies	929	1,374
Corporate customers	378,328	363,489
Entrepreneurs	91,584	84,022
Public sector	184	75
Individuals	155,987	137,988
Non-residents	2,431	1,608
Other customers	22,590	9,818
TOTAL	688,838	646,718
Fee and commission income in foreign currencies:		
Foreign banks	16,009	11,483
Western Union	2,388	2,678
Individuals	2,046	1,618
Entrepreneurs	1,076	1,349
Other customers	47	43
	21,566	17,171
TOTAL:	**710,404**	**663,889**

All amounts expressed in thousands of RSD, unless otherwise stated.

5. FEE AND COMMISSION INCOME AND EXPENSES (Continued)

b) FEES AND COMMISSION EXPENSES

	Year Ended December 31, 2017	Year Ended December 31, 2016
Fee and commission expenses in RSD		
Banks and other financial institutions	24,853	22,525
Companies	38,448	33,219
Entrepreneurs	-	84
Public sector	318	316
Other customers	13,915	11,253
	77,534	67,397
Fee and commission expenses in foreign currencies:		
Banks and other financial institutions	8,123	7,995
Non-residents	20,402	11,941
	28,525	19,936
TOTAL:	**106,059**	**87,333**

6. NET GAINS ON THE FINANCIAL ASSETS HELD FOR TRADING

	Year Ended December 31, 2017	Year Ended December 31, 2016
Gains from sales of securities and other financial assets held for trading	77	5,063
Losses from sales of securities and other financial assets held for trading	-	(290)
Net gains	77	4,773
Gains on changes in the fair value of securities and other financial assets held for trading	6,122	19,219
Losses on changes in the fair value of securities and other financial assets held for trading	(4,654)	(12,346)
Net gains	1,468	6,873
Gains on changes in the value of derivatives held for trading	470	-
TOTAL:	**2,015**	**11,646**

7. NET GAINS ON THE FINANCIAL ASSETS AVAILABLE FOR SALE

	Year Ended December 31, 2017	Year Ended December 31, 2016
Gains from sales of securities and other financial assets available for sale	4,270	-
TOTAL:	**4,270**	**-**

NOTES TO THE FINANCIAL STATEMENTS
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8. NET FOREIGN EXCHANGE GAINS AND POSITIVE CURRENCY CLAUSE EFFECTS

	Year Ended December 31, 2017	Year Ended December 31, 2016
Foreign exchange gains	2,658,370	1,480,764
Positive currency clause effects	924,699	1,043,672
TOTAL:	3,583,069	2,524,436
Foreign exchange losses	(1,875,220)	(1,706,983)
Negative currency clause effects	(1,682,611)	(816,955)
TOTAL:	(3,557,831)	(2,523,938)
Net foreign exchange gains:	**25,238**	**498**

The share of foreign currency items in the total Bank's balance sheet assets was 61.49%, while the share of foreign currency items in the total balance sheet liabilities was 61.12%.

9. OTHER OPERATING INCOME

	Year Ended December 31, 2017	Year Ended December 31, 2016
Operating income	5,515	4,099
Gains on the sales property, equipment and intangible assets	4,698	3,994
Dividend income and profit sharing	759	3,144
Other income	10,144	9,731
Write-off and value adjustment of liabilities	3,995	27
TOTAL:	**25,111**	**20,995**

10. NET GAINS/(LOSSES) FROM IMPAIRMENT OF FINANCIAL ASSETS AND CREDIT RISK-WEIGHTED OFF-BALANCE SHEET ASSETS

a) (Charged)/Credited to the Income Statement

	Year Ended December 31, 2017	Year Ended December 31, 2016
Impairment losses on balance sheet items	(877,297)	(1,042,406)
Reversal of impairment of balance sheet items (Note 10b)	543,481	659,760
Net losses	(333,816)	(382,646)
Provisions for off-balance sheet items (Note 22)	(4,625)	(9,333)
Reversal of provisions for off-balance sheet items (Note 22)	9,139	1,772
Net gains/(losses)	4,514	(7,561)
Write-off of irrecoverable receivables	(1,608)	(488)
Collected receivables previously written off	61,145	1,406
Net gains	59,537	918
TOTAL:	**(269,765)**	**(389,289)**

NOTES TO THE FINANCIAL STATEMENTS
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All amounts expressed in thousands of RSD, unless otherwise stated.

10. NET LOSSES FROM IMPAIRMENT OF FINANCIAL ASSETS AND CREDIT RISK-WEIGHTED OFF-BALANCE SHEET ASSETS (Continued)

b) Movements on impairment allowance accounts

	Loans and receivables due from banks (Note 16)	Loans and receivables due from customers (Note 17)	Financial assets available for sale (Note 15)	Other assets (Note 19)	Total
Balance at January 1, 2017	**19,746**	**2,777,210**	**225**	**38,414**	**2,835,595**
Impairment losses on balance sheet items	61	788,134	5	5,437	793,637
Reversal of impairment of balance sheet items (Note 10a)	-	(540,154)	(63)	(3,264)	(543,481)
Foreign exchange effects	(606)	(5,217)	(1)	3	(5,821)
Impairment allowance translation due to currency clause		(42,914)			(42,914)
NBS write-offs aligned	(19,122)	(226,928)	-	(6,391)	(252,441)
Other write-offs	-	(35,643)	-	-	(35,643)
Cancelation of fx differences (in line with the Law on Bankruptcy)	-	(35,668)	-	10	(35,658)
Balance at December 31, 2017	**79**	**2,678,820**	**166**	**34,209**	**2,713,274**

					2016
	Loans and receivables due from banks (Note 16)	**Loans and receivables due from customers (Note 17)**	**Financial assets available for sale (Note 15)**	**Other assets (Note 19)**	**Total**
Balance at January 1, 2016	**12**	**4,813,167**	**162**	**70,441**	**4,883,782**
Impairment losses on balance sheet items	-	926,965	223	3,514	930,702
Reversal of impairment of balance sheet items (Note 10a)	-	(648,413)	(69)	(11,278)	(659,760)
Foreign exchange effects	-	(1,630)	-	15	(1.615)
Impairment allowance translation due to currency clause	-	39,224	(91)	-	39,133
Other write-offs	-	(2,330,869)	-	(19,539)	(2.350.408)
Other postings	19,734	(21,234)	-	(4,739)	(6.239)
Balance at December 31, 2016	**19,746**	**2,777,210**	**225**	**38,414**	**2,835,595**

All amounts expressed in thousands of RSD, unless otherwise stated.

10. NET LOSSES FROM IMPAIRMENT OF FINANCIAL ASSETS AND CREDIT RISK-WEIGHTED OFF-BALANCE SHEET ASSETS (Continued)

The amount of RSD 226,928 thousand refers to the accounting write-off in accordance with Decision on the Accounting Write-Off of Bank Balance Sheet Assets of the National Bank of Serbia, effective as from September 30, 2017. Within the meaning of this Decision, the accounting write-off is a write-off of a non-performing loan when the amount of the impairment of that loan calculated by the bank and credited to allowance for impairment equals 100% of its gross carrying amount. During 2017, the Bank amended its accounting policies in accordance with this NBS Decision.

The amendments to the Bank's accounting policies define that the Bank's foreign currency loans and receivables, as well as those in RSD with a currency clause index, due from clients in bankruptcy shall be recorded in RSD in the Bank's books as of the bankruptcy instigation date. By such reclassification the gross amount of receivables from the client was reduced to the registered and fully recognized claim per specific loan facility within the Bank's balance sheet assets as of the bankruptcy instigation date. The reclassification decreased the gross assets because RSD exchange constantly decreased throughout 2017 but had no impact on the income statement in terms of effects on the profit for the year but solely on the redistribution of the foreign exchange losses to the losses from impairment of loans and receivables, while the client net exposures remained unchanged. The method and process of the reclassification was controlled and approved by the Bank's Treasury, takin care of the Bank's foreign currency position so as not to compromise currency matching of assets and liabilities.

For the year ended December 31, 2017, the Bank recognized interest income on impaired loans using the effective interest rate on the amortized cost of loans, i.e., their net values along with adjustment of the income recorded in the income statement and with the calculated impairment allowance of receivables in this respect, recorded losses on impairment of loans and receivables yet excluding the adjustment of the impairment allowance accounts within the statement of financial position. Losses on impairment of loans and receivables are reported as amounting to RSD 83,660 thousand (2016: RSD 111,704 thousand).

Due to the foregoing, losses on impairment of loans and receivables recorded in the income statement exceeded by the same amount losses on impairment presented in the table of movements on impairment allowance accounts.

11. STAFF COSTS

	Year Ended December 31, 2017	Year Ended December 31, 2016
Salaries and salary compensations	453,879	406,900
Taxes on salaries and salary compensations	57,532	51,402
Contributions on salaries and salary compensation	119,786	106,558
Other personal expenses	17,359	34,968
Provisions for retirement and other employee benefits (Note 22)	5,520	4,231
Reversal of provisions for retirement and other employee benefits (Note 22)	(5,311)	(19,523)
TOTAL:	**648,765**	**584,536**

Within the line item of salaries and salary compensations, the amount of RSD 28,312 thousand (2016: RSD 26,857 thousand) refers to the remunerations to the Executive Board members remunerations, while the Board of Directors members' remunerations are presented within the line item of other personal expenses in the amount RSD 12,322 thousand (2016: RSD 12,169 thousand).

All amounts expressed in thousands of RSD, unless otherwise stated.

12. OTHER EXPENSES

	Year Ended December 31, 2017	Year Ended December 31, 2016
Operating expenses		
Cost of materials	54,105	57,151
Costs of production services	359,907	321,164
Non-material expenses	334,866	248,456
Taxes payable	15,608	8,169
Contributions payable	109,865	97,995
Other expenses	2,855	1,537
Provisions for liabilities	7,149	3,001
Other operating expenses		
Losses on the retirement and disposal of property, equipment and intangible assets	1	-
Other expenses	1,200	364
TOTAL:	**885,556**	**737,837**

Within the line item of costs of production services, the largest amount relates to rental costs of RSD 193,853 thousand (2016: RSD 132,298 thousand), and within non-material expenses the most significant amount refers to paid insurance premiums of RSD 134,528 thousand (2016: RSD 98,008 thousand), of which the largest portion is the insurance premium paid for retail deposits in the amount of RSD 106,900 thousand (2016: RSD 84,394 thousand) and insurance premium paid for cash loans for pensioners in the amount of RSD 27,628 thousand (2016: RSD 9,577 thousand).

13. INCOME TAXES

a) Income tax components

Income from created deferred tax assets and decrease in deferred tax liabilities and expenses from decrease in deferred tax assets and creation of deferred tax liabilities were zero for both 2017 and 2016.

The Bank can create additional deferred tax assets in accordance with the projected profits based on the adopted five-year Bank's Business Strategy. In addition, a conservative approach was applied in the calculation of deferred tax assets, i.e., the projections were not changed in 2016 and 2017.

b) Income tax reconciliation with prescribed tax rates

	December 31, 2017	December 31, 2016
Profit before taxes	194,631	136,080
Income tax at the statutory rate of 15%	29,195	20,412
Tax effects of expenses not recognized for tax purposes and other expense adjustments	(1,518)	(7,083)
Tax effects of income from debt securities and other income adjustments	(32,860)	(29,719)
Adjustments in respect of transfer pricing	367	103
Capital gains	257	300
Utilization of capital gains	(257)	(300)
Other	2,368	2,172
Tax losses carried forward for which deferred tax assets were not recognized	2,448	14,115
Income tax stated in the tax statement	-	-
Effective tax rate	**0%**	**0%**

All amounts expressed in thousands of RSD, unless otherwise stated.

13. INCOME TAXES (Continued)

c) Components of deferred tax assets

	December 31, 2017	December 31, 2016
Tax effects of temporary differences on fixed assets	13,832	11,762
Tax credit based on tax losses	41,209	43,194
Impairment of securities held for trading	7,352	7,437
Deferred tax assets	**62,393**	**62,393**

d) Tax credit breakdown:

	Remaining tax credit amount	Non-recognized deferred tax assets	Recognized deferred tax assets	Year of expiry
Tax credit for capital expenditures				
	1,129	(1,129)	-	2018
	4,387	(4,387)	-	2020
	8,348	(8,348)	-	2023
	13,864	(13,864)	-	
Tax credit based on tax losses				
	29,745	-	29,745	2018
	44,922	(33,458)	11,464	2019
	29,098	(29,098)	-	2020
	14,115	(14,115)	-	2021
	2,448	(2,448)		2022
	120,328	(79,119)	41,209	

As of December 31, 2017 the Bank had capital gains carried forward in the amount of RSD 1,845 thousand which could be utilized until 2018.

14. CASH AND BALANCES HELD WITH THE CENTRAL BANK

	December 31, 2017	December 31, 2016
Gyro account	1,512,004	1,639,413
Cash in hand in RSD	424,457	297,637
Receivables for accrued interest, fees and commissions related to cash and balances held with the central bank	21	19
Cash in hand in foreign currencies	562,273	426,267
Mandatory foreign currency reserve held with NBS	2,341,096	1,727,276
TOTAL:	**4,839,851**	**4,090,612**

Mandatory RSD reserve represents the minimum average balance of RSD funds that the Bank has to allocate to its gyro account in accordance with the National Bank of Serbia's Decision on Banks' Required Reserves with the National Bank of Serbia (Official Gazette of the Republic of Serbia nos. 3/2011, 31/2012, 57/2012, 78 / 2012, 107/2012, 62/2013, 125/2014, 135/2014, 4/2015, 78/2015 and 102/2015).

All amounts expressed in thousands of RSD, unless otherwise stated.

14. CASH AND BALANCES HELD WITH THE CENTRAL BANK (Continued)

In accordance with item 5 of this Decision, the Bank is obligated to calculate and allocate the RSD mandatory reserve by applying a rate of 5% on the average daily balance of RSD deposits, borrowings and other liabilities with contractual maturity up to two years during one calendar month, while for deposits, borrowings and other liabilities with contractual maturity over two years the allocation rate is 0%. Mandatory reserve is calculated once a month.

In 2017 NBS calculated and paid interest on the amount of the calculated mandatory RSD reserve at the rate 1.75% p.a. (2016: 1.75% p.a.).

As of December 31, 2017, RSD mandatory reserve was calculated in the amount of RSD 1,623,509 thousand (2016: RSD 1,283,036 thousand).

The mandatory foreign currency reserve represents the minimum average balance of foreign currency assets which the Bank is obligated to allocate to its account held with NBS, in accordance with the Decision on Banks' Required Reserves with the National Bank of Serbia (Official Gazette of the Republic of Serbia nos. 3/2011, 31/2012, 57 / 2012, 78/2012, 107/2012, 62/2013, 125/2014, 135/2014, 4/2015, 78/2015 and 102/2015).

The Bank is obligated to calculate and allocate the foreign currency reserve to the amount of the average daily balance of foreign currency deposits, borrowings and other liabilities during one calendar month at a rate of 20% for those with contractual maturity of up to two years, 13% for those with contractual maturity of over two years and 100% for the average balance of the foreign currency clause-indexed RSD liabilities. The portion of the calculated foreign currency mandatory reserve allocated in dinars amounts to 38% and refers to deposits, borrowings and other liabilities with contractual maturity of up to two years and 30% refers to deposits, borrowings and other liabilities with contractual maturity of over two years. NBS does not calculate and pay interest on the funds of the foreign currency mandatory reserve.

As at December 31, 2017, the Bank was completely in compliance with the Decision on Required Reserves with the National Bank of Serbia. As at December 31, 2017, the Bank's mandatory foreign currency reserve amounted to RSD 2,341,096 thousand (2016: RSD 1,727,276 thousand).

For the purposes of the statement of cash flows cash and cash balances held with Central bank include gyro account, cash in hand in RSD, cash in hand in foreign currencies and nostro accounts. Cash and cash balances with Central bank at the end of the reporting period as shown in the statement of cash flows can be reconciled to the related items in the statement of financial position as follows:

	December 31, 2017	December 31, 2016
Cash and balances held with the central bank	4,839,851	4,090,612
Mandatory foreign currency reserve held with NBS	(2,341,096)	(1,727,276)
Nostro accounts	804,000	519,896
Receivables for accrued interest, fees and commissions related to cash and balances held with the central bank	(21)	(19)
Total:	**3,302,734**	**2,883,213**

NOTES TO THE FINANCIAL STATEMENTS
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15. FINANCIAL ASSETS

	December 31, 2017	December 31, 2016
a) Pledged financial assets		
Bonds issued by the Republic of Serbia	-	90,000
TOTAL:	**-**	**90,000**
b) Financial assets at fair value through profit or loss, held for trading		
Banks shares	814	519
Corporate shares	23,474	23,465
Receivables from derivatives held for trading	470	-
TOTAL:	**24,758**	**23,984**
c) Financial assets available for sale		
Municipal bonds:		
- Sabac	30,839	39,650
- Stara Pazova	15,317	21,753
- Autonomous Province of Vojvodina	-	25,091
Treasury bills issued by the Republic of Serbia in RSD	-	207,069
Bonds issued by the Republic of Serbia in RSD	4,020,424	1,947,447
Bonds issued by the Republic of Serbia in foreign currencies	293,436	936,810
	4,360,016	3,177,820
Allowance for impairment of municipal bonds (Note 10b)	(166)	(225)
TOTAL:	**4,359,850**	**3,177,595**
d) Financial assets held to maturity		
Treasury bills issued by the Republic of Serbia in RSD	-	598,823
Bonds issued by the Republic of Serbia in RSD	414,425	569,881
Bonds issued by the Republic of Serbia in foreign currencies	58,467	184,621
TOTAL:	**472,892**	**1,353,325**

As at December 31, 2017, the securities and investments traded by the Bank in the Belgrade Stock Exchange comprised bank and corporate shares.

The Bank's portfolio of securities held to maturity consists of bonds issued by the Republic of Serbia.

The Autonomous Province of Vojvodina exercised its rights and re-purchased bonds before their maturity, in June 2017, in the amount of RSD 25,027 thousand.

The rates of return on government securities in RSD ranged from 3.65% to 4.83% p.a., while for FX securities they were between 1.00% and 4.00% p.a.

NOTES TO THE FINANCIAL STATEMENTS
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16. LOANS AND RECEIVABLES DUE FROM BANKS AND OTHER FINANCIAL INSTITUTIONS

	December 31, 2017	December 31, 2016
Receivables for accrued interest on loans, deposits and other investments:		
- in RSD	15	7
- in foreign currencies	9	-
Foreign currency accounts	804,000	519,896
Receivables for accrued fees on loans, deposits and other investments in foreign currencies	2	-
Loans in RSD	1,711	19,732
Other investments:		
- in RSD	296,275	123,520
- in foreign currencies	266,692	251,230
Deposits in foreign currencies	153,412	122,073
Accrued receivables for interest on loans, deposits and other investments:		
- in RSD	2,447	1,933
- in foreign currencies	132	115
Deferred income from receivables carried at amortized cost using the effective interest rate	(3)	-
Gross loans and receivables due from banks and other financial institutions	**1,524,692**	**1,038,506**
Allowances for impairment (Note 10b)	(79)	(19,746)
TOTAL:	**1,524,613**	**1,018,760**

In 2017, in repo transactions with the National Bank, the Bank realized interest at annual rates ranging from 2.52% to 2.96% (2016: from 2.52% to 2.99%). As of December 2017, the Bank had no loans per repo transactions.

Foreign currency assets with the Central Securities Depository and foreign currency assets on transaction accounts held with foreign banks as of December 31, 2017 amounted to RSD 804,000 thousand (2016: RSD 519,896 thousand), and are presented within the line item of foreign currency accounts. The most significant balances on nostro accounts are related to balance at Commerzbank AG - RSD 317,313 thousand (2016: RSD 320,521 thousand), Turkiye Halk Bankasi AS - RSD 215,434 thousand (2016: RSD 14,150 thousand) and KBC BANK NV, Brussels, Belgium - RSD 124,164 thousand (in 2016 Bank did not have an open nostro account with this bank).

The item of deposits in foreign currency refers to the term deposit held with Turkiye Halk Bankasi AS in the amount of RSD 99,116 thousand or, in the original currency, USD 1,000 thousand (2016: RSD 117,135 thousand), a deposit held with OTP Bank in the amount of RSD 49,558 thousand or, in the original currency USD 500 thousand, and an earmarked deposit held with the Central Registry of Securities in the amount of RSD 4,738 thousand or EUR 40 thousand (2016: RSD 4,938 thousand).

The item of other investments in RSD refers to receivables from the National Bank of Serbia for the contracted purchase and sale of foreign currency monetary assets.

The item of other investments in foreign currency mostly relates to receivables for contracted purchase and sale of foreign currency monetary assets:

- from domestic banks (National Bank of Serbia, NLB Bank) in the amount of RSD 236,945 thousand,
- from foreign banks (Commerzbank AG, Frankfurt) in the amount of RSD 29,735 thousand.

All amounts expressed in thousands of RSD, unless otherwise stated.

17. LOANS AND RECEIVABLES DUE FROM CUSTOMERS

	December 31, 2017	December 31, 2016
Receivables for accrued interest on loans, deposits and other investments in RSD	90,821	92,226
Receivables for accrued fees on loans, deposits and other investments in RSD	11,814	11,691
Receivables for accrued interest on loans, deposits and other investments in foreign currencies	1,014	1,883
Loans in RSD and loans indexed to EUR	31,049,667	25,835,462
Other investments in RSD	277,394	304,995
Loans and receivables in foreign currencies	241,542	564,259
Other investments in foreign currencies		9,557
Accrued receivables for interest on loans, deposits and other investments in RSD	12,594	49,855
Accrued receivables for interest on loans, deposits and other investments in foreign currencies	1,285	14
Deferred income for receivables carried at amortized cost using the effective interest rate	(112,405)	(94,949)
Gross loans and receivables due from customers	**31,573,726**	**26,774,993**
Allowances for impairment (Note 10b)	(2,678,820)	(2,777,210)
TOTAL:	**28,894,906**	**23,997,783**

Short-term loans were extended to corporate customers and entrepreneurs for the improvement of production, trade of goods, provision of services, import, export, maintenance of current liquidity and other purposes. Short-term loans were approved for repayment periods of up to 12 months, in RSD, RSD equivalents of foreign currency amounts and in foreign currencies.

In 2017 RSD short-term loans were approved from the Bank's own resources at annual interest rates equal to 6-month BELIBOR + 0.25% p.a. to 26.40% p.a., while short-term RSD loans with currency clause index and foreign currency loans were approved at annual interest rates equal to 6 month EURIBOR + 2.50% p.a. to 9.00% p.a.. (In 2016 RSD short-term loans were approved from the Bank's own resources at annual interest rates equal to 6-month BELIBOR +0.50% p.a. to 29.84% p.a., while short-term RSD loans with currency clause index and foreign currency loans were approved at annual interest rates equal to 3 month EURIBOR + 2.50% p.a. to 9.00% p.a.)

Long-term loans were extended in RSD with and without foreign currency clause and in foreign currencies at fixed and variable interest rates.

Major portion of long-term loans approved in 2017 referred to:

- FRK loans of EUR 3,934,000 from the NBS credit line - Revolving Credit Fund Management Department approved to small and medium-sized companies for the purchase of equipment, purchase and construction of production plant facilities and for working capital. The loan repayment period lasts up to 5 years, with a grace period of 12 months, at an annual interest rate of 3-mont LIBOR for EUR loans increased by a 2.75% to 3.25% p.a. margin;
- EFSE Credit Line loans totaling EUR 8,630,000, in cooperation with the European Fund for Southeast Europe, where funds were approved to small and medium-sized companies to finance working capital and fixed assets. The loan repayment period lasts up to 5 years, with a grace period up to June 15, 2019 at an interest rate of 2.1% p.a. + 6M EUR LIBOR.

In addition, in 2017, the Bank participated in the state program of subsidized loans for the purchase of equipment for SMEs and through this program disbursed investment loans in the amount of EUR 2,180,000.

All amounts expressed in thousands of RSD, unless otherwise stated.

17. LOANS AND RECEIVABLES DUE FROM CUSTOMERS (Continued)

Breakdown of Loans and Receivables due from Customers

- Gross loans and receivables due from customers – Corporate

As of December 31, 2017, the Bank's gross amount of loans and receivables due from corporate customers (excluding interest, commissions and accrued commissions) including NPLs – totaled RSD 23,246,865 (2016: RSD 20,458,275 thousand) and are broken down as follows:

Loan type	December 31, 2017	December 31, 2016	% Variance
Loans from Bank's resources	18,503,811	15,255,123	21.30%
Loans from credit lines obtained from the International Financial Institutions	4,743,054	5,203,152	(8.84)%
Total	**23,246,865**	**20,458,275**	**13.63%**

- Gross loans and receivables due from customers – Retail

As of December 31, 2017, the Bank's gross amount of loans and receivables due from retail customers – including NPLs – totaled RSD 8,321,738 thousand (2016: RSD 6,255,866 thousand) and are broken down as follows:

Loan type	December 31, 2017	December 31, 2016	% Variance
Cash loans	4,529,143	2,761,504	64.01%
Housing loans	2,989,251	2,530,638	18.12%
Consumer loans – energy efficiency	261,769	361,660	(27.62)%
Consumer loans – other purposes	271,847	326,756	(16.80)%
Authorized current account overdrafts	125,995	105,163	19.81%
Matured loan receivables	55,952	108,429	(48.40)%
Consumer loans – purchase of vehicle	54,689	31,609	73.02%
Unauthorized current account overdrafts	26,338	19,962	31.94%
Receivables per DinaCard credit cards	6,754	10,265	(34.20)%
Total	**8,321,738**	**6,255,986**	**33.02%**

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17. LOANS AND RECEIVABLES DUE FROM CUSTOMERS (Continued)

Movements on the impairment allowance accounts **2017**

	Loans and receivables due from banks	Loans and receivables due from customers	Financial assets	Other assets	Total
Balance, beginning of year	**19,746**	**2,777,210**	**225**	**38,414**	**2,835,595**
Individual allowance	19,733	2,707,329	-	14,967	2,742,029
Collective allowance	13	69,881	225	23,447	93,566
Impairment allowance of loans and receivables (Note 10)	**61**	**788,134**	**5**	**5,437**	**793,637**
Individual allowance	-	716,196	-	3,596	719,792
Collective allowance	61	71,938	5	1,841	73,845
Reversal of imapirment allowance of loans and receivables (Note 10)	**-**	**(540,154)**	**(63)**	**(3,264)**	**(543,481)**
Individual allowance	-	(473,047)	-	(1,149)	(474,196)
Collective allowance	-	(67,107)	(63)	(2,115)	(69,285)
Foreign exchange effects	**(606)**	**(48,131)**	**(1)**	**3**	**(48,735)**
Individual allowance	(606)	(48,076)	-	3	(48,679)
Collective allowance	-	(55)	(1)	-	(56)
Write-offs	**(19,122)**	**(262,571)**	**-**	**(6,391)**	**(288,084)**
Individual allowance	(19,122)	(262,571)	-	(6,391)	(288,084)
Collective allowance	-	-	-	-	-
Other	**-**	**(35,668)**	**-**	**10**	**(35,658)**
Individual allowance	-	(35,668)	-	-	(35,668)
Collective allowance	-	-	-	10	10
Balance, end of year	**79**	**2,678,820**	**166**	**34,209**	**2,713,274**
Individual allowance	5	2,604,163	-	11,026	2,615,194
Collective allowance	74	74,657	166	23,183	98,080

Movements on the impairment allowance accounts **2016**

	Loans and receivables due from banks	Loans and receivables due from customers	Financial assets	Other assets	Total
Balance, beginning of year	**12**	**4,813,167**	**162**	**70,441**	**4,883,782**
Individual allowance	-	4,768,849	-	70,441	4,839,290
Collective allowance	12	44,318	162	-	44,492
Impairment allowance of loans and receivables (Note 10)	**-**	**926,965**	**223**	**3,514**	**930,702**
Individual allowance	-	869,349	-	3,512	872,861
Collective allowance	-	57,616	223	2	57,841
Reversal of imapirment allowance of loans and receivables (Note 10)	**-**	**(648,413)**	**(69)**	**(11,278)**	**(659,760)**
Individual allowance	-	(637,314)	-	(25)	(637,339)
Collective allowance	-	(11,099)	**(69)**	(11,253)	(22,421)
Foreign exchange effects	**-**	**(1,630)**	**-**	**15**	**(1,615)**
Individual allowance	**-**	(1,629)	-	15	(1,614)
Collective allowance	**-**	(1)	-	-	(1)
Indexation due to foreign currency clause	**-**	**39,224**	**(91)**	**-**	**39,133**
Individual allowance	**-**	38,943	-	-	38,943
Collective allowance	**-**	281	(91)	-	190
Write-offs	**-**	**(2,330,869)**	**-**	**(19,539)**	**(2,350,408)**
Individual allowance	**-**	(2,330,869)	-	(19,539)	(2,350,408)
Collective allowance	**-**	-	-	-	-
Other	**19,734**	**(21,234)**	**-**	**(4,739)**	**(6,239)**
Individual allowance	19,733	-	-	295	20,028
Collective allowance	1	(21,234)	-	**(5,034)**	(26,267)
Balance, end of year	**19,746**	**2,777,210**	**225**	**38,414**	**2,835,595**
Individual allowance	19,733	2,707,329	-	14,967	2,742,029
Collective allowance	13	69,881	225	23,447	93,566

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18. INTANGIBLE ASSETS, PROPERTY, EQUIPMENT AND INVESTMENT PROPERTY

a) INTANGIBLE ASSETS

	December 31, 2017	December 31, 2016
Cost		
Balance as of January 1	182,268	96,663
Additions	76,101	85,605
Balance as of December 31	258,369	182,268
Accumulated amortization		
Balance as of January 1	108,292	68,578
Charge for the year	51,130	39,714
Balance as of December 31	159,422	108,292
Net book value as of December 31	**98,947**	**73,976**

The most significant amount of additions, i.e., capital expenditures, made in 2017 relates to IT equipment, equipping of newly opened branches and re-branding of the Bank's organizational units.

The largest portion of additions to the intangible assets relates to the purchase of Microsoft licenses in the amount of RSD 31,954 thousand and the purchase and implementation of a software solution for managing bank payment cards and point of sale terminals in the amount of RSD 15,985 thousand.

b) BUILDINGS

	December 31, 2017	December 31, 2016
Cost		
Balance as of January 1	704,105	700,874
Additions	1,535	9,151
Sales	-	(5,920)
Balance as of December 31	705,640	704,105
Accumulated depreciation		
Balance as of January 1	212,747	197,128
Charge for the year	17,730	17,447
Sales	-	(1,828)
Balance as of December 31	230,477	212,747
Net book value as of December 31	**475,163**	**491,358**

As of December 31, 2017, the Bank had proper title deeds of the property in its possession with no encumbrances registered over the assets, except four real estates which net present value as of December 31, 2017 amounts to RSD 1,177 thousand.

In accordance with the Bank's accounting policies, valuation of building properties is performed every three years. The Bank engaged a certified appraiser to carry out valuation of all buildings owned by the Bank as of December 31, 2015. The market approach was used in valuation. In the valuation report submitted to the Bank, the appraiser stated that the carrying amounts of buildings owned by the Bank did not depart from their market values. As at December 31, 2017, the Bank tested its buildings and investment property for impairment by considering real estate market trends during 2017. No evidence of impairment was identified.

Should the Bank apply the cost model less accumulated depreciation for measurement of the buildings owned by the Bank, the carrying value of its buildings would amount to RSD 172,456 thousand as at December 31, 2017 (2016: RSD 188,651 thousand).

All amounts expressed in thousands of RSD, unless otherwise stated.

18. INTANGIBLE ASSETS, PROPERTY, EQUIPMENT AND INVESTMENT PROPERTY

Fair value of buildings as of December 31, 2017 is presented as follows:

	Level 1	Level 2	Level 3	Total
Buildings	-	-	475,163	475,163
Total	**-**	**-**	**475,163**	**475,163**

Fair value of buildings as of December 31, 2016 is presented as follows:

	Level 1	Level 2	Level 3	Total
Buildings	-	-	491,358	491,358
Total	**-**	**-**	**491,358**	**491,358**

The table below presents valuation techniques and significant unobservable inputs used in valuation of building properties:

Valuation technique	**Significant unobservable inputs**	**Relationship between the key unobservable inputs and the fair value** The assessed fair value would increase/(decrease) if
Market approach – based on the comparable transaction method, i.e., on comparison of properties being valued to other comparable properties traded in the market.	Prices of properties in the local real estate market are observed. For own buildings comparable properties could be found on market. Comparative prices on the market on 31.12.2017 for Belgrade are in range 1400-2000 EUR/sqm, for Cacak and Gornji Milanovac are in range from 400-800 EUR/sqm, in Jagodina 400-800 EUR/sqm, in Kraljevo from 450-650 EUR/sqm, in Krusevac from 500-800 EUR/sqm, in Uzice from 500-800 EUR/sqm.	Prices of properties in the local real estate market increased/(decreased)

Valuation process

The valuations of the properties are performed once in three years on the basis of valuation reports prepared by independent and qualified valuers.

These reports are based on both:

Information provided by the Bank such as current rents, terms and conditions of lease agreements, service charges, capital expenditure, etc. This information is derived from the Bank's financial and property and collateral management systems and is subject to the overall control environment.

Assumptions and valuation models used by the valuers - the assumptions are typically market related, such as comparative prices. These are based on their professional judgment and market observation.

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18. INTANGIBLE ASSETS, PROPERTY, EQUIPMENT AND INVESTMENT PROPERTY (Continued)

The information provided to the valuers and the assumptions and the valuation models used by the valuers are reviewed by the Collateral Management Department and the Head of Finance Management and Planning Division. This includes a review of fair value movements over the period. When the Head of Finance Management and Planning division considers that the valuation report is appropriate, the valuation report is recommended to the Executive Board. The Executive Board considers the valuation report as part of its overall responsibilities.

c) EQUIPMENT

	December 31, 2017	December 31, 2016
Cost		
Balance as of January 1	873,075	638,936
Additions	94,517	248,330
Sales	(10,915)	(10,066)
Disposals and write-offs	-	(4,125)
Balance as of December 31	956,677	873,075
Accumulated depreciation		
Balance as of January 1	545,987	514,112
Charge for the year	78,927	46,063
Sales	(10,915)	(10,063)
Disposals and write-offs	(1)	(4,125)
Balance as of December 31	613,998	545,987
Net book value as of December 31	**342,679**	**327,088**

d) INVESTMENT PROPERTY

	December 31, 2017	December 31, 2016
Cost		
Balance as of January 1	147,643	147,643
Additions	5,170	-
Balance as of December 31	152,813	147,643
Accumulated depreciation		
Balance as of January 1	21,306	17,615
Charge for the year	3,780	3,691
Balance as of December 31	25,086	21,306
Net book value as of December 31	**127,727**	**126,337**

The Bank's rental income – from the lease of investment property – amounted to RSD 2,987 thousand in 2017 (2016: RSD 2,367 thousand). Costs associated with the leases and incurred in earning the rental income amounted to RSD 1,277 thousand in 2017 (2016: RSD 1,012 thousand).

The appraised value of investment property according to the certified appraiser's report as at December 31, 2015 amounted to RSD 130,020 thousand. As there were no significant changes in the real estate market, it was concluded that the fair value of investment property as of the reporting date did not depart from the last available appraisal as at December 31, 2015.

Fair value of investment properties as of December 31, 2017 is presented as follows:

	Level 1	Level 2	Level 3	Total
Investment properties	-	-	127,727	127,727
Total	**-**	**-**	**127,727**	**127,727**

Fair value of investment properties as of December 31, 2016 is presented as follows:

	Level 1	Level 2	Level 3	Total
Investment properties	-	-	126,337	126,337
Total	**-**	**-**	**126,337**	**126,337**

All amounts expressed in thousands of RSD, unless otherwise stated.

18. INTANGIBLE ASSETS, PROPERTY, EQUIPMENT AND INVESTMENT PROPERTY (Continued)

Valuation technique	**Significant unobservable inputs**	**Relationship between the key unobservable inputs and the fair value** The assessed fair value would increase/(decrease) if
Market approach – based on the comparable transaction method, i.e., on comparison of properties being valued to other comparable properties traded in the market.	Prices of properties in the local real estate market are observed. For investment properties comparable properties could be found on market. Comparative prices on the market on 31.12.2017 for Belgrade are in range 1400-2000 EUR/sqm and for Cacak are in range from 400-800 EUR/sqm.	Prices of properties in the local real estate market increased/(decreased)

As of December 31, 2017, the Bank had proper title deeds of the investment property in its possession with no encumbrances registered over the assets, except for two properties the net present value of which as of December 31, 2017 amounted to RSD 81,894 thousand.

Valuation process

The valuations of the properties are performed once in three years on the basis of valuation reports prepared by independent and qualified valuers.

These reports are based on both:

Information provided by the Bank such as current rents, terms and conditions of lease agreements, service charges, capital expenditure, etc. This information is derived from the Bank's financial and property and collateral management systems and is subject to the overall control environment.

Assumptions and valuation models used by the valuers - the assumptions are typically market related, such as comparative prices. These are based on their professional judgment and market observation.

The information provided to the valuers and the assumptions and the valuation models used by the valuers are reviewed by the Collateral Management Department and the Head of Finance Management and Planning Division. This includes a review of fair value movements over the period. When the Head of Finance Management and Planning division considers that the valuation report is appropriate, the valuation report is recommended to the Executive Board. The Executive Board considers the valuation report as part of its overall responsibilities.

All amounts expressed in thousands of RSD, unless otherwise stated.

19. OTHER ASSETS

	December 31, 2017	December 31, 2016
Receivables for calculated fees and commissions related to other assets	9,112	10,089
Trade receivables	4,377	2,640
Other receivables from regular operating activities – subsidized interest	40,922	27,352
Receivables for accrued interest related to other assets	10	10
Other receivables in RSD	100,968	54,370
Other receivables in foreign currencies	37,372	49,153
Other investments	3,349	3,349
Other deferred expenses	10,278	7,035
Accrued receivables	107	-
Deferred interest expenses in foreign currencies	13,924	10,412
Other prepayments in foreign currencies	528	-
Inventories of materials, tools, spare parts and other inventories	43,684	31,638
	264,631	196,048
Allowances for impairment (Note 10b)	(39,233)	(43,448)
TOTAL:	**225,398**	**152,600**

The line item of other receivables in RSD mostly relates to receivables per VISA cards of OTP banka a.d. Novi Sad in the amount of RSD 57,841 thousand.

20. DEPOSITS AND OTHER LIABILITIES DUE TO BANKS, OTHER FINANCIAL INSTITUTIONS AND THE CENTRAL BANK

	December 31, 2017	December 31, 2016
Deposits due to banks		
Transaction deposits	14,956	15,544
Earmarked deposits	201,569	6,059
Other deposits	2,973,830	1,693,724
Other financial liabilities due to banks	611,740	378,449
Interest and fee liabilities due to banks	1,740	1,312
Accrued liabilities for accrued interest on deposits and other financial liabilities due to banks	8,249	2,537
Total deposits and other liabilities due to banks and other financial institutions	**3,812,084**	**2,097,625**

The line item of other deposits refers to short-term RSD deposits of banks and insurance companies in the amount of RSD 661,000 thousand and to foreign currency deposits of domestic banks in the amount of RSD 535,739 thousand, as well as foreign banks - Turkiye Halk Bankasi AS Head Office in the amount of RSD 1,777,091 thousand (2016: RSD 1,234,723 thousand). Deposits were mostly placed for periods of up to 7 days, at an annual interest rate of 0.25%. RSD short-term deposits of banks and insurance companies were placed at interest rates ranging from 2.6% to 4.00% p.a. for the placement periods ranging from 7 days to 1 year, while deposits of domestic banks nominated in foreign currencies were placed at interest rates ranging from 0.05% p.a. to 0.2% p.a. for the placement periods ranging from 7 days to 2 months and 0.75% for the placement period of 6 months. The Parent Bank’s deposits were mostly placed for periods of up to 7 days at an interest rate of 0.25% p.a.

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20. DEPOSITS AND OTHER LIABILITIES DUE TO BANKS, OTHER FINANCIAL INSTITUTIONS AND THE CENTRAL BANK (Continued)

The line item of other financial liabilities due to banks mostly relates to:

- RSD financial liabilities due to domestic banks (NLB Banka ad, Belgrade and the National Bank of Serbia) for contracted purchase and sale of foreign currency cash in the amount of RSD 236,900 thousand and other RSD financial liabilities in the amount of RSD 255 thousand.
- Foreign currency financial liabilities relate to liabilities for contracted purchase and sale of foreign currency cash to: OTP banka Srbija ad, Novi Sad in the amount of RSD 118,500 thousand, UniCredit Bank Serbia ad, Belgrade in the amount of RSD 59,125 thousand, AIK banka ad, Belgrade in the amount of RSD 118,650 thousand and Commerzbank AG, Frankfurt in the amount of RSD 29,685 thousand.

	December 31, 2017	December 31, 2016
Borrowings due to banks		
Borrowings due to banks	2,476,671	841,464
Liabilities for accrued interest on borrowings due to banks	6,208	305
Deferred expenses for liabilities measured at amortized cost using the effective interest rate	(17,212)	(1,375)
Total borrowings due to banks	**2,465,667**	**840,394**
Total: deposits, borrowings and other liabilities due to banks, other financial institutions and the central bank	**6,277,751**	**2,938,019**

The item of borrowings due to banks in the amount of RSD 2,476,671 thousand refers to the following credit lines: Demir-Halk Bank (Netherlands) NV, European Fund for Southeast Europe (EFSE) and Green for Growth Fund (GGF) credit line. The borrowings were obtained at interest rates ranging from 2.10% plus 6-month EURIBOR to 2.85% plus 6-month EURIBOR.

Maturities of borrowings due to banks

Creditors	in EUR '000 Balance at December 31, 2017	in RSD '000 Balance at December 31, 2017	in EUR '000 Matures in 2018	in EUR '000 Matures in 2019 and after 2019
Demir-Halk Bank (Netherlands)	5,000	592,364	2,500	2,500
Green for Growth Fund (GGF)	5,905	699,580	905	5,000
European Fund for Southeast Europe(EFSE)	10,000	1,184,727	-	10,000
TOTAL	**20,905**	**2,476,671**	**3,405**	**17,500**

All amounts expressed in thousands of RSD, unless otherwise stated.

21. DEPOSITS AND OTHER LIABILITIES DUE TO CUSTOMERS

	December 31, 2017	December 31, 2016
Deposits due to customers		
Transaction deposits	10,134,074	8,446,234
Savings deposits	8,220,491	7,116,709
Deposits securitizing loans	1,606,906	1,024,804
Earmarked deposits	311,067	355,252
Other deposits	3,176,552	2,283,691
Other financial liabilities due to customers	132,648	66,703
Interest and fee liabilities due to customers	1,592	5,283
Liabilities for interest payable on deposits and other financial liabilities to customers	67,479	56,741
Total deposits and other liabilities due to customers	**23,650,809**	**19,355,417**

	December 31, 2017	December 31, 2016
Borrowings due to customers		
Borrowings due to customers	5,109,228	6,520,880
Liabilities for accrued interest on borrowings	2,682	2,834
Deferred expenses for liabilities measured at amortized cost using the effective interest rate	(621)	(1,085)
Total borrowings due to customers	**5,111,289**	**6,522,629**
Total: deposits, borrowings and other liabilities due to customers	**28,762,098**	**25,878,046**

RSD and foreign currency demand deposits and current accounts of retail customers are non-interest bearing, i.e., they were deposited at the annual interest rate of 0.00%.Short-term retail deposits were deposited at annual interest rates ranging from 2.50% to 4.25% for RSD funds, and from 0.10% to 1.30% for foreign currency funds. Long-term retail deposits in foreign currencies were deposited at annual interest rates ranging from 1.10% to 2.00%.

By ongoing monitoring of market trends, individual and proactive approach to the customers, the Bank increased the amount of corporate customer deposits by 24.98%. With its offer of several types of deposit products, the Bank provided its clients with adequate funds management, resulting in an increase of deposits of private individuals by 19.32%, with the Bank’s market share reaching 1.08%.

Deposits of corporate clients nominated in RSD were placed at interest rates ranging from 0.50% p.a. do 3.00% p.a, while deposits nominated in foreign currency were placed at interest rates ranging from 0.10% p.a. to 0.80% p.a.

Borrowings refer to long-term loans approved to the Bank by the European Investment Bank with the mediation of NBS in the amount of EUR 31.3 million, the German Development Bank – Kreditanstalt für Wiederaufbau (KfW) in the amount of EUR 1.8 million and the European Agency for Reconstruction in the amount of EUR 9.2 million. In addition, the Bank obtained borrowings from the Government of the Republic of Italy in the amount of EUR 756 thousand.

In accordance with the loan agreements concluded with the International Financial Institutions, the German Development Bank (KfW) and the Green for Growth Fund (GGF), the Bank is required maintain certain financial indicators at the defined levels until the final repayment of the borrowings.

As at December 31, 2017, the Bank did not comply with the following covenants:

Financial institution	Covenant	Prescribed ratio	Realized ratio
KfW	Open credit exposure ratio	20.00%	25.23%

All amounts expressed in thousands of RSD, unless otherwise stated.

21. DEPOSITS AND OTHER LIABILITIES DUE TO CUSTOMERS (Continued)

KFW was informed of non-compliance of the aforesaid covenant compared to the stipulations of the loan agreement. As defined in the loan agreement, the loan matures for collection immediately in case of breach of financial covenants. KFW neither informed the Bank in respect of execution of the aforesaid stipulation of the loan agreement nor provided a waiver to the Bank until the date of the auditor’s report on the Bank’s 2017 financial statements.

In accordance with the loan agreements concluded with the said International Financial Institutions, the Bank reports on a regular basis on the performance of its operating indicators and provides detailed explanations for each covenant breached. The Bank expects no adverse responses from creditors in respect of breach of covenants.

Maturities of borrowings due to customers

in EUR thousand

Creditors	Balance as at 31 December 2017	Matures in 2018	Matures in 2019	Matures in 2020	Matures in 2021	Matures in 2022	Matures after 2022
EIB	31,392	6,934	6,898	6,952	4,361	2,469	3,778
KFW	1,818	909	909	-	-	-	-
FRK	9,159	4,523	2,969	1,165	330	172	-
Government of Republic of Italy	756	189	161	146	130	130	-
TOTAL	**43,125**	**12,555**	**10,937**	**8,263**	**4,821**	**2,771**	**3,778**

Borrowings due to customers were approved to the Bank at the following annual interest rates:

- from 0.85 to 3.45% - fixed annual interest rates;
- 0.75% plus 3-month LIBOR for EUR loans; and
- from 0.40% to 0.966% plus 3-month EURIBOR.

The movements of borrowings and subordinated loans are presented in the following table:

Description / in 000 RSD	2017 Borrowings due to banks, other IFIs and customers	2017 Subordinated debt	2016 Borrowings due to banks, other IFIs and customers	2016 Subordinated debt
Balance as at 1.1.	7,362,344	-	8,159,925	1,824,392
Net Cash Flow from financing	517,547	-	(919,880)	(1,842,216)
FX difference	(293,992)	-	122,299	17,824
Balance as at December 31	**7,585,899**	**-**	**7,362,344**	**-**

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22. PROVISIONS

	December 31, 2017	December 31, 2016
a) Movements on provisions for potential losses on off-balance sheet items		
Balance as of January 1	9,569	2,008
Charge for the year (Note 10a)	4,625	9,333
Reversal of provisions (Note 10a)	(9,139)	(1,772)
Balance as of December 31	**5,055**	**9,569**
b) Movements on provisions for retirement benefits		
Balance as of January 1	29,523	52,673
Charge for the year (Note 11)	5,520	4,231
Reversal of provisions (Note 11)	(5,311)	(19,523)
Release of provisions	(3,583)	(4,845)
Actuarial gains/(losses)	990	(3,013)
Balance as of December 31	**27,139**	**29,523**
c) Movement on the provisions for litigations		
Balance as of January 1	-	-
Charge for the year	7,149	-
Balance as of December 31	**7,149**	**-**
d) Movement on the provision for short-term severance pays		
Balance as of January 1	3,374	36,958
Charge for the year	-	3,374
Release of provisions	(3,374)	(36,958)
Balance as of December 31	**-**	**3,374**
TOTAL:	**39,343**	**42,466**

The opening balance of provisions for short-term severance pays in the amount of RSD 3,374 thousand related to the short-term severance pays that the Bank was obligated to pay due to relocation of the Bank's Head Office to Belgrade and the expected termination of employment for employees who did not accept transfer to Belgrade. These provisions were paid in full in 2017.

Provisions for potential losses in the amount of RSD 5,055 thousand (2016: RSD 9,569 thousand) were created per guarantees and other off-balance sheet items.

In respect of a single lawsuit filed against Bank and the relating claim, according to the case status as of December 31, 2017, the Bank made a provision of RSD 7,149 thousand (equivalent of EUR 60,000).

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23. OTHER LIABILITIES

	December 31, 2017	December 31, 2016
Trade payables	46,691	40,514
Advances received	92,704	68,128
Liabilities from consignment operations	189	75
Other operating liabilities	57,578	41,013
Accrued liabilities	2,618	1,331
Temporary and suspense accounts	770	2,314
Liabilities for employee salaries	1,000	721
VAT liabilities	3,844	4,915
Liabilities for other taxes and contributions payable	1,486	1,502
Accrued liabilities for other calculated expenses	10,539	3,791
Deferred other income	22,679	21,459
Other accruals – subsidized interest	18	260
Other liabilities	10,162	57,672
TOTAL:	**250,278**	**243,695**

Within trade payables totaling RSD 46,691 thousand, the most significant amounts relate to:
- liabilities for costs of advertising due to Initiative d.o.o. Belgrade in the amount of RSD 9,617 thousand;
- liabilities for purchase of AML software in the amount of RSD 7,594 thousand to Asseco SEE d.o.o. Belgrade;
- liabilities for equipment maintenance in the amount of RSD 6,080 thousand to Asseco SEE d.o.o. Belgrade; and
- liabilities for investments made in, upgrade and improvement of the telephone network in the amount of RSD 3,535 thousand to Algotech d.o.o., Belgrade.

These liabilities were settled in January 2018.

The line item of advances received relates to the payments received from customers for loan repayment liabilities not yet matured in the amount of RSD 92,704 thousand.

The line item of other operating liabilities mostly consists of liabilities for the second installment to Comparex d.o.o. Belgrade for purchased licenses (RSD 21,159 thousand) and liabilities per securities sold and dividend payable in RSD - clients without current accounts (RSD 35,864 thousand). Liabilities in respect of securities sold and dividend payable in RSD pertain to the customers taken over from the broker-dealer companies that discontinued their business, in accordance with the rules of business operation of the Central Register of Securities.

The line item of other liabilities totaling RSD 10,162 thousand as of December 31, 2017 mostly relates to foreign currency advances received from the National Bank of Serbia per payment of old foreign currency savings in the amount of RSD 5,934 thousand.

24. EQUITY

Equity and the Bank's Share Capital

In accordance with the Articles of Association and the Statute, the Bank's equity consists of:
- share capital
- share premium
- profit and
- reserves.

The Bank is managed by its founders commensurately to their holdings of the Bank’s ordinary shares, in accordance with the Bank's Articles of Association and the Statute.

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24. EQUITY (Continued)

Equity and the Bank's Share Capital (Continued)

Breakdown of the Bank's equity as at December 31, 2017 and 2016 is provided in the following table:

	December 31, 2017	December 31, 2016
Share capital – ordinary shares	1,819,820	1,819,820
Share capital – preference shares	601,340	601,340
Share premium	1,827,323	1,827,323
Revaluation reserves	364,162	322,675
Reserves from profit	1,312,431	1,174,274
Retained earnings	194,631	138,153
TOTAL:	**6,119,707**	**5,883,585**

The Bank's share capital consists of 181,982 ordinary shares and 60,134 preference shares with the par value of RSD 10,000 per share. The total equity of the Bank consists of share capital in the amount of RSD 2,421,160 thousand, share premium in the amount of RSD 1,827,323 thousand, reserves from profit in the amount of RSD 1,312,431 thousand (2016: RSD 1,174,274 thousand), revaluation reserves in the amount of RSD 364.162 thousand (2016: RSD 322.675 thousand). The Bank realized a profit in 2017 in the amount of RSD 194,631 thousand (2016: RSD 136,080 thousand).

Through acquisition by Turkiye Halk Bankasi AS, the Bank was recapitalized in 2015 with RSD 1,200,000 thousand, by issue of 60,000 preference shares with a par value of RSD 10,000. The share premium the Bank realized from this issue amounted to RSD 600,000 thousand. The majority owner of Turkiye Halk Bankasi AS is the Turkish Privatization Administration holding a 51.11% interest therein.

The Bank is required to maintain the minimum capital adequacy ratio of 8% as prescribed by the National Bank of Serbia. The Bank's capital adequacy ratio as at December 31, 2017 was 17.11% (2015: 15.64%), which is well above the minimum prescribed by the National Bank of Serbia.

Breakdown of Reserves

	December 31, 2017	December 31, 2016
Revaluation reserves		
Reserves from changes in the value of fixed assets	302,707	302,707
Reserves from changes in the value of RSD securities available for sale	54,579	5,376
Reserves from changes in the value of foreign currency securities available for sale	2,704	9,430
Actuarial gains	4,172	5,162
Total revaluation reserves	364,162	322,675
Reserves from profit	1,312,431	1,174,274
TOTAL:	**1,676,593**	**1,496,949**

Reserves arising from valuation of property, plant and equipment relate to effects of assessment of buildings from previous years, decreased for the calculated deferred tax liabilities. Reserves due to available for sale financial assets relate to fair value adjustments calculated as of December 31, 2017 and December 31, 2016. Actuarial gains relate to the effects of valuation of long-term provision for employee benefits based on actuarial calculations. Reserves from profit relate to cumulative effects of profit distribution and loss absorption from previous years.

NOTES TO THE FINANCIAL STATEMENTS
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24. EQUITY (Continued)

Equity and the Bank's Share Capital (Continued)

Basic Earnings per Share

	December 31, 2017	December 31, 2016
Net profit for the year	194,631	136,080
Weighted average number of shares outstanding	181,982	181,982
Earnings per share in RSD	**1,070**	**748**

The Bank's Shareholders as of December 31, 2017:

No.	Shareholder	RSD '000 Ordinary Shares	RSD '000 Cumulative preference shares	RSD '000 Other preference shares	RSD '000 TOTAL	Interest share (%) Ordinary Shares	Interest share (%) Cumulative preference shares	Interest share (%) Other preference shares	Interest share (%) TOTAL
1	Turkiye Halk Bankasi a.s.	1,817,640	900	600,000	2,418,540	99.88	67.16	100.00	99.89
2	Mera invest doo Beograd	2,020	-	-	2,020	0.11	0.00	-	0.08
3	SP Jugoprevoz DP Jagodina – in bankruptcy	-	440	-	440	0.00	32.84	-	0.02
4	Mk rudnik ad Gornji Milanovac	130	-	-	130	0.01	0.00	-	0.01
5	Milka Ćirović	20	-	-	20	0.00	0.00	-	0.00
6	Ortačko društvo Agro Sašex	10	-	-	10	0.00	0.00	-	0.00
	TOTAL:	**1,819,820**	**1,340**	**600,000**	**2,421,160**	**100.00**	**100.00**	**100.00**	**100.00**

During 2017, there were further significant changes in the structure of the Bank's share capital. On August 24, 2017, the Bank's majority owner, Turkiye Halkbankasi AS purchased 18,200 ordinary shares on the Stock Exchange and then through the Share Takeover Bid, approved by the Securities Commission, in the period from August 7 to August 27, 2017, acquired additional 6,118 ordinary Bank's shares. After the completed Share Takeover Bid, on November 15, 2017, the majority shareholder conducted the squeeze-out purchase of shares from the remaining shareholders, so that on December 31, 2017, it owned 99.88% of ordinary shares, i.e., 99.89% of the Bank's total share capital (December 31, 2016: 76.75% of ordinary shares, or 82.47% of the Bank's total share capital)..

December 31, 2017	Total Shares	Turkiye Halkbankasi	% Turkiye Halkbankasi
Ordinary shares	181,982	181,764	99.88%
Preference shares	60,134	60,090	99.93%
Total:	**242,116**	**241,854**	**99.89%**

December 31, 2016	Total Shares	Turkiye Halkbankasi	% Turkiye Halkbankasi
Ordinary shares	181,982	139,680	76.75%
Preference shares	60,134	60,000	99.78%
Total:	**242,116**	**199,680**	**82.47%**

NOTES TO THE FINANCIAL STATEMENTS
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25. OFF-BALANCE SHEET ITEMS

	December 31, 2017	December 31, 2016
a) Transactions for and on behalf of third parties	**278,305**	**295,879**
b) Guarantees, sureties and irrevocable commitments		
Guarantees in RSD	4,034,871	3,327,084
Guarantees in foreign currencies	1,106,581	1,135,460
Total guarantees:	5,141,452	4,462,544
Irrevocable commitments for undrawn loans in RSD	1,231,859	1,182,820
Irrevocable commitments for undrawn loans in foreign currencies	27,249	-
Total irrevocable commitments for undrawn loans	1,259,108	1,182,820
Total guarantees and irrevocable commitments	**6,400,560**	**5,645,364**
c) Financial assets pledged as collateral	**-**	**90,000**
d) Derivatives held for trading at the agreed value	**36,024**	**-**
e) Other off-balance sheet items		
Calculated suspended interest	4,542,059	4,081,544
Commitments for framework loans and facilities	3,929,284	3,714,151
Other off-balance sheet items	37,448,579	43,107,385
Total other off-balance sheet items	**45,919,922**	**50,903,080**
TOTAL:	**52,634,811**	**56,934,323**

The line item of irrevocable commitments for undrawn (undisbursed) loans in RSD as at December 31, 2017 relates to the approved yet unused corporate loans in the amount of RSD 1,050,767 thousand (2016: RSD 1,015,539 thousand), unused retail loans the amount of RSD 161,156 thousand (2016: RSD 151,959 thousand) and unused loans approved to entrepreneurs in the amount of RSD 19,936 thousand (2016: RSD 15,322 thousand).

The line item of other off-balance sheet items includes all tangible and intangible assets the Bank obtained as collateral securitizing repayment of loans totaling RSD 33,841,686 thousand as of December 31, 2017 (2016: RSD 39,694,058 thousand).

In addition, as of December 31, 2017 other off-balance items included:

- receivables for suspended (broken period) interest in the amount of RSD 4,542,059 thousand (2016: RSD 4,081,544 thousand),
- bonds of the Republic of Serbia for prior deposited foreign currency savings in the amount of RSD 777,689 thousand (2016: RSD 840,019 thousand),
- assumed commitments per framework loans in the amount of RSD 3,929,284 thousand (2016: RSD 3,714,151 thousand), and
- other off-balance sheet items in the amount of RSD 2,829,204 thousand (2016: RSD 2,573,309 thousand).

As of December 31, 2017 within other off-balance sheet items the amount of RSD 2,149,401 thousand (2016: RSD 2,042,043 thousand) refers to the direct write-offs of receivables under the relevant decisions of the Board of Directors made in 2017 and 2016. The amount of RSD 226,928 thousand refers to the accounting write-off in accordance with Decision on the Accounting Write-Off of Bank Balance Sheet Assets of the National Bank of Serbia, effective as from September 30, 2017. within the meaning of this Decision, the accounting write-off is a write-off of a non-performing loan when the amount of the impairment of that loan calculated by the bank and credited to allowance for impairment equals 100% of its gross carrying amount. During 2017, the Bank amended its accounting policies in accordance with this NBS Decision.

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25. OFF-BALANCE SHEET ITEMS (Continued)

Commitments per operating lease arrangements, i.e. leases of business premises, ATMs and automobiles are presented in the following table:

	December 31, 2017	December 31, 2016
Commitments with maturity:		
- up to one year	10,194	1,442
- between 1 and 5 years	254,488	240,526
- over 5 years	506,370	599,053
TOTAL:	**771,052**	**841,021**

Total operating lease expenses for 2017 are RSD 193,853 thousand, and for 2016 RSD 138,937 thousand.

26. RELATED PARTY DISCLOSURES

The Bank enters into transactions with its related parties. All receivables and payables at the reporting date, as well as income and expenses incurred during the year, are the result of common regular business activities. The Bank charges and pays interest on its receivables and liabilities, calculated by applying the usual interest rates.

The following table presents the total exposure to related parties that may have an impact on the Bank's performance:

	December 31, 2017	December 31, 2016
a) Loans, deposits and other receivables		
Parent company and entities under common control by parent company:		
Turkiye Halk Bankasi AS	314,550	131,400
Halkbank a.d. Skopje	86,496	38,385
Other related parties:		
Company TGK d.o.o. Cacak	26,064	5
Agrohemija d.o.o. Cacak	3,866	5,578
Company Silver d.o.o. Cacak	1,091	967
Profesional 2000 d.o.o. Gornji Milanovac	578	-
Individuals	140,981	146,715
TOTAL:	**573,626**	**323,050**
b) Borrowings and deposits		
Parent company and entities under common control by parent company:		
Turkiye Halk Bankasi AS	1,777,091	1,234,723
Entities under significant infuence by parent company:		
Demir Halkbank Netherlands	592,364	617,362
Other related parties:		
Company Interprogres Cacak	-	3,085
Agrohemija d.o.o. Cacak	-	2,153
Banprom DOO	-	1,225
TIBO Kompanija doo Beograd Mladenovac	-	358
Bodri DOO Gornji Milanovac	-	175
Individuals	167,079	181,020
TOTAL:	**2,536,534**	**2,040,101**

All amounts expressed in thousands of RSD, unless otherwise stated.

26. RELATED PARTY DISCLOSURES

	December 31, 2017	December 31, 2016
c) Off-balance sheet items		
Parent company and entities under common control by parent company:		
Halkbank a.d. Skopje	118,473	123,472
Turkiye Halk Bankasi AS	5,935	-
Other related parties:		
Ninex d.o.o. Cacak - in bankruptcy	67,388	67,706
Agrohemija d.o.o. Cacak	5,831	5,300
Quince M Pro d.o.o. Beograd Zemun	7,390	-
Company TGK d.o.o. Cacak	4,254	4,404
Company Interprogres Cacak	1,000	-
Company Silver d.o.o. Cacak	546	325
Profesional 2000 d.o.o. Gornji Milanovac	300	300
Individuals	14,386	15,211
TOTAL:	**225,503**	**216,718**

Loans, deposits and other receivables as well borrowings and deposits granted and received by parent company and entities under common control and significant influende by parent company are given and received at usual market interest rates in range disclosed in Notes 16, 17, 20 and 21.

	Year Ended December 31, 2017	Year Ended December 31, 2016
d) Interest, fee and commission income		
Parent company and entities under common control by parent company:		
Turkiye Halk Bankasi AS	1,281	1,463
Other related parties:		
Agrohemija d.o.o. Cacak	410	596
Company TGK d.o.o. Cacak	522	-
Profesional 2000 d.o.o. Gornji Milanovac	101	-
Company Interprogres Cacak	38	29
TIBO Kompanija doo Beograd Mladenovac	26	23
Transkomerc Pantovic doo Ivanjica	6	-
Vuxa 10 doo Sabac	5	-
Company Silver doo Cacak	-	169
PD Banprom d.o.o. Pirot	-	22
Individuals	8,327	9,111
TOTAL:	**10,716**	**11,413**
e) Interest, fee and commission expenses		
Parent company and entities under common control by parent company:		
Turkiye Halk Bankasi AS	2,624	406
Halkbank a.d. Skopje	18	-
Entities under significant infuence by parent company:		
Demir Halkbank Netherlands	16,466	-
Other related parties:		
Agrohemija d.o.o. Cacak	1	2
Company Interprogres Cacak	3	5
PD Banprom d.o.o. Pirot	-	3
Company Silver doo Cacak	-	1
Individuals	423	567
TOTAL:	**19,535**	**984**

26. RELATED PARTY DISCLOSURES (Continued)

Gross remunerations to the Chairmen and members of the Bank's Board of Directors and Executive Board in 2017 amounted to RSD 44,654 thousand (2016: RSD 48,572 thousand). Net remunerations to the Chairmen and members of the Board of Directors and Executive Board in 2017 amounted to RSD 37,109 thousand (2016: RSD 38,976 thousand).

As of December 31, 2017 the Bank presented provisions for loans, deposits and other receivables from related parties in the amount of RSD 261 thousand (December 31, 2016: RSD 1,113 thousand). During the year, losses from impairment of financial assets and credit risk-weighted off-balance sheet assets amounted to RSD 122 thousand, gains from impairment of financial assets and credit risk-weighted off-balance sheet assets amounted to RSD 364 thousand and direct write-offs of financial assets and credit risk-weighted off-balance sheet assets amounted to RSD 610 thousand.

27. RISK MANAGEMENT

In accordance with the Law on Banks and NBS Decision on Risk Management by Banks, Halkbank a.d. Beograd (the " Bank") has identified the following risks the Bank is exposed to in its operations:

- Liquidity risk;
- Credit risk, which includes the residual risk, downgrade risk, settlement/free delivery risk, counterparty risk and credit-foreign exchange risk;
- Interest rate risk;
- Foreign exchange risk and other market risks;
- Concentration risk;
- Investments risks relating to investments in other entities and own fixed assets;
- Country risk;
- Operational risk, including legal risk;
- Risk of inadequate IS management;
- Strategic risk;
- Regulatory compliance risk, which includes the risk of sanctions by the regulator, risk of financial loss and reputation risk; and
- Environmental risk.

The Bank's objectives in risk management, defined within the risk management system, are minimization of the adverse effects of the Bank's exposure to the above listed risks on the Bank's performance and capital with simultaneous adherence to the defined limits of the acceptable risk levels and maintenance of the required capital adequacy ratio.

The Bank's risk management system in place is comprised of:

- Risk management strategies and policies as well as the procedures and instructions for risk identification, measurement, assessment and management;
- Internal organization, i.e., organizational structure that ensures functional and organizational separation of the risk management activities from the risk assumption activities, with clearly defined segregation of duties for employees, which prevents conflicts of interests;
- Effective and efficient risk management process entailing mitigation, monitoring and control of the risks the Bank is or may be exposed to;
- Internal control system as a set of processes and procedures in place intended to ensure adequate risk control, operational effectiveness and efficiency monitoring, financial and other data reliability and compliance with the effective legislation and the Bank's internal bylaws with a view to achieve safe and stable banking operations;
- Adequate information system.

The Bank's Board of Directors is responsible for establishment of a uniform risk management system throughout the Bank and for supervision of that system. The Board of Directors must ensure that the Bank's Executive Board will identify the risks the Bank is exposed to and control such risks in accordance with the bank's adopted policies and procedures.

27. RISK MANAGEMENT (Continued)

The Bank's Executive Board implements the risk management strategies and polices adopted by the Board of Directors, defines procedures, instructions and guidelines for risk identification, measurement, assessment and management, analyzes their efficiency and reports to the Board of Directors on these activities. The Audit Committee is in charge of an ongoing oversight of implementation of the risk management policies and procedures and performance of the internal control system.

The Asset and Liability Management Committee ("ALCO") is in charge of monitoring the Bank's exposure to the risks arising from the structure of the Bank's receivables and liabilities and off-balance sheet items, and proposes measures for risk management. The Liquidity Committee considers the Bank's liquidity risk exposure on a daily basis and proposes activities with regard to the obtaining and deploying funds given the set up liquidity goals.

The Competent Credit Committees decide on loan approval and origination of other receivables as well as on the amendments to the contracted terms of such loans and receivables.

The committee for monitoring of collection of potential NPLs, NPLs and doubtful receivables considers and adopts proposals for collection of such loans and receivables and proposes to the Executive Board enactment of decisions on execution of out-of-court settlement agreements, decisions on full or partial write-off of NPLs and doubtful receivables.

The Bank's IT Committee reviews and approves IT standards and policies, reports by regulatory and independent inspection bodies and proposes to the Executive Board introduction of new technologies.

27.1 Credit Risk

Credit Risk Management

Credit risk is a risk of possible negative effects on the Bank's financial performance and capital arising from the customers failing to meet their obligations toward the Bank. The effects of this risk are measured by the amount of the Bank's expenses incurred due to the customer default.

The following organizational units of the Bank are responsible for credit risk management:

- The Board of Directors, which defines the risk management strategy and credit risk management policy;
- The Executive Board, which implements the adopted strategy and policy and defines procedures and instructions for risk management;
- ALCO, which monitors the Bank's exposure to the credit risk and proposes adequate measures for credit risk management;
- The Bank's Credit Committees, which approve loans;
- The committee for monitoring of collection of potential NPLs, NPLs and doubtful receivables, which considers and adopts proposals for collection of such loans and receivables;
- Credit Monitoring Department, which assess the customer credit risk; and
- Risk Management Department, which monitors the loan portfolio quality.

Pursuant to the relevant decision of the Bank's Board of Directors and Executive Board, the following credit committees have been formed:

- The Bank Credit Committee;
- The Bank Credit Sub-Committee;
- The Branch Credit Committees; and
- The Sub-Branch Credit Committees.

The Bank Credit Committee decides on approval of corporate and retail loans when the Bank's exposure to a single entity or a group of related entities, including the loan applied for, exceeds EUR 200 thousand.

The Bank Credit Sub-Committee decides on approval of corporate and retail loans when the Bank's exposure to a single entity or a group of related entities, including the loan applied for, amounts up to EUR 200 thousand.

The Branch Credit Committees decide on approval of corporate and retail loans when the Bank's exposure to a single entity or a group of related entities, including the loan applied for, amounts up to EUR 100 thousand in line with the following set up limits.

27. RISK MANAGEMENT (Continued)

27.1 Credit Risk (Continued)

Credit Risk Management (Continued)

Loans to corporate customers:
- with mortgage lien as collateral – up to EUR 100,000; and
- with other collateral types- up to EUR 50,000.

Loans of retail customers:
- cash and consumer loans up to EUR 10,000;
- car loans up to EUR 20,000; and
- housing loans up to EUR 100,000.

The Sub-Branch Credit Committees decide on approval of loans to individuals when the Bank's exposure to a single person or a group of related persons, including the loan applied for, amounts up to EUR 10,000.

Assessment of the credit risk exposure is carried out within the Crediting Division and Risk Management Department. Within the Crediting Department credit risk exposure is assessed upon analysis of the customer loan requests.

Within the Crediting Division credit risk is identified, controlled and monitored at the individual borrower level, through the assessment of the borrower credit rating and collateral quality.

Credit risk identification, control and monitoring on a portfolio basis are performed by the Risk Management Department through preparation and analysis of the report on the Bank's portfolio, control over classification of the balance sheet assets and off-balance sheet items, calculation and recording of reserves for estimated losses, calculation of impairment allowance and provisions and control of the quality of the balance sheet assets and off-balance sheet items.

27.1.2 Analysis of the Financial Assets, Financial Liabilities and Off-Balance Sheet Items

The following tables provide the breakdowns of the Bank's financial assets and financial liabilities as of December 31, 2017 and 2016 as per:

- Items of the statement of the financial position, in the net amounts,
- Credit risk exposure, in the gross amounts,
- Impairment, in the gross and net amounts,
- Internal categories in accordance with IAS 39, in the gross and net amounts,
- Fair value of collaterals, in the gross amounts,
- LTV ratio for financial assets securitized with mortgages,
- Past-due intervals, in the gross and net amounts,
- Industry, in the gross and net amounts,
- Geographic region, in the net amounts,
- Fair value,
- Assets acquired in lieu of debt collection,
- Write-off of receivables, and
- Breakdown of restructured financial assets.

Structure of the Net Financial Assets, Financial Liabilities and Off-Balance Sheet Items

The Bank's financial assets, financial liabilities and off-balance sheet items are presented in the following breakdowns in the net amounts. Loans and receivables due from banks and other financial institutions as well as loans and receivables due from customers are presented net of the collected but not credited to income loan processing fees, which are included in the effective interest rate calculation upon loan approval, and subsequently recognized within interest income using the effective interest rate and net of impairment allowances. As for off-balance sheet items, the Bank has no deferred fees for processing costs (the effective interest method) but defers the fees on a straight-line basis. Therefore, the off-balance sheet items are also presented in the net amounts, i.e., their gross amounts are decreased by the provisions for losses.

All amounts expressed in thousands of RSD, unless otherwise stated.

27. RISK MANAGEMENT (Continued)

27.1.2 Analysis of the Financial Assets, Financial Liabilities and Off-Balance Sheet Items (Continued)

Structure of the Net Financial Assets, Financial Liabilities and Off-Balance Sheet Items (Continued)

As of December 31, 2017 the Bank's cash, cash equivalents and balances held with the central bank increased by RSD 749,239 thousand compared to December 31, 2016 and comprised 12.03% of the Bank's total financial assets. Financial assets available recorded an increase by RSD 1,182,255 thousand, and loans and receivables due form customers were by RSD 4,897,123 thousand higher, comprising 71.62% of the Bank's total financial assets.

As of December 31, 2017 the Bank's deposits and other liabilities due to banks, other financial institutions and the central bank went up by RSD 3,339,732 thousand and deposits and other liabilities due to customers increased by RSD 2,884,052 thousand compared to December 31, 2016.

Financial assets and financial liabilities, net

	December 31, 2017	December 31, 2016
Financial assets	**40,238,141**	**33,811,617**
Cash and balances held with the central bank	4,839,851	4,090,612
Financial assets at fair value through profit or loss, held for trading (including pledged assets)	24,758	23,984
Financial assets available for sale (including pledged assets)	4,359,850	3,177,595
Financial assets held to maturity (including pledged assets)	472,892	1,443,325
Loans and receivables due from banks and other financial institutions	1,524,613	1,018,760
Loans and receivables due from customers	28,894,906	23,997,783
Other assets	121,271	59,558
Financial liabilities	**35,259,993**	**29,031,163**
Deposits and other liabilities due to banks, other financial institutions and the central bank,	6,277,751	2,938,019
Deposits and other liabilities due to customers	28,762,098	25,878,046
Other liabilities	220,144	215,098

	December 31, 2017	December 31, 2016
Off-balance sheet items, net	**10,324,789**	**9,349,947**
Guarantees and letter of credit	**5,141,392**	**4,458,247**
Large corporate customers	603,489	796,275
SMEs, micro-sized entities and entrepreneurs	4,523,186	3,649,499
Retail customers	10,663	4,322
Other customers	4,054	8,151
Commitments per undrawn loans	**5,183,397**	**4,891,700**
Large corporate customers	271,155	368,432
SMEs, micro-sized entities and entrepreneurs	4,672,415	4,349,347
Retail customers - individuals	237,535	169,538
Other customers	2,292	4,385

Gross Credit Risk Exposure

Gross credit risk exposure per loans and receivables due from customers increased by RSD 4,798,733 thousand. Exposure to SMEs, micro business and entrepreneurs rose by RSD 3,293,602 thousand, while exposure to retail customers – individuals rose by RSD 2,032,137 thousand. On the other hand, exposure to other customers – non-profit entities, entities involved in social activities and entities in bankruptcy – decreased by RSD 333,318 thousand. Exposures to the public sector and large corporate customers went down by RSD 43,515 thousand and RSD 150,173 thousand, respectively.

Within loans and receivables due from customers, gross, the most significant decrease of 12.64% was recorded by the large corporate customers and other customers (11.43%), while the other categories had increases, as follows: retail customers – individuals by 32.64% and SMEs, micro businesses and entrepreneurs by 20.67%.

All amounts expressed in thousands of RSD, unless otherwise stated.

27. RISK MANAGEMENT (Continued)

27.1 Credit Risk (Continued)

Gross Credit Risk Exposure (Continued)

Credit risk – gross exposure

	December 31, 2017	December 31, 2016
Financial assets	**42,951,415**	**36,647,212**
Cash and balances held with the central bank	**4,839,851**	**4,090,612**
Financial assets at fair value through profit or loss, held for trading (including pledged assets)	**24,758**	**23,984**
Financial assets available for sale (including pledged assets)	**4,360,016**	**3,177,820**
Financial assets held to maturity (including pledged assets)	**472,892**	**1,443,325**
Loans and receivables due from banks and other financial institutions	**1,524,692**	**1,038,506**
Loans and receivables due from customers	**31,573,726**	**26,774,993**
Of which:		
Public sector	468,685	512,200
Large corporate customers	1,038,226	1,188,399
SMEs, micro-sized entities and entrepreneurs	19,224,862	15,931,260
Retail customers - individuals	8,258,573	6,226,436
Other customers	2,583,380	2,916,698
Other assets	**155,480**	**97,972**

Gross credit risk exposure per off-balance sheet items increased by RSD 970,329 thousand as of December 31, 2017 in comparison to December 31, 2016. Gross credit risk exposures per guarantees and letters of credit to SMEs, micro-sized entities and entrepreneurs on one end and retail customers on the other increased by RSD 873,746 thousand, and by RSD 6,341 thousand, respectively, whereas the exposures large corporate and other customers decreased by RSD 192,786 thousand and RSD 8,394 thousand, respectively.

Commitments per undrawn loans were by RSD 291,421 thousand or 5.95% higher as of December 31, 2017 in comparison to December 31, 2016. The gross exposures in this respect increased toward SMEs, micro-sized entities and entrepreneurs by RSD 327,897 thousand and to retail customers by RSD 68,074 thousand, while the gross exposure to other customers (non-profit organizations and entities) and large corporate customers fell by RSD 7,353 thousand and by RSD 98,197 thousand.

Gross credit risk exposure per off-balance sheet items

	December 31, 2017	December 31, 2016
Off-balance sheet items	**10,329,844**	**9,359,515**
Guarantees and letter of credit	**5,141,452**	**4,462,544**
Large corporate customers	603,489	796,275
SMEs, micro-sized entities and entrepreneurs	4,523,246	3,649,499
Retail customers	10,663	4,322
Other customers	4,054	12,448
Commitments per undrawn loans	**5,188,392**	**4,896,971**
Large corporate customers	271,235	368,432
SMEs, micro-sized entities and entrepreneurs	4,677,244	4,349,347
Retail customers - individuals	237,612	169,538
Other customers	2,301	9,654

27. RISK MANAGEMENT (Continued)

27.1 Credit Risk (Continued)

Gross Credit Risk Exposure (Continued)

Total on-balance sheet and off-balance sheet exposures to certain sectors/customer segments were within the prescribed limits:

- For the public sector (government bodies and agencies, the mandatory social insurance funds, the autonomous province, local governance units, legal entities financed from the budget) the prescribed maximum is 10% of the gross balance sheet assets and off-balance sheet items subject to classification; as of December 31, 2017 the share of this sector equaled 1.44%;
- For corporate customers the prescribed maximum is 90% of the gross balance sheet assets and off-balance sheet items subject to classification; as of December 31, 2017 the share of this sector equaled 64.76%; and
- For retail customers 25% the prescribed maximum is 25% of the gross balance sheet assets and off-balance sheet items subject to classification; as of December 31, 2017 the share of this sector equaled 19.93%.

Financial Assets – Impairment

Individual Assessment for Impairment

In accordance with IAS 39, the Bank first assesses whether there is objective evidence of impairment ("loss event") of individually significant financial assets or whether collective assessment will be applied to the financial assets that are not individually significant. Individually significant are those financial assets that exceed a certain set up limit or have borrower-specific or transactions-specific risks (e.g. industry risk concentration, rating category, default status, loan type, etc.).

The Bank's adopted internal Methodology for Impairment Allowance Calculation and Provisioning in accordance with IAS 39 (the "Methodology") defines as individually significant financial assets all financial assets in excess of RSD 2,500 thousand and such assets are subject to individual assessment for impairment. Upon definition of the said limit, the Bank considered the crediting policy limits, quality of the collective impairment assessment models, size of the loan portfolio and best banking practices. The Methodology also stipulates that all financial assets with the default status, whether individually significant or not, shall be individually assessed for impairment.

Objective evidence of impairment of a financial asset include the following loss events:
1) Default status of the borrower in respect of any materially significant liability to the Bank;
2) Existence of any other loss event irrespective of the possibility of collection from collateral foreclosure, particularly the following:
   - discontinued interest calculation and accrual in accordance with the Bank's internal bylaws;
   - partial or full write-off of the receivables;
   - loans and receivables restructuring due to deterioration of the borrower's financial situation with decreased amounts of or extension of the period for repayment of the loan principal, interest of fees;
   - the borrower being subject to liquidation or bankruptcy proceedings.

A materially significant amount is an amount above 1% of an individual receivable due to the Bank by the borrower but not below RSD 1,000 for private individuals and not below RSD 10,000 thousand for entities. In other words, only material amounts are included in the default receivables.

Default status of legal entity borrowers is determined and stated at the borrower level, for all receivables from the same borrower. Default status of retail borrowers – entrepreneurs, farmers and private individuals – is determined and reported at a single receivable level.

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27. RISK MANAGEMENT (Continued)

27.1 Credit Risk (Continued)

Financial Assets – Impairment (Continued)

Individual Assessment for Impairment (Continued)

Definition of the default status depends on the type of the financial assets it relates to. For this purpose, the Bank's financial assets are classified into the following four portfolios:

- retail customers;
- corporate customers;
- banks and other financial institutions;
- public sector (government).

For the financial assets where retail customers are borrowers, the default status has occurred if:

- a single receivable due from the customer is over 90 days past due as of the reporting date; or
- another loss event exists.

Due to the specific nature of the product, for authorized current account overdrafts the default status occurs in instances of delays of over 60 days. Such transactions shall be regarded as in default status when the customer has exceeded the approved limit amount of the current account overdraft or has been notified on the limit amount less than the amount of the customer's current debt.

For corporate customers the default status occurs if at least one of the following criteria is met:

- the borrower is over 90 days past due in liability settlement, where delays are considered per all the currently existing receivables due from the borrower as of the reporting date, or
- another loss event exists.

For entrepreneurs and farmers (agricultural estates) the default status occurs if at least one of the following criteria is met:

- the borrower is over 90 days past due in liability settlement per a single receivable; or
- another loss event exists.

Approved current account overdrafts (the current account debit balance) shall be regarded as past due when the customer has exceeded the approved limit amount of the current account overdraft or has an outstanding amount to settle after the overdraft maturity.

For banks the default status occurs if:

- a bank has delays in liability settlement toward the Bank (even of a single day); or
- another loss event exists.

For provisioning purposes, it is assumed that probability of default (PD) of loans and receivables due from the public sector (the government) is zero. It is believed that the Government cannot be in default in liability settlement and therefore there is no need for any provisioning.

The process of individual assessment for impairment comprises two phases:

- Identification of loss event(s) and
- Assessment of individual cash flows for provisioning purposes.

Individual assessment is performed through projection of cash flows based on:

- the number of days past due;
- previous period's repayment dynamics;
- collateral quality;
- executed protocols on collection (e.g., surety agreements, debt assumption agreements).

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27. RISK MANAGEMENT (Continued)

27.1 Credit Risk (Continued)

Financial Assets – Impairment (Continued)

Individual Assessment for Impairment (Continued)

The impairment allowance is recognized as the difference between the carrying value of the receivable and net present value arrived at by discounting the future cash flows.

The calculated impairment of a financial asset is charged to expenses and credited to the impairment allowance of the financial asset while the calculated amount of probable losses per off-balance sheet items is charged to expenses and credited to the provisions for losses per off-balance sheet items.

Collective Assessment for Impairment

All financial assets for which there is no objective evidence of impairment are included in groups of receivables with similar credit risk characteristics and assessed for impairment collectively. The Bank makes provisions for financial instruments that are not in default in the amount of the portion of loans and receivables for which it is assumed that loss events have occurred but have not yet been individually identified by the Bank.

To this end, for the customers / financial asset that are not in default, a portion of receivables is identified, which is expected to migrate to the group of receivables in default after the loss identification period (LIP). In this manner, based on the past events, the amount of the required provisions is determined assuming that for a number of receivables loss events have occurred indicative of the probability of default but have not yet been identified. LIP equals 1 (period for loss identification of 12 months) for all receivables.

Collective assessment for imapirment is performed for groups of borrowers, classified into those groups in accordance with the Methodology, based on the classification category and regularity in liability settlement, industry, loan type and collateral type.

Impairment allowance is calculated as the product of the probability of the loss scenario (PD * (1-RI) and the loss amount (LA), or

$$\text{Impairment Loss} = PD * (1 - RI) * LA$$

where:

PD denotes probability of default,
RI repayment indicator showing what share (percentage) of the transaction in default has been realized without collateral activation during the given period,
LA denotes loss amount in the event of repayment.

In order to calculate RI, the Bank determines probability of return to the non-default group for all default status group over a 12-month period.

Haircut rates used by the Bank to reduce the market value of collaterals to the value used in imapirment calculation are defined by the collateral valuation procedure. For collaterals that comprise pledged debt and equity securities the Bank uses the security market values at the calculation date for impairment purposes. Collaterals are allocated in accordance with the instruction for collateral registration and allocation.

Impairment allowances/provisions ought to be equal to the difference between the carrying values of financial assets and the net present value of the estimated future cash flows, assuming that there will be delays in liability settlement and that collaterals will be activated. These cash flows represent projected repayments of principal and interest by the borrowers, cash flows from the sale of collaterals less any cost to sell. The estimated future cash flows are discounted to their net present value using the effective interest rate.

All amounts expressed in thousands of RSD, unless otherwise stated.

27. RISK MANAGEMENT (Continued)

27.1 Credit Risk (Continued)

Financial Assets – Impairment (Continued)

Collective Assessment for Impairment (Continued)

The Bank's aggregate impairment allowance totaling RSD 2,713,274 thousand as of December 31, 2017 (December 31, 2016: RSD 2,835,595 thousand) decreased by RSD 122,321 thousand or 4.31% compared to December 31, 2016, primarily as a result of the improved portfolio quality due to collection of NPLs and write-off of fully impaired receivables.

Breakdown of financial assets per impairment

	December 31, 2017	December 31, 2016
Undue and unimpaired	36,980,694	29,979,651
Past due but unimpaired	1,068,387	783,245
Impaired	4,902,334	5,884,316
Total gross	**42,951,415**	**36,647,212**
Collective impairment allowance	98,080	93,566
Individual impairment allowance	2,615,194	2,742,029
Total impairment allowance	**2,713,274**	**2,835,595**
Total net	**40,238,141**	**33,811,617**

Financial Assets per Category

The following breakdown presents financial assets per categories used for calculation of impairment allowance in accordance with IAS 39. The gross and net amounts of financial assets without category (A0 – without category), which are not subject to classification, increased in 2017 (by RSD 4,824,718 thousand gross), due to increase in receivable due form the Government and the National Bank of Serbia.

Financial assets classified into better categories – A1 and A2 according to IAS 39 – increased in 2017 by RSD 2,270,400 thousand, gross due to increase in the total financial assets. Financial assets classified into worse categories A3, A4 and A5 decreased by RSD 688,465 thousand, gross, as well as the assets in the worst A6 category, which decreased by RSD 91,375 thousand due to write-off and collection of NPLs.

Gross and net exposure shares in the total financial assets per category as of December 31, 2017 and 2016 are provided in the table below:

Breakdown of financial asses per category in accordance with the Methodology for Impairment Allowance Calculation and Provisioning under IAS 39

	December 31, 2017		December 31, 2016	
Category	**Gross exposure**	**Net exposure**	**Gross exposure**	**Net exposure**
A0-without category	9,673,747	9,657,012	4,860,104	4,817,003
Categories A1 and A2	27,196,704	27,124,800	24,926,304	24,875,950
Categories A3, A4 and A5	1,179,050	1,155,831	1,867,515	1,715,375
Category A6	4,901,914	2,300,498	4,993,289	2,403,289
Total	**42,951,415**	**40,238,141**	**36,647,212**	**33,811,617**

All amounts expressed in thousands of RSD, unless otherwise stated.

27. RISK MANAGEMENT (Continued)

27.1 Credit Risk (Continued)

Financial Assets – Impairment (Continued)

Breakdown of financial asses per category in accordance with the Methodology for Impairment Allowance Calculation and Provisioning under IAS 39 (Continued)

Percentage shares of asset categories under IAS 39 in the total financial assets are presented below:

Category	December 31, 2017 Gross	Net	December 31, 2016 Gross	Net
A0-without category	22.52%	24.00%	13.26%	14.25%
Categories A1 and A2	63.32%	67.41%	68.02%	73.57%
Categories A3, A4 and A5	2.75%	2.87%	5.10%	5.07%
Category A6	11.41%	5.72%	13.63%	7.11%
Total	**100.00%**	**100.00%**	**100.00%**	**100.00%**

Fair Value of Collaterals

The Bank's collateral management system entails a set of activities and prescribed measured and rules implemented for ongoing recording, allocation and valuation of collaterals.

For assessment of additional credit risk arising from possible problems in collateral activation and time intervals between the default status occurrence and the Bank's successful collateral foreclosure, the market value of the collateral serving or to be serving as a security instrument is reduced to arrive at the value that the Bank would achieve in the event of sale collateral in order to collect its receivable secured by the collateral.

The fair values of collaterals are presented in the following breakdown per appraised market value but only to the amount of the respective receivables securitized with mortgage and pledge lines, deposits and guarantees received from borrowers.

Coverage of the total financial assets by collaterals valued as described above equaled 38.71% as of December 31, 2017. Total collateral coverage ratio for the individually impaired gross exposures equaled 84.25%, while mortgage collateral coverage ratio was 76.97%. Total collateral coverage ratio of matured (past-due) but unimpaired assets was 7.30%, while their mortgage collateral coverage ratio was 5.67%. Total collateral coverage ratio for not matured (undue) and unimpaired financial assets equaled 33.58%, while their mortgage collateral coverage ratio was 25.28%.

Assessment of the collateral fair value per financial asset as of December 31, 2017

	Gross assets	Mortgages	Pledges	Deposits	Other
Financial assets	**42,951,415**	**13,182,233**	**1,422,399**	**1,121,071**	**902,109**
Individually impaired	4,902,334	3,773,417	128,764	0	227,885
Past due but unimpaired	1,068,387	60,599	8,859	7,013	1,504
Undue and unimpaired	36,980,694	9,348,217	1,284,776	1,114,058	672,720

Assessment of the collateral fair value per financial asset as of December 31, 2016

	Gross assets	Mortgages	Pledges	Deposits	Other
Financial assets	**36,647,212**	**13,472,969**	**1,197,026**	**758,394**	**1,015,690**
Individually impaired	5,884,316	4,721,113	104,344	59	221,681
Past due but unimpaired	783,245	59,445	12,005	4,050	3,193
Undue and unimpaired	29,979,651	8,692,411	1,080,677	754,285	790,816

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27. RISK MANAGEMENT (Continued)

27.1 Credit Risk (Continued)

Financial Assets – Impairment (Continued)

LTV Ratio

As for the financial assets securitized with mortgages, as of December 31, 2017 the largest share of 36.79% was that of the mortgages with LTV ratios below 50%, followed by the share of mortgages with LTV ratios ranging from 51% to 70% equal to 22.33% and the share of mortgages with LTV ratios ranging between 71% and 90% equal to 20.59%. Mortgages with LTV ratios from 91% to 100% had a share of 11.74%, and mortgages with LTV ratios above 100% (which are therefore regarded as inadequate collaterals) had a share of 8.56%.

LTV ratio balances as of December 31, 2017

	Below 50%	51%-70%	71%-90%	91%-100%	Above 100%
Financial assets securitized with mortgages	**4,849,581**	**2,943,212**	**2,714,172**	**1,547,002**	**1,128,266**
Individually impaired	896,600	409,273	765,174	1,040,925	661,445
Past due but unimpaired	36,863	12,611	6,208	2,029	2,888
Undue and unimpaired	3,916,118	2,521,328	1,942,790	504,048	463,933

LTV ratio balances as of December 31, 2016

	Below 50%	51%-70%	71%-90%	91%-100%	Above 100%
Financial assets securitized with mortgages	**4,965,969**	**3,705,532**	**2,411,823**	**928,567**	**1,461,078**
Individually impaired	973,144	1,261,675	1,046,394	501,599	938,301
Past due but unimpaired	37,364	13,411	5,010	2,426	1,234
Undue and unimpaired	3,955,461	2,430,446	1,360,419	424,542	521,543

Financial Assets per Number of Days Past Due

As of December 31, 2017 the financial assets without days past due had a share of 88.03% in the total financial assets, gross, those from 1 to 30 days past due had a share of 4.04%, assets from 31 to 90 days past due had a share of 0.53%, assets from 91 to 180 and from 181 to 365 days past due had respective shares of 0.68% and 0.05%, while the share of assets with a number of days past due of over 365 days was 6.67%.

Breakdown of financial assets per past-due interval

	December 31, 2017		December 31, 2016	
	Gross exposure	Net exposure	Gross exposure	Net exposure
Without delays, no days past due	37,811,455	37,138,383	30,706,042	30,250,568
From 1 to 30 days past due	1,734,323	1,728,364	1,464,948	1,460,392
From 31 to 90 days past due	228,734	220,614	187,734	173,740
From 91 to 180 days past due	293,786	47,445	29,403	18,519
From 181 to 365 days past due	19,394	11,940	450,053	252,461
Over 365 days past due	2,863,723	1,091,395	3,809,032	1,655,937
Total	**42,951,415**	**40,238,141**	**36,647,212**	**33,811,617**

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27. RISK MANAGEMENT (Continued)

27.1 Credit Risk (Continued)

Financial Assets per Industry

Financial assets are presented below per industry in the gross and net amounts.

As of December 31, 2017, the largest share in the total gross financial assets was that of the processing industry – 25.24%, followed by the retail sector - private individuals, trade and repairs of motor vehicles and motorcycles with respective share of 19.27% and 13.68%.

Concentration of the financial assets per industry

	December 31, 2017		December 31, 2016	
	Gross exposure	Net exposure	Gross exposure	Net exposure
Agriculture, forestry and fisheries	478,124	475,875	191,109	188,617
Mining and quarrying	77,526	77,194	94,916	93,443
Manufacturing and processing industry	10,841,064	9,048,551	10,680,046	8,849,575
Electricity, gas, steam and air conditioning Supply	422,008	368,978	100,095	99,656
Construction industry	1,793,577	1,536,430	1,264,720	1,003,619
Wholesale and retail trade and repair of motor vehicles and motorcycles	5,876,843	5,559,506	4,754,639	4,378,379
Transport and storage, hotel and restaurant services, information and communications	2,479,693	4,797	1,901,272	1,704,090
Real estate, professional, scientific and technical activities, arts, entertainment and leisure	675,921	342,594	618,504	612,925
Banks, financial institutions and insurance Companies	3,925,227	3,920,047	2,848,103	2,823,775
Private individuals	8,274,969	8,223,999	6,244,636	6,156,142
Other	8,106,463	10,680,170	7,949,172	7,901,396
Total	**42,951,415**	**40,238,141**	**36,647,212**	**33,811,617**

Concentration of the off-balance sheet items per industry

	December 31, 2017		December 31, 2016	
	Gross exposure	Net exposure	Gross exposure	Net exposure
Agriculture, forestry and fisheries	80,900	80,887	88,316	88,270
Mining and quarrying	22,758	22,745	30,425	30,421
Manufacturing and processing industry	3,251,335	3,248,971	2,948,525	2,942,895
Electricity, gas, steam and air conditioning Supply	29,280	29,247	34,689	34,626
Construction industry	2,922,811	2,922,461	2,617,414	2,616,804
Wholesale and retail trade and repair of motor vehicles and motorcycles	2,081,186	2,079,933	1,892,094	1,889,884
Transport and storage, hotel and restaurant services, information and communications	677,947	677,229	664,087	663,369
Real estate, professional, scientific and technical activities, arts, entertainment and leisure	450,854	450,712	253,883	253,716
Banks, financial institutions and insurance companies	396,795	396,791	507,577	507,577
Private individuals	248,275	248,197	173,867	173,859
Other	167,703	167,616	148,638	148,526
Total	**10,329,844**	**10,324,789**	**9,359,515**	**9,349,947**

All amounts expressed in thousands of RSD, unless otherwise stated.

27. RISK MANAGEMENT (Continued)

27.1 Credit Risk (Continued)

Financial Assets per Region

The table below shows financial assets per exposure to certain geographic regions. As of December 31, 2017, the predominant share was the share of exposure to customers in Serbia (97.66%). The share of the exposure to the European Union borrowers was 1.31%, USA and Canada's share was 0%, and the share of borrowers from other regions equaled 1.03%.

Concentration of the financial assets per region, net exposures

	December 31, 2017	December 31, 2016
Serbia	39,296,461	33,146,313
European Union	526,979	465,065
USA and Canada	'-	61,532
Other	414,701	138,707
Total	**40,238,141**	**33,811,617**

Financial Assets per Serbian Region

The table below shows financial assets per exposure to certain geographic regions in Serbia. As of December 31, 2017, the predominant share was the share of exposure to customers in Belgrade (47.08%), followed by the share of exposure to borrowers in Western Serbia (35.05%), while Vojvodina, Southern Serbia and Eastern Serbia had shares of 6.75%, 6.56% and 4.56%, respectively.

Concentration of the financial assets per Serbian region, net exposures

	December 31, 2017	December 31, 2016
Belgrade	18,499,131	15,343,165
Vojvodina	2,653,336	2,123,162
Southern Serbia	2,579,735	2,482,328
Eastern Serbia	1,792,501	1,741,736
Western Serbia	13,771,758	11,455,922
Total	**39,296,461**	**33,146,313**

Write-Off of Receivables

The Bank will adequately manage collection of NPLs as long as it assesses that collection activates are economically justified. If the bank assesses that a loan will not be collected, in accordance with NBS guidelines, the Bank will write-off such a loan or a receivable, which does not mean the bank's waiver of the contractual obligations and entitlements in respect of the loan or receivable.

Regarding implementation of the Guidelines for Disclosure of Bank Data and Information Related to the Quality of Assets (the "Guidelines") issued by NBS, the required qualitative and quantitative information will be presented within disclosures required by the Decision on Disclosure of Data and Information by Banks (Official Gazette of RS, nos. 125/2014, 4/2015 and 103/2016). Such information has not been subject to the external audit

Direct write-off of receivables, i.e., derecognition of loans and receivables or a portion thereof in the Bank's balance sheet assets and their reclassification to the off-balance sheet items does not mean a loss of the Bank's entitlement to or waiver of the collection.

In order to reduce the gross non-performing loans, the Bank will write-off all receivables that have been fully impaired and provided for.

27. RISK MANAGEMENT (Continued)

27.1 Credit Risk (Continued)

Loan Rescheduling and Restructuring

In 2017 the Bank rescheduled, i.e., extended, loan repayment periods in accordance with NBS Decision on Classification of Balance Sheet Assets and Off-Balance Sheet Items.

In accordance with the amended NBS Decision on Classification of Balance Sheet Assets and Off-Balance Sheet Items dated June 29, 2016, days past due in collection of receivables are calculated from the last contractual defined maturity date for materially significant amount of receivables.

Restructuring entails approval of concessions on repayment of individual loans and receivables due to borrower's financial difficulties, which would not otherwise be allowed, regardless of the maturity, impairment or default status of the receivables in accordance with the decision governing capital adequacy of banks, in at least one of the following ways:

- modification of the original terms of the loan and/or receivable, particularly if the subsequently agreed terms of repayment are more favorable than the original terms (reduction of the interest rate, write-off of a portion pf the principal outstanding, entailing derecognition of that portion in the balance sheet assets, write-off of a portion of the accrued interest, release of a portion of the amount due, extension of the maturity of the principal and/or interest, etc.) or than the terms that would be approved to another borrower with the same or similar risk level at the time of the modification of terms;
- refinancing of the loan where a new receivable is originated from a loan approved to settle a portion of or the entire amount of the borrower's liability to the Bank or another entity to which the receivable due from the borrower has been assigned.

Restructured receivables due from corporate customers are:

- receivables restructured at the Bank level, where the Bank defines the restructuring terms;
- receivables restructured in collaboration with other creditors, either under interbank agreement on equal terms of restructuring or under the Law on Consensual Financial Restructuring of Companies with participation of an institutional mediator;
- receivables due from debtors where, in the pre-bankruptcy procedure, a pre-packed reorganization plan has been proposed and adopted; and
- receivables due from debtors where, in the bankruptcy procedure, a bankruptcy debtor reorganization plan has been proposed and adopted.

Upon undertaking restructuring measures the bank is required to estimate whether the loan restructuring approved to a debtor is sustainable and economically justified both for the Bank and the debtor and to determine the restructuring schedule and regularly monitor its implementation and effects.

On a regular basis, at least semi-annually, the Bank monitors implementation of the loan restructuring schedule, taking into account the size and significance of the loan/receivable restructured against its other receivables, as well as the specific nature of the restructuring schedule and the Bank's activities stipulated therein.

The Bank may cease to treat a loan and/or receivable as restructured if at the end of the trial period the following criteria are met:

- the restructured loan/receivable is not classified as NPL;
- the borrower has repaid through regular payments of principal and/or interest amounts materially significant portion of the debt during at least half of the trial period; and
- the borrower is not over 30 days past due in any liability settlement toward the Bank.

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27. RISK MANAGEMENT (Continued)

27.1 Credit Risk (Continued)

Loan Rescheduling and Restructuring (Continued)

Loans restructured in 2017 and 2016 are presented below (balance in thousands of RSD, number of borrowers and number of restructured loans):

Balance as of December 31, 2017	Number of borrowers	Number of restructured loans
675,767	23	33

Balance as of December 31, 2016	Number of borrowers	Number of restructured loans
981,319	23	41

In 2017 the Bank restructured 33 loans for 23 borrowers.

As of December 31, 2017, the balance of all restructured impaired loans totaled RSD 4,042,961 thousand, gross and RSD 2,139,040 thousand, net.

Breakdown of the total restructured and impaired loans as of December 31, 2017

Category	December 31, 2017			
	Gross exposure	Net exposure	Number of borrowers	Number of loan facilities
A1	167,861	167,609	10	10
A2	343,869	341,604	5	10
A3	148	146	1	1
A4	2,208	2,094	9	9
A5				
A6	3,528,875	1,627,587	73	119
Total	**4,042,961**	**2,139,040**	**98**	**149**

Breakdown of the total restructured and impaired loans as of December 31, 2016

Category	December 31, 2016			
	Gross exposure	Net exposure	Number of borrowers	Number of loan facilities
A1	-	-	-	-
A2	146,682	146,282	1	5
A3	652	648	3	3
A4	6,494	5,856	14	15
A5	51,414	50,967	7	9
A6	4,212,024	2,412,031	84	140
Total	**4,417,266**	**2,615,784**	**109**	**172**

27. RISK MANAGEMENT (Continued)

27.1 Credit Risk (Continued)

Fair Value of Assets and Liabilities

The fair value stated in the financial statements is the amount for which an asset could be exchange or a liability settled between knowledgeable, willing parties in an arm's length transaction.

Fair value is calculated using the market information available as of the reporting date.

Whenever possible, the Bank measures the fair vale using the market prices available in an active market for the specific instrument. A market is deemed active if the quoted prices are easily and regularly available and reflect actual common market transactions performed at arms' length.

The fair value of a current liquid instrument presented at its nominal value approximates its carrying value. This applies to cash as well as receivables and liabilities without determined maturity or without a fixed interest rate. For the other receivables and liabilities, the expected future cash flows are discounted to their net present values using the market prevailing effective rates.

Quoted market prices are used to determine the fair values of trading securities. The fair value is calculated as the net present value of the expected future cash flows using the interest rates applied to the similar securities.

In determining the fair value of municipal bonds issued by the local governance units in the Republic of Serbia, the applicable discount rate is increased by the issuer risk/premium at the time of the municipal bond issue or at the more recent date if such an input is available. The Bank applies an approach based on the initially assessed value of the risk premium to the calculated credit spread, which is determined as the cost of risk,.

Given that there is no sufficiently developed secondary market for loans where the fair value of these financial instruments could be determined, it is necessary to use inputs of the level lower than Levels 1 and 2, i.e., level 3 inputs. The unit for fair value assessment is a single loan, i.e., loan facility, and the approach used is the income approach and discounted cash flow method.

Disbursement of new loans to the retail and corporate customers in 2017 was in line with the market conditions (departures per months in certain product categories, taking into account maturity, currency and loan type were within the range of +/-1 p.p.). Given the foregoing, the fair values determined for loans disbursed in 2017 are equal to their carrying values.

Loans disbursed before 2017 are assessed in two separate groups - loans at variable interest rates and loans at fixed interest rates.

Since up to December 31, 2017 the Bank performed monthly interest rate adjustments (repricing based on the variable portion of the interest rate) all loan in the group of loans at variable interest rates have fair values equal to their carrying values.

Loans at fixed interest rates disbursed before 2017 were subject to discounting using the interest rates available at the website of the National Bank of Serbia, in the Report on interest rates of banks applied to the loans approved to retail and non-FSI customers per type, maturity and purpose – newly approved loans, The Bank used inputs for December 2017.

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27. RISK MANAGEMENT (Continued)

27.1 Credit Risk (Continued)

Fair Value of Assets and Liabilities (Continued)

Valuation of Financial Instruments

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

- Level 1: Quoted market price (unadjusted) in an active market for an identical asset or a liability accessible to the market participants as of the fair value measurement date;
- Level 2: Valuation techniques based on observable inputs other than Level 1 quoted prices, either directly (i.e. as prices) or indirectly (i.e. derived from prices, interest rates, correlations, etc.). This category includes instruments valued using: quoted market prices in active markets for similar instruments; quoted prices for identical or similar instruments in markets that are considered less than active; or other valuation techniques where all significant inputs are directly or indirectly observable from market data;
- Level 3: Valuation techniques using significant unobservable inputs.

Financial assets measured at fair value

	Level 1	Level 2	Level 3	Total
December 31, 2017				
Financial assets at fair value through profit or loss, held for trading (including pledged assets)	24,758	-	-	24,758
Financial assets available for sale (including pledged assets)	-	4,359,850	-	4,359,850
December 31, 2016				
Financial assets at fair value through profit or loss, held for trading (including pledged assets)	23,984	-	-	23,984
Financial assets available for sale (including pledged assets)	-	3,177,595	-	3,177,595

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27. RISK MANAGEMENT (Continued)

27.1 Credit Risk (Continued)

Fair Value of Assets and Liabilities (Continued)

Valuation of Financial Instruments (Continued)

Financial assets and liabilities measured at other than fair value

December 31, 2017	Level 1	Level 2	Level 3	Total
Financial assets				
Cash and balances held with the central bank	-	4,839,851	-	4,839,851
Financial assets at fair value through profit or loss, held for trading (including pledged assets)	-		472,892	472,892
Loans and receivables due from banks and other financial institutions	-	-	1,524,613	1,524,613
Loans and receivables due from customers	-	-	28,894,906	28,894,906
Other assets	-	-	121,271	121,271
Financial liabilities				
Deposits and other liabilities due to banks, other financial institutions and the central bank,	-	-	6,277,751	6,277,751
Deposits and other liabilities due to customers	-	-	28,762,098	28,762,098
Other liabilities	-	-	220,144	220,144
December 31, 2016				
Financial assets				
Cash and balances held with the central bank	-	4,090,612	-	4,090,612
Financial assets at fair value through profit or loss, held for trading(including pledged assets)	-	1,443,325	-	1,443,325
Loans and receivables due from banks and other financial institutions	-	-	1,018,760	1,018,760
Loans and receivables due from customers	-	-	23,997,783	23,997,783
Other assets	-	-	59,558	59,558
Financial liabilities				
Deposits and other liabilities due to banks, other financial institutions and the central bank,	-	-	2,938,019	2,938,019
Deposits and other liabilities due to customers	-	-	25,878,046	25,878,046
Other liabilities	-	-	215,098	215,098

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27. RISK MANAGEMENT (Continued)

27.1 Credit Risk (Continued)

Fair Value of Assets and Liabilities (Continued)

Breakdown of financial assets and liabilities at fair value

December 31, 2017	Determined fair value	Held to maturity	Available for sale	Other – amortized cost	Total book value	Total fair value
Financial assets						
Cash and balances held with the central bank	-	-	-	4,839,851	4,839,851	4,839,851
Financial assets at fair value through profit or loss, held for trading	24,758	-	-	-	24,758	24,758
Financial assets available for sale	-	-	4,359,850	-	4,359,850	4,359,850
Financial assets held to maturity (including pledged assets)	-	472,892	-	-	472,892	471,504
Loans and receivables due from banks and other financial institutions	-	-	-	1,524,613	1,524,613	1,524,613
Loans and receivables due from customers	-	-	-	28,894,906	28,894,906	30,337,329
Other assets	-	-	-	121,271	121,271	121,271
Financial liabilities						
Deposits and other liabilities due to banks, other financial institutions and the central bank,	-	6,277,751	-	-	6,277,751	6,277,751
Deposits and other liabilities due to customers	-	28,762,098	-	-	28,762,098	28,748,134
Other liabilities	-	-	-	220,144	220,144	220,144

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27. RISK MANAGEMENT (Continued)

27.1 Credit Risk (Continued)

Fair Value of Assets and Liabilities (Continued)

Breakdown of financial assets and liabilities at fair value

December 31, 2016	Determined fair value	Held to maturity	Available for sale	Other – amortized cost	Total book value	Total fair value
Financial assets						
Cash and balances held with the central bank	-	-	-	4,090,612	4,090,612	4,090,612
Financial assets at fair value through profit or loss, held for trading	23,984	-	-	-	23,984	23,984
Financial assets available for sale	-	-	3,177,595	-	3,177,595	3,177,595
Financial assets held to maturity (including pledged assets)	-	1,443,325	-	-	1,443,325	1,443,325
Loans and receivables due from banks and other financial institutions	-	-	-	1,018,760	1,018,760	1,018,760
Loans and receivables due from customers	-	-	-	23,997,783	23,997,783	23,997,783
Other assets	-	-	-	59,558	59,558	59,558
Financial liabilities						
Deposits and other liabilities due to banks, other financial institutions and the central bank,	-	2,938,019	-	-	2,938,019	2,938,019
Deposits and other liabilities due to customers	-	25,878,046	-	-	25,878,046	25,878,046
Other liabilities	-	-	-	215,098	215,098	215,098

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27. RISK MANAGEMENT (Continued)

27.2 Capital and Capital Adequacy

The Bank manages capital and capital adequacy ratios in order to maintain the required level of capital to support the development of the Bank and its business activities.

The capital adequacy ratio represents the Bank's capital relative to its risk-weighted assets. The Bank's risk weighted assets equal the sum of its credit-risk weighted assets and the capital requirements for the foreign exchange and operational risks multiplied by the reciprocal value of the capital adequacy ratio.

The Bank's capital is comprised of the core capital and supplementary capital less the sum of deductible items. The Bank is thereby required to maintain the minimum amount of capital of no less that EUR 10,000,000 in RSD equivalent at all times.

The Bank calculates the capital requirement for credit risk using the standardized approach, by multiplying the total credit risk-weighted assets by 8%. the Bank's credit risk-weighted assets comprise the sum of the gross carrying values of the Bank's balance sheet assets less impairment allowances and the reserve for estimated losses and the gross carrying values of the Bank's off-balance sheet items less provisions and the required reserve for estimated losses, multiplied by the credit conversion factors.

The Bank calculates the capital requirement for foreign exchange risk by multiplying the sum of the total net open foreign currency position and absolute value of the net open position in gold by 8%. The total net open foreign currency position represents the absolute value of the higher of the total long and total short foreign currency positions.

The Bank calculates the capital requirement for operational risk by applying the basic indicator approach equal to the three-year average exposure indicator multiplied by the capital requirement rate of 15%.

Since the Bank has not reached the prescribed limits, it is not required to calculate, in addition to the above said capital requirements for credit, foreign exchange and operational risks, and ensure coverage for capital requirements for other market risks arising from the items in the Bank's trading book.

As of December 31, 2017 the Bank's capital and capital adequacy were calculated under the relevant decisions of NBS, which are aligned with Basel III Standard.

As of December 31, 2017 the Bank achieved the following capital adequacy ratios:

- the Bank's total capital adequacy ratio (CAR) was 17.11%;
- the Bank's core capital adequacy ratio (T1 ratio) was 17.11%; and
- the Bank's common equity Tier 1 capital ratio (CET 1 ratio) was 13.04%,

which were well above the minimum values for those ratios defined by the Decision on Capital Adequacy of Banks:

- the total capital adequacy ratio (CAR) minimum of 8%;
- the core capital adequacy ratio (T1 ratio) minimum of 6%,;and
- the common equity Tier 1 capital ratio (CET 1 ratio) minimum of 4.5%**.**

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27. RISK MANAGEMENT (Continued)

27.2 Capital and Capital Adequacy (Continued)

Breakdown of the Bank's capital and capital adequacy ratios as of December 31, 2017 and 2016:

Item no.	Item	December 31, 2017	December 31, 2016
1	**CAPITAL**	**5,045,235**	**3,974,875**
1.1	**CORE CAPITAL**	**5,043,895**	**3,973,535**
1.1.1	**Common equity Tier 1 capital**	**3,843,895**	**2,773,535**
1.1.1.1	**Common equity Tier 1 instruments and relevant share premium**	**3,047,143**	**3,047,143**
1.1.1.1.1	Paid in common equity Tier 1 instruments	1,819,820	1,819,820
1.1.1.1.2	Relevant share premium with the common equity Tier 1 instruments	1,227,323	1,227,323
1.1.1.2	(-) Loss	**-**	**-**
1.1.1.3	Revaluation reserves and other unrealized gains/losses	**364,162**	**274,273**
1.1.1.4	Reserves from profit, other reserves and reserves for general banking risks	**1,312,431**	**1,174,276**
1.1.1.5	(+/-) Regulatory adjustment of the common equity Tier 1 capital	**(5,499)**	**-**
1.1.1.6	(-) Goodwill decreased by the related deferred tax liabilities	**-**	**-**
1.1.1.7	(-) Other intangible assets decreased by related deferred tax assets	**(98,947)**	**(73,975)**
1.1.1.8	(-) Deferred tax assets dependable on the Bank's future profitability, except for those arising from the temporary differences less related deferred tax liabilities	**(62,393)**	**-**
1.1.1.9	(-) Amount of the required reserve for estimated losses on the Bank's balance sheet assets and off-balance sheet items	**(713,002)**	**(1,648,182)**
1.1.2	**Additional Tier 1 capital**	**1,200,000**	**1,200,000**
1.1.2.1	**Common additional Tier 1 capital instruments and relevant share premium**	1,200,000	1,200,000
1.1.2.1.1	Paid in additional Tier 1 capital instruments	600,000	600,000
1.1.2.1.2	Relevant share premium with the additional Tier 1 capital instruments	600,000	600,000
1.2	**SUPPLEMENTARY CAPITAL**	**1,340**	**1,340**
1.2.1	Supplementary capital instruments, subordinated liabilities and he relevant share premium	1,340	1,340
1.2.1.1	Paid in supplementary capital instruments	1,340	1,340
1.2.1.2	Relevant share premium with the supplementary capital instruments	**-**	**-**
2.	**TOTAL RISK-WEIGHTED ASSETS:**	**29,486,849**	**25,410,505**
2.1	Risk-weighted credit risk exposures	25,885,182	23,089,655
2.2	Risk-weighted foreign exchange risk exposures	126,707	90,442
2.3	Risk-weighted market risk exposures	3,474,960	2,230,408
3.	**CAPITAL ADEQUACY RATIOS**		
3.1	Total capital adequacy ratio	**17.11%**	**15.64%**
3.2	Tier 1 capital ratio (T1 ratio)	**17.11%**	**15.64%**
3.3	Common Equity Tier 1 capital ratio (CET 1 ratio)	**13.04%**	**10.91%**

All amounts expressed in thousands of RSD, unless otherwise stated.

27. RISK MANAGEMENT (Continued)

27.3 Assets Acquired in Lieu of Debt Collection

In order to prevent losses contingent on the sales of assets assigned by mortgages in favor of the Bank at rather low prices, the Bank participates in public auctions to prevent other bidders from purchasing real estate properties at low prices and collect non-performing loans and doubtful receivables in less time, thus creating opportunities for better terms of sale of assets thus foreclosed in subsequent periods.

The bank is actively involved in sales of assets acquired in lieu of debt collection and may retain the foreclosed assets for a certain time only in the event that prompt sale would result in the Bank's significant losses.

The Bank may acquire assets in order to collect non-performing loans and receivables as long as:

- Its liquid asset ratio, as the liquid assets (cash and deposits held with other banks with remaining maturities of up to 30 days, mandatory reserves held with NBS, marketable precious metals and marketable government securities) relative to the total assets, is above 20%;
- The total value of the tangible assets acquired in lieu of debt collection does not exceed 25% of the Bank's capital;
- The Bank's total permanent investments in its property, equipment and investment property, along with the Bank's investments in non-FSI entities, range within low to medium investment risk levels, i.e., up to 55% of the Bank's capital.

Assets acquired in lieu of debt collection as of December 31, 2017 and 2016:

No.	Acquired asset	Area (m^2)	Acquisition date	Execution debtor	Net book value December 31, 2017	Net book value December 31, 2016
1.	Business premises, counter room, cadastral lot no. 3120/1 CM Šume	48	26/12/2014	Mercury internacional a.d. Ivanjica	1,415	1,415
2.	Apartment at no. 19, Filipa Filipovića St., Čačak	87	01/09./2016	Nebojša Protić	-	4,790
3.	Outlet 45/i Kraljevo at no. 45, Cara Dušana St., Kraljevo	27	24/04/2017	Trgomen Nekretnine d.o.o. Ratina	1,831	-
4.	Outlet 45/j Kraljevo at no. 45, Cara Dušana St., Kraljevo	43	24/04/2017	Trgomen Nekretnine d.o.o. Ratina	2,814	-
5.	Outlet 45/k Kraljevo at no. 45, Cara Dušana St., Kraljevo	34	24/04/2017	Trgomen Nekretnine d.o.o. Ratina	2,168	-
6.	Apartment at no. 29, Tomislava Andrića-Džigija St., Kraljevo	140	16.06/2017	Zoran Milašinović	10,221	-
	Total				**18,449**	**6,205**

The apartment with the area of 87 m2 acquired from the execution debtor Mr. Nebojša Protić from Čačak was sold in February 2017 to the buyer Agricolacoop d.o.o. Čačak.

All amounts expressed in thousands of RSD, unless otherwise stated.

27. RISK MANAGEMENT (Continued)

27.4 Liquidity Risk

Liquidity risk is a risk of adverse effects on the Bank's financial performance and capital due to its inability to discharge its liabilities when these fall due. Hence the aim of liquidity risk management is to maintain the Bank's liquid assets at the level that ensures the Bank's timely settlement of its liabilities.

The Bank manages its assets and liabilities in the manner that enables settlement of its liabilities matured at any time (liquidity) and permanent settlement of all its liabilities (solvency).

The following organizational units of the Bank are responsible for liquidity risk management:

- The Board of Directors, which defines the liquidity risk management policy and the contingency business plan (liquidity crisis plan);
- The Executive Board, which implements the adopted policy and defines procedures and instructions for liquidity risk management;
- ALCO, which monitors the Bank's exposure to the liquidity risk and proposes adequate measures for liquidity risk management;
- The Bank's Liquidity Committee, which determines and monitors liquidity on a daily basis and proposes adequate measure for prevention of elimination of the non-liquidity causes; and
- Risk Management Department and Treasury which monitor and maintain liquidity on a daily basis.

Liquidity risk is measured by the Risk Management Department by means of calculation of the liquidity ratio, quick ratio and liquidity coverage ratio as well as additional internal liquidity ratios, deposit concentration ratio, GAP analyses and stress testing.

The Bank's exposure to the liquidity risk is measured by monitoring the liquidity ratio, rigid or quick ratio and liquidity coverage ratio as prescribed by NBS Decision on Liquidity Risk Management by Banks and the Bank's Liquidity Risk Management Procedure. The liquidity ratio is the sum of the level 1 and level 2 liquid receivables relative to the sum of liabilities payable on demand or without contractually defined maturity and liabilities falling due within a month from the ratio calculation date. The rigid or quick liquidity ratio is the sum of level 1 liquid receivables relative to the sum of liabilities payable on demand or without contractually defined maturity and liabilities falling due within a month from the ratio calculation date. The liquidity coverage ratio represents the Bank's liquidity buffer relative to the net liquid asset outflows over an assumed 30-day stress period.

Liquidity ratios and quick ratios achieved by the Bank

	Liquidity ratio	
	2017	**2016**
At December 31	1.51	1.76
Average	1.71	1.79
Maximum	2.21	2.75
Minimum	1.37	1.20

	Quick ratio	
	2017	**2016**
At December 31	1.26	1.38
Average	1.45	1.30
Maximum	1.98	1.70
Minimum	1.04	0.90

All amounts expressed in thousands of RSD, unless otherwise stated.

27. RISK MANAGEMENT (Continued)

27.4 Liquidity Risk (Continued)

The Bank's liquidity was also monitored via its liquid asset ratio, which represents liquid assets relative to the total assets.

Liquid asset ratios achieved by the Bank

	2017	2016
At December 31	25.14%	24.46%
Average	26.51%	27.62%
Maximum	28.73%	31.23%
Minimum	23.93%	22.07%

During 2017 the Bank monitored its liquidity levels based on the movements of its additional liquidity ratios, defined by its internal Liquidity Risk Management Procedure, as well as based on the covenants stipulated by the loan/line of credit agreements that the bank executed with the international financial institutions. Values of the ratios and covenants were within limits prescribed by the said Procedure and the relevant agreements with the international financial institutions.

The critical element of liquidity risk monitoring and management is monitoring of asset and liability maturity matching. Maturity match and controlled mismatch of the asset and liability maturities are critical to the Bank's management. It is uncommon for banks to achieve complete maturity matching of their assets and liabilities since transactions are often performed for indefinite periods and are different in nature and type. Mismatched position may increase profitability but at the same time it increases a risk of a financial loss.

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27. RISK MANAGEMENT (Continued)

27.4 Liquidity Risk (Continued)

The table below presents the Bank's assets and liabilities grouped in maturity buckets as per their remaining maturities – from the reporting date to their respective contractually defined maturity dates.

December 31, 2017	Up to 30 days	30 to 90 days	90 to 365 days	1 to 5 y ears	Over 5 years	Total
Cash and balances held with the central bank	4,839,851	-	-	-	-	**4,839,851**
Financial assets at fair value through profit or loss, held for trading	24,758	-	-	-	-	**24,758**
Financial assets available for sale	203,678	-	-	3,603,227	552,945	**4,359,850**
Financial assets held to maturity (including pledged assets)	14,649	399,784	58,459	-	-	**472,892**
Loans and receivables due from banks and other financial institutions	1,423,793	99,116	524	1,180	-	**1,524,613**
Loans and receivables due from customers	1,366,619	698,641	4,635,635	14,171,753	8,022,258	**28,894,906**
Other assets	116,915	-	-	-	4,356	**121,271**
Total financial assets	**7,990,263**	**1,197,541**	**4,694,618**	**17,776,160**	**8,579,559**	**40,238,141**
Deposits and other liabilities due to banks, other financial institutions and the central bank,	2,736,965	50,000	479,783	1,807,091	1,203,912	**6,277,751**
Deposits and other liabilities due to customers	12,484,335	2,245,690	6,086,690	6,049,710	1,895,673	**28,762,098**
Other liabilities	220,144	-	-	-	-	**220,144**
Total financial liabilities	**15,441,444**	**2,295,690**	**6,566,473**	**7,856,801**	**3,099,585**	**35,259,993**
Maturity match/mismatch (gap)	**7,451,181)**	**(1,098,149)**	**(1,871,855)**	**9,919,359**	**5,479,974**	**4,978,148**

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27. RISK MANAGEMENT (Continued)

27.4 Liquidity Risk (Continued)

December 31, 2016	Up to 30 days	30 to 90 days	90 to 365 days	1 to 5 years	Over 5 years	Total
Cash and balances held with the central bank	4,090,612	-	-	-	-	**4,090,612**
Financial assets at fair value through profit or loss, held for trading	23,984	-	-	-	-	**23,984**
Financial assets available for sale	539,611	50,000	683,802	1,464,016	440,166	**3,177,595**
Financial assets held to maturity (including pledged assets)	612,207	-	373,285	457,833	-	**1,443,325**
Loans and receivables due from banks and other financial institutions	901,625	117,135	-	-	-	**1,018,760**
Loans and receivables due from customers	1,761,787	487,041	3,899,596	12,008,715	5,840,644	**23,997,783**
Other assets	59,558	-	-	-	-	59,558
Total financial assets	**7,989,384**	**654,176**	**4,956,683**	**13,930,564**	**6,280,810**	**33,811,617**
Deposits and other liabilities due to banks, other financial institutions and the central bank,	1,955,102	21,000	121,549	840,368	-	**2,938,019**
Deposits and other liabilities due to customers	10,683,088	1,764,922	5,625,087	4,235,394	3,569,555	**25,878,046**
Other liabilities	215,098	-	-	-	-	**215,098**
Total financial liabilities	**12,853,288**	**1,785,922**	**5,746,636**	**5,075,762**	**3,569,555**	**29,031,163**
Maturity match/mismatch (gap)	**(4,863,904)**	**(1,131,746)**	**(789,953)**	**8,854,802**	**2,711,255**	**4,780,454**

27. RISK MANAGEMENT (Continued)

27.5 Market Risk (Interest Rate Risk, Foreign Exchange Risk and Security Price Risk

27.5.1 Interest Rate Risk

Interest rate risk is a risk of a possible adverse effects on the Bank's financial performance and capital due to changes in interest rates. The Bank is exposed to the interest rate risk per items recorded in its banking book.

The objective of the Bank's interest rate risk management is to minimize the adverse effects that may arise from the changes in the market interest rates.

The following organizational units of the Bank are responsible for interest rate risk management:

- The Board of Directors, which defines the interest rate risk management policy;
- The Executive Board, which implements the adopted policy and defines procedures and instructions for interest rate risk management;
- ALCO, which monitors the Bank's exposure to the interest rate risk and proposes adequate measures for interest rate risk management;
- Risk Management Department, which implements the risk management policy and procedure and reports to the Bank's management on this risk exposure; and
- Marketing Division, which monitors market interest rates on a daily basis and proposes interest rates for the Bank's products.

Interest rate risk is measured by the Risk Management Department by means of repricing risk measurement, basis risk, yield curve risk and optionality risk measurements.

The following tables provide breakdowns of the interest bearing assets and liabilities grouped into maturity buckets for items at fixed interest rates and repricing periods for instruments at variable interest rates.

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27. RISK MANAGEMENT (Continued)

27.5 Market Risk (Interest Rate Risk, Foreign Exchange Risk and Security Price Risk (Continued)

27.5.1 Interest Rate Risk (Continued)

December 31, 2017	Up to 30 days	30 to 90 days	90 to 365 days	1 to 5 years	Over 5 years	Non-interest bearing	Total
Cash and balances held with the central bank	1,512,004	-	-	-	-	3,327,847	4,839,851
Financial assets at fair value through profit or loss, held for trading	-	-	-	-	-	24,758	24,758
Financial assets available for sale	-	-	-	3,603,227	552,945	203,678	4,359,850
Financial assets held to maturity (including pledged assets)	-	399,784	58,458	-	-	14,650	472,892
Loans and receivables due from banks and other financial institutions	50,758	99,116	526	-	-	1,374,213	1,524,613
Loans and receivables due from customers	9,831,497	3,100,547	3,591,666	7,816,595	3,724,869	829,732	28,894,906
Other assets	-	-	-	-	-	121,271	121,271
Total financial assets	**11,394,259**	**3,599,447**	**3,650,650**	**11,419,822**	**4,277,814**	**5,896,149**	**40,238,141**
Deposits and other liabilities due to banks, other financial institutions and the central bank,	4,501,484	50,000	1,070,581	30,000	-	625,686	6,277,751
Deposits and other liabilities due to customers	3,607,099	3,217,679	6,641,870	2,513,705	196,923	12,584,822	28,762,098
Other liabilities	-	-	-	-	-	220,144	220,144
Total financial liabilities	**8,108,583**	**3,267,679**	**7,712,451**	**2,543,705**	**196,923**	**13,430,652**	**35,259,993**

December 31, 2016	Up to 30 days	30 to 90 days	90 to 365 days	1 to 5 years	Over 5 years	Non-interest bearing	Total
Cash and balances held with the central bank	1,639,413	-	-	-	-	2,451,199	4,090,612
Financial assets at fair value through profit or loss, held for trading	-	-	-	-	-	23,984	23,984
Financial assets available for sale	383,421	51,598	698,415	1,482,656	457,746	103,759	3,177,595
Financial assets held to maturity (including pledged assets)	598,823	-	377,133	467,369	-	-	1,443,325
Loans and receivables due from banks and other financial institutions	-	117,135	-	-	-	901,625	1,018,760
Loans and receivables due from customers	10,902,620	2,002,752	2,531,471	4,831,567	2,661,414	1,067,959	23,997,783
Other assets	-	-	-	-	-	59,558	59,558
Total financial assets	**13,524,277**	**2,171,485**	**3,607,019**	**6,781,592**	**3,119,160**	**4,608,084**	**33,811,617**
Deposits and other liabilities due to banks, other financial institutions and the central bank,	1,561,827	21,000	120,000	-	-	1,235,192	2,938,019
Deposits and other liabilities due to customers	5,592,860	3,669,402	7,144,545	2,085,342	18,521	7,367,376	25,878,046
Other liabilities	-	-	-	-	-	215,098	215,098
Total financial liabilities	**7,154,687**	**3,690,402**	**7,264,545**	**2,085,342**	**18,521**	**8,817,666**	**29,031,163**

All amounts expressed in thousands of RSD, unless otherwise stated.

27. RISK MANAGEMENT (Continued)

27.5 Market Risk (Interest Rate Risk, Foreign Exchange Risk and Security Price Risk (Continued)

27.5.1 Interest Rate Risk (Continued)

The following table presents the Bank's sensitivity to changes in interest rates. The sensitivity is measured against the impact of the parallel shift of the yield curve by 200 basis points on the Bank's capital and income.

	2017		2016	
	Impact on capital	Impact on income	Impact on capital	Impact on income
At December 31	(41,650)	49,793	5,077	57,684
Average	(41,281)	46,402	45,479	54,636
Maximum	49,569	75,672	109,673	58,070
Minimum	(177,973)	34,218	774	52,075

27.5.2 Foreign Exchange Risk

Foreign exchange risk is a risk of adverse effects on the Bank's financial performance and capital due to fluctuations in the foreign exchange rates. The Bank is exposed to the foreign exchange risk per items maintained in both the banking book and the trading book.

The Bank manages foreign exchange risk to minimize losses arising from changes in foreign exchange rates.

The following organizational units of the Bank are responsible for foreign exchange risk management:
- The Board of Directors, which defines the market risk management policy;
- The Executive Board, which implements the adopted policy and defines procedures and instructions for foreign exchange risk management;
- ALCO, which monitors the Bank's exposure to the foreign exchange risk and proposes adequate measures for foreign exchange risk management;
- Risk Management Department and Treasury, which monitor and manage the currency structure of sources of assets on a daily basis.

The foreign exchange risk is measured by the Risk Management Department based on the foreign exchange ratio as the net open foreign currency position and the Bank's capital, in accordance with NBS Decision on Capital Adequacy of Banks and Decision on Reporting Requirements for Banks and the Bank's Procedure for Foreign Exchange Risk Management.

Foreign exchange risk ratios achieved by the Bank

	2017	2016
At December 31	2.51%	2.28%
Average	1.94%	3.07%
Maximum	6.53%	11.90%
Minimum	0.18%	0.30%

In the course of 2017, the foreign exchange risk, measured by the foreign exchange risk ratio, was mostly in the low risk range. The average value of the ratio for the year equaled 1.94%.

The following tables present the breakdown of the open net foreign currency positions per currency as of December 31, 2017 and 2016.

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27. RISK MANAGEMENT (Continued)

27.5 Market Risk (Interest Rate Risk, Foreign Exchange Risk and Security Price Risk (Continued)

27.5.2 Foreign Exchange Risk (Continued)

Breakdown of assets and liabilities per currency

December 31, 2017	EUR	USD	CHF	Other currencies	Total FX	RSD	Total
Cash and balances held with the central bank	2,774,440	35,090	82,153	11,686	2,903,369	1,936,482	**4,839,851**
Financial assets at fair value through profit or loss, held for trading	-	-	-	-	-	24,758	**24,758**
Financial assets available for sale	337,427	-	-	-	337,427	4,022,423	**4,359,850**
Financial assets held to maturity (including pledged assets)	58,466	-	-	1	58,467	414,425	**472,892**
Loans and receivables due from banks and other financial institutions	784,088	212,688	136,445	90,953	1,224,174	300,439	**1,524,613**
Loans and receivables due from customers	20,912,882	-	-	-	20,912,882	7,982,024	**28,894,906**
Other assets	21,634	733	10,187	17,771	50,325	70,946	**121,271**
Total financial assets	**24,888,937**	**248,511**	**228,785**	**120,411**	**25,486,644**	**14,751,497**	**40,238,141**
Deposits and other liabilities due to banks, other financial institutions and the central bank,	5,109,964	-	-	-	5,109,964	1,167,787	6,277,751
Deposits and other liabilities due to customers	19,644,408	241,758	224,418	103,987	20,214,571	8,547,527	28,762,098
Other liabilities	10,095	48	4	15	10,162	209,982	220,144
Total financial liabilities	**24,764,467**	**241,806**	**224,422**	**104,002**	**25,334,697**	**9,925,296**	**35,259,993**
Net foreign currency position	**124,470**	**6,705**	**4,363**	**16,408**	**151,946**	**4,826,202**	**4,978,148**

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27. RISK MANAGEMENT (Continued)

27.5 Market Risk (Interest Rate Risk, Foreign Exchange Risk and Security Price Risk (Continued)

27.5.2 Foreign Exchange Risk (Continued)

Breakdown of assets and liabilities per currency (Continued)

December 31, 2016	EUR	USD	CHF	Other currencies	Total FX	RSD	Total
Cash and balances held with the central bank	2,045,225	74,006	18,469	15,843	2,153,543	1,937,069	**4,090,612**
Financial assets at fair value through profit or loss, held for trading	-	-	-	-	-	23,984	**23,984**
Financial assets available for sale	1,021,063	-	-	-	1,021,063	2,156,532	**3,177,595**
Financial assets held to maturity (including pledged assets)	184,621	-	-	-	184,621	1,258,704	**1,443,325**
Loans and receivables due from banks and other financial institutions	449,269	180,592	173,238	90,202	893,301	125,459	**1,018,760**
Loans and receivables due from customers	17,779,613	1,175	-	-	17,780,788	6,216,995	**23,997,783**
Other assets	25,744	383	10	28,283	54,420	5,138	**59,558**
Total financial assets	**21,505,535**	**256,156**	**191,717**	**134,328**	**22,087,736**	**11,723,881**	**33,811,617**
Deposits and other liabilities due to banks, other financial institutions and the central bank,	2,247,918	-	-	30,761	2,278,679	659,340	**2,938,019**
Deposits and other liabilities due to customers	19,142,321	260,552	214,152	77,412	19,694,437	6,183,609	**25,878,046**
Other liabilities	57,641	10	4	17	57,672	157,426	**215,098**
Total financial liabilities	**21,447,880**	**260,562**	**214,156**	**108,190**	**22,030,788**	**7,000,375**	**29,031,163**
Net foreign currency position	**57,655**	**(4,406)**	**(22,439)**	**26,138**	**56,948**	**4,723,506**	**4,780,454**

All amounts expressed in thousands of RSD, unless otherwise stated.

27. RISK MANAGEMENT (Continued)

27.5 Market Risk (Interest Rate Risk, Foreign Exchange Risk and Security Price Risk (Continued)

27.5.2 Foreign Exchange Risk (Continued)

The tables below present the impact of the change in the RSD to foreign currency exchange rates by 15% on the Bank's net foreign currency position as of December 31, 2017 and 2016. RSD items with currency clause index are presented within the FX items of the currency to which they are indexed.

December 31, 2017	EUR	EUR 15%	EUR -15%	USD	USD 15%	USD -15%	CHF	CHF 15%	CHF -15%
Financial assets	24,888,937	28,622,278	21,155,596	248,511	285,788	211,234	228,785	263,103	194,467
Financial liabilities	24,764,467	28,479,137	21,049,797	241,806	278,077	205,535	224,422	258,085	190,759
Net currency position	**124,470**	**143,141**	**105,799**	**6,705**	**7,711**	**5,699**	**4,363**	**5,018**	**3,708**

December 31, 2016	EUR	EUR +15%	EUR -15%	USD	USD +15%	USD -15%	CHF	CHF +15%	CHF -15%
Financial assets	21,505,535	24,731,365	18,279,705	256,156	294,579	217,733	191,717	220,475	162,960
Financial liabilities	21,447,880	24,665,062	18,230,698	260,562	299,646	221,478	214,156	246,279	182,033
Net currency position	**57,655**	**66,303**	**49,007**	**(4,406)**	**(5,067)**	**(3,745)**	**(22,439)**	**(25,804)**	**(19,073)**

27.5.3 Security Price Risk

Security price risk is a risk of adverse effects on the Bank's financial performance and capital due to changes in prices of securities within the Bank's portfolio.

The Bank manages the risk of changes in prices of securities to minimize the adverse effects of changes in prices of securities in the Bank's portfolio.

The following organizational units of the Bank are responsible for security price risk management:
- The Board of Directors, which defines the security portfolio management policy and market risk management policy;
- The Executive Board, which implements the adopted policies;
- ALCO, which monitors the Bank's exposure to the security price risk and proposes adequate measures for this risk management;
- Treasury, which manages the portfolio of securities on a daily basis and the Risk Management Department, which monitor the values of the trading book items and reports to the Bank's management.

Based on the relevant sources of market information, the Risk Management Department actively monitors the values of securities in the Bank's possession and controls their compliance with the internally prescribed limits.

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27. RISK MANAGEMENT (Continued)

27.5 Market Risk (Interest Rate Risk, Foreign Exchange Risk and Security Price Risk (Continued)

27.5.3 Security Price Risk

Value of the Bank's portfolio

	Market value at December 31, 2017	Market value at December 31, 2016
Pledged financial assets		
Bonds issued by the Republic of Serbia	-	90,000
	-	**90,000**
Financial assets at fair value through profit or loss, held for trading		
Bank shares	814	519
Corporate shares	23,474	23,465
Receivables per derivatives held for trading	470	-
	24,758	**23,984**
Financial assets available for sale		
Treasury bills of the Republic of Serbia in RSD	-	207,069
Bonds issued by the Republic of Serbia in foreign currencies	293,436	936,810
Bonds issued by the Republic of Serbia in RSD	4,020,424	1,947,447
Municipal bonds (net of impairment allowance)	45,990	86,269
	4,359,850	**3,177,595**
Financial assets held to maturity		
In RSD	**414,425**	**1,168,704**
Treasury bills of the Republic of Serbia	-	598,823
Bonds issued by the Republic of Serbia	414,425	569,881
In foreign currencies	**58,467**	**184,621**
Treasury bills of the Republic of Serbia	-	-
Bonds issued by the Republic of Serbia	58,467	184,621
	472,892	**1,353,325**
Total	**4,857,500**	**4,644,904**

27.6 Operational Risk

Operational risk is the risk of the adverse effects on the Bank's financial result and capital due to failures in the employees performance, inadequate internal procedures and processes, inadequate management of the information and other systems in the Bank or due to unforeseen external events. Operational risk includes legal risk but not the reputation and strategic risks.

The following organizational units of the Bank are responsible for operational risk management:

- The Board of Directors, which defines the operational risk management policy;
- The Executive Board, which implements the adopted policy and defines the operational risk management procedure;
- ALCO, which monitors the Bank's exposure to the operational risk and proposes adequate measures for this risk management;
- Risk Management Department, which on a daily basis monitors the risk, collects information on the operational risk events, and reports to the management on the Bank's exposure to the operational risk.
- Operational risk exposure is measured by the Risk Management Department through identification of the operational risks, creation, maintenance and analysis of the database on the operational risk events in accordance with the bank's relevant procedure.

All amounts expressed in thousands of RSD, unless otherwise stated.

27. RISK MANAGEMENT (Continued)

27.6 Operational Risk (Continued)

The Bank's exposure to the operational risk is in fact measured by monitoring the number of events of the same type during the calendar year and the financial effect of each such event:

	2017	2016.
Number of events	105	134
Gross loss (EUR)	1,358,404	167,159
Net loss (EUR)	9,700	978

In 2017, 105 operational risk events were recorded – 29 down year on year. The largest number of events relate to the cashier shortages or surpluses and those were successfully resolved (39 events of cashier shortages and 16 events of cashier surpluses). The remaining 50 events pertained to instances of external fraud, disruptions in operations and system failures, technical problems and difficulties in communication, incomplete documentation, incorrect bank account numbers upon payment, accounting errors, problems regarding reserves on the customer current accounts, problems in using software applications, etc.

The total gross loss from all operational risk events during 2017 amounted to EUR 1,358,404 while the net loss amounted to EUR 9,700. The gross loss from cashier shortages and surpluses amounted to EUR 12,760 and EUR 4,734, respectively and the gross loss from all other operational risk events totaled EUR 1,340,910. the net loss from cashier shortages was EUR 177, while the net loss incurred per all other events amounted to EUR 9,523.

The largest portion of the gross loss in EUR refers to the use of incorrect date of processing upon accounting for a guarantee issued to Company Teklas (the gross loss amounted to EUR 1,092,060.01 while the net loss was EUR 0.00, as reported in February 2017). other operational risk events mostly relate to external fraud, of which the most significant in terms of losses were the following events:

1. An external fraud case – theft that occurred in the New Mill Branch on October 24, 2017 (with the gross loss of EUR 33,690.30, comprised of the following amounts/original currencies: EUR 6,880, USD 7,064 and RSD 2,481,010). The damage was reimbursed as the perpetrators were apprehended. The net loss incurred by the Bank equaled zero.
2. A customer submitted a money transfer order amounting to RSD 594,450 as an authorized representative of the Company Kolpa but the Bank's Officer subsequently found that the Company stamp and representative's signature were abused by that person. The customer was not an authorized representative of the Company (his signature was not included in the signature specimen card).
3. A loan in the amount of RSD 500,000 RSD (EUR 4,143) was approved to customer who provided counterfeit documents as evidence of employment.

The total net loss incurred by the Bank in respect of the cases of external fraud amounted to EUR 9,140.

According to business lines, 89 of the reported operational risk events in 2017 related to accounts and payments, 8 events pertained to retail banking, 6 to corporate banking and 2 to trade and sales.

According to the type of event, 81 events pertained to the execution, delivery and process management, 14 to disruptions in operations and system failures, 7 to external fraud cases and 3 to damages on property and equipment.

As per the criterion of the number of the same type of events in a year, the event type of cashier shortage was within the medium risk level range, while the cashier surplus type of event was within the low risk level range.

The Bank assesses the risk of activity outsourcing. Outsourcing is performed under the relevant contracts where rights and obligations of the contracting parties are clearly defined.

The Bank also identifies and assesses operational risks upon each introduction of new products, processes and systems of new business activities.

27. RISK MANAGEMENT (Continued)

27.7 Risk of Inadequate Information System Management

The Bank's objective in managing the risk of inadequate information system management is to minimize negative effects that may arise from the Bank's IS exposure to public networks, malicious internal attacks, hardware fault and breakdown and sabotage and to maintain such risk exposures within the prescribed limits. In accordance with NBS Decision on the Minimum Standards for Financial Institution IS Management, the Bank has undertaken a number of activities for full compliance with the said Decision.

To this end, the Bank has adopted the IS Development Strategy, the Business Continuity Strategy, Exit Strategies For Outsourced Activities, and IS Security Policy. Furthermore, a series of new procedures and quality assurance instructions have been adopted, all in accordance with NBS Decision on the Minimum Standards for Financial Institution IS Management.

The Bank is currently in the process of PCI DSS certification so as to ensure an adequate level of data protection, primarily for improvement of card operations, which are also being set up. The process of compliance with PCI DSS standard induced not only processing improvements, but information system protection enhancement as well, which will consequently enable higher levels of protection for card operations as well as the Bank's overall business processes.

The Bank's information system has functionalities to support the business processes, ensure timely, accurate and complete information significant for decision making and risk management. The Bank continuously improves its information system. The current IS Development Strategy is regularly updated. For a better quality IS management, regular meetings of the IT Committee are held where current and pending IT projects are discussed.

The framework for IS management comprises the adopted Project Management Methodology and system of reporting on the information system function and security.

The following organizational units of the Bank are responsible for management of the inadequate IS management risk:

- The Board of Directors, which defines the IS Development Strategy, the IS Security Policy and the Business Continuity Strategy;
- The Executive Board, which implements the adopted strategies and policies and defines relating procedures and instructions;
- IT Committee, which monitors IS functioning and development, makes relevant decisions and proposes adequate measure to the Bank's Executive Board;
- IT Division, which plans, proposes and performs all activities related to the Bank's information system and reports to the IT Committee.

The Information Security Manager assesses the IS security risk and reports to the IT Committee on the assessment.

27.8 Exposure Risk

The Bank manages the exposure risk in order to minimize the negative effects that may arise from the concentration of the Bank's exposure to a single entity or a group of related entities and entities/persons related to the Bank and to maintain such exposures within prescribed limits.

The following organizational units of the Bank are responsible for exposure risk management:

- The Board of Directors, which decides on the Bank's exposures to a single entity or a group of related entities in excess of 10% of the Bank's capital and on exposures to the entities related to the Bank;
- The Executive Board, which defines the exposure risk management procedure, decides on the Bank's exposures to a single entity or a group of related entities up to 10% of the Bank's capital and on exposures to the entities related to the Bank in accordance with the Board of Directors' Decision on Authorizing the Bank's Executive Board to Execute Legal Transactions with a Related Party;
- ALCO, which monitors the Bank's exposures to a single entity, a group of related entities and entities/persons related to the Bank and proposes adequate measures for exposure risk management;
- Risk Management Department, which reports to the management on the Bank's exposures to a single entity, a group of related entities and entities/persons related to the Bank.

All amounts expressed in thousands of RSD, unless otherwise stated.

27. RISK MANAGEMENT (Continued)

27.8 Exposure Risk (Continued)

Exposure risks are measured by the Risk Management Department through preparation of the reports prescribed by the relevant NBS decision and the Bank's procedures.

Net exposures to the Bank's related parties and large exposures

	2017		2016	
	Exposure amount	Share in capital	Exposure amount	Share in capital
Bank's related parties	664,850	13.18%	434,398	10.93%
Large exposures	523,714	10.38%	712,488	17.92%

In 2017 the Bank's exposures to a single entity/a group of related entities and entities/persons related to the Bank were within the prescribed limits. For all exposures within the medium exposure risk level range, prior approval of the Executive Board was obtained.

The Bank monitors its concentration ratio for 20 largest gross exposures. The concentration ratio for 20 gross largest exposures represents the Bank's balance sheet assets and off-balance sheet items subject to classification for 20 largest business groups other than banks, relative to the total classifying assets less assets representing exposures to the other banks. The Bank's goal is to maintain this ratio at the levels below 30%.

As of December 31, 2017, the Bank's balance sheet assets and off-balance sheet items subject to classification for 20 largest business groups other than banks amounted to RSD 7,363,565 thousand. The Bank's balance sheet assets and off-balance sheet items subject to classification less deposits held with banks amounted to RSD 42,683,748 thousand. As of December 31, 2016, the Bank's concentration ratio for 20 largest gross exposures equaled 17.25%.

27.9 Investment Risks – Investments in Non- FSI Entities and Own Fixed Assets

Investments in other entities are investments whereby the Bank acquires equity interests or share in entities that do not belong to the financial services industry. Such investments are not associated with acquisition of shares for further sales within six months from their acquisition date.

The following organizational units of the Bank are responsible for investment risk management:

- The Board of Directors, which decides on the individual investments to be made in the Bank's own fixed assets in excess of EUR 250 thousand in RSD equivalent;
- The Executive Board, which defines the investment risk procedure and decides on the investments to be made in the Bank's own fixed assets up to EUR 250 thousand in RSD equivalent;
- ALCO, which monitors the bank's investments risks and proposes adequate measures for the investment risk management;
- IT Division, Technical Affairs Unit and Information Security Unit, which are in charge of acquisition of fixed assets.

The Bank's investment risks are measured by the Risk Management Department and Financial Management and budgeting Department.

Investments in non- FSI entities and own fixed assets relative to the Bank's capital

	December 31, 2017	December 31, 2016
Investments in non-FSI entities	0.00%	0.00%
Total investments in non-FSI entities and Bank's own fixed assets	18.74%	23.77%

During 2017 the Bank's investment were within the low risk level range.

All amounts expressed in thousands of RSD, unless otherwise stated.

27. RISK MANAGEMENT (Continued)

27.10 Country Risk

Country risk is the risk relating to the country of origin of the entities/persons the Bank is exposed to, i.e., a risk of negative effects on the Bank's financial performance and capital due to the Bank's inability to collect receivables due from non-residents for reasons resulting from political, economic and social circumstances prevailing in the country of origin of such entities/persons.

The following organizational units of the Bank are responsible for country risk management:
- The Board of Directors, which defines the country risk management policy;
- The Executive Board, which implements the adopted policy and defines the country risk management procedure;
- ALCO, which monitors the Bank's exposure to the country risk and proposes adequate measures for this risk management;
- Payment Operations Department, which is involved in account opening and closing and money transfers with correspondent banks.

Country risk is measured by the Risk Management Department, where the monthly identification of the country risk is made upon preparation of the monthly report on the Bank's risk exposure..

The bank has system in place for classification of countries per country risk level based on the risk categories assigned to countries by the largest international credit rating agencies (Moody's, Standard &Poors and Fitch).

In 2017 the Bank had funds deposited on accounts held with banks operating in the countries, which, according to the rating of the said rating agencies and in line with the Bank's relevant procedure, were classified as low-risk and medium-risk countries.

The Bank's exposure to the low-risk countries is not limited. As of December 31, 2017, such countries were Germany, Belgium and Austria. As of December 31, 2017 the medium-risk countries were Turkey, Macedonia and Croatia. The Bank's exposure to these three medium-risk countries was significantly lower that the internally prescribed limits during December 2017.

List of countries to which the Bank was exposed as of December 31, 2017

Country	Risk level	Limit	Share in the Bank's capital*
Germany	low	No limit	7.18%
Belgium	low	No limit	2.44%
Austria	low	No limit	0.75%
Turkey	medium	100% of regulatory capital	6.64%
Macedonia	medium	100% of regulatory capital	9.35%
Croatia	medium	10% of regulatory capital	0.09%

*Share in the Bank's capital in the table above was arrived at based on the gross exposure amounts.

As of December 31, 2017, the Bank's total exposure to TÜRKİYE HALK BANKASI A.Ş amounted to RSD 320,617, thousand, which is 6.33% of the Bank's capital. The exposure comprised deposits placed with the Parent Bank.

27. RISK MANAGEMENT (Continued)

27.11 Compliance Risk and Risk Management Activities Relating to Prevention of Money Laundering and Financing of Terrorism

Compliance entails performance of banking operations in accordance with the legislation, regulations, standards, procedures, business policies and other internal bylaws. Compliance risk occurs as a result of failure to align banking operations with the said regulations and enactments.

The Bank manages the compliance risk in order to avoid sanctions of the regulatory authority, financial losses, compromise to the Bank's reputation and clients' trust.

The following organizational units of the Bank are responsible for compliance risk management:
- The Board of Directors, which defines the compliance risk management policy;
- The Executive Board, which implements the adopted policy and defines the compliance risk management procedure;
- Compliance and AML Department, which identifies, assesses and monitors the compliance risk.

In 2017 the Compliance and AML identified and assessed compliance risk by implementing adequate control activities and conducting inspections prescribed by the Rules of Procedure in the manner governed by the Compliance Risk Management Procedure.

<u>The report on the conducted inspection of compliance and risk management activities relating to the prevention of money laundering and financing of terrorism</u>

The report contains information on the conducted compliance inspections and undertaken activities on identification and monitoring of compliance risk of money laundering and financing of terrorism.

1. In accordance with the Annual Operating Plan, during 2017, based on the randomly selected sample, the Compliance and AML Department personnel conducted 13 inspections of the compliance with the legislation and internal bylaws in several organizational units of the Bank.

Compliance inspections were also conducted in the following branches: Kalenić, Šabac, Jagodina (Sub-branch Paraćin), Gornji Milanovac, Čačak, Pivarska, Kragujevac, Kraljevo, Novi Pazar, Novi Sad, Pančevo, Belgrade and in HR and Training Department.

Recommendations were provided and deadlines set for elimination of risks and findings identified upon inspection. All the suggested recommendations were implemented within the deadlines set.

The findings identified upon inspections conducted in the above said organizational units of the Bank were evaluated as *acceptable with certain corrections*, since the operations subject to inspection were performed in compliance with the relevant effective legislation and the Bank's procedures.

2. The Compliance and AML Department had a preventive role in compliance risk identification and monitoring by keeping track of novel solutions in and amendments to the effective legislation, by notifying the competent management on significant new developments and obligations of aligning the Bank's procedures and instructions with the legislation and by overseeing implementation and incorporation of the legislation in the Bank's internal bylaws.

During 2017 heads of the Bank's competent organizational units were promptly notified of amendments to 53 legislative regulations.

27. RISK MANAGEMENT (Continued)

27.11 Compliance Risk and Risk Management Activities Relating to Prevention of Money Laundering and Financing of Terrorism (Continued)

<u>The report on the conducted inspection of compliance and risk management activities relating to the prevention of money laundering and financing of terrorism (continued)</u>

The more relevant new laws and decisions enacted by the National Bank of Serbia published in the Official Gazette of RS during 2017 that have a significant impact on the Bank's operations are: The Decision on the Rate and Manner of Maintaining the Systemic Risk Buffer, Decision on the Countercyclical Buffer Rate for the Republic of Serbia, Decision on the Accounting Write-Off of Bank Balance Sheet Assets, Decision on Amendments and Supplements to the Decision on the Minimum Requirement for Capital and Eligible Liabilities of Banks, Decision on Amendments and Supplements to the Decision on the Information and Data Submitted to the National Bank of Serbia for Preparation and Update of Bank and Banking Group Restructuring Plan, Decision on Amendments and Supplements to the Decision on Reporting of Banks, Decision on Amendments and Supplements to the Decision on Classification of Bank Balance Sheet Assets and Off-Balance Sheet Items, Decision on Amendments and Supplements to the Decision on Risk Management, Law on Prevention of Money Laundering and Financing of Terrorism, amendments to the regulations governing payment operations whereby companies and entrepreneurs no longer need to use stamps in dealings with banks, amendments to the regulations on the taxation system, etc.

At the request of the Bank's Risk Management Department, an inspection was conducted on the Report on publishing the Bank's data and information as of June 30, 2017, which found that the Report was prepared in conformity with the relevant NBS decision and that it contained all the prescribed elements. In 2017 an inspection was made on the Report on the process of internal assessment of the Bank's capital adequacy for 2016 (Report to ICAAP). It was found that the Report was prepared in conformity with the relevant NBS decision and that it contained all the prescribed elements.

3. In order to identify and detect suspicious transactions, the compliance and AML Department staff performed daily control and inspection activities, analyses and reporting of the cash transactions amounting to and in excess of EUR 15,000 in RSD equivalent (at the middle exchange rate of NBS) to the Administration for Prevention of Money Laundering. During 2017, the Department reported t 3,767 regular cash transactions to the Administration for Prevention of Money Laundering.

Particular attention was paid to the monitoring, analysis and detection of suspicious transactions of the Bank's customers. In the observed period, the staff reported 11 suspicious transactions to the Administration for Prevention of Money Laundering.

4. In accordance with both external and internal regulations, the following reports were prepared for the competent Bank's bodies and regulators:

- The annual report on the conducted analysis and assessment of the Bank's exposure to the risk of money laundering and financing of terrorism;
- The annual report on the conducted compliance inspections with identified and assesses main compliance risks and risk management plan;
- The annual report on the conducted internal inspection and actions undertaken in the area of prevention of money laundering and financing of terrorism;
- Quarterly reports on the conducted compliance inspections and actions undertaken in the area of prevention of money laundering and financing of terrorism.

In accordance with the effective regulations, the Bank prepared the annual plan and program of staff education and training for implementation of the regulations and procedures in the area of prevention of money laundering and financing of terrorism.

In 2017 the Bank's authorized personnel held trainings for all the Bank's employees and tested their knowledge in the area of prevention of money laundering and financing of terrorism.

All amounts expressed in thousands of RSD, unless otherwise stated.

27. RISK MANAGEMENT (Continued)

27.12 Environmental Risks

The Bank manages the environmental risks in order to identify, assess and control risks that may cause jeopardy to the natural and social environment in accordance with the Environmental Risk Management Policy and Procedure.

The following organizational units of the Bank are responsible for environmental risk management:

- The Board of Directors, which defines and at least annually reviews the environmental risk policy and assesses the need to amend this policy;
- The Executive Board, which implements the adopted policy and defines procedures for environmental risk management;
- Credit Committees, which decide on the loan approval in accordance with the available information and opinion of the Credit Division on the risk of impact on the natural and social environment;
- The Bank's Crediting Department, which assesses the impact of the borrower's business activities and financed assets/purposes during the assessment of the borrower credit quality; and
- Risk Management Department, which monitors the loans at the portfolio level per categories of environmental risk through preparation and analysis of the risk reports.

Upon processing an individual client's loan request, the first step is to classify the environmental risk per the client's core business activity and the activity that is to be financed.

Environmental risk categories are:

- High – exclusion list;
- High – category A;
- High;
- Medium; and
- Low.

If the activity subject to financing is included in the exclusion list, the client's loan request is denied. If it is classified into high risk category A, the client is required to provide the Assessment of the Impact on the Environment and the impact on the environment is further considered before a decision is made on loan approval by the competent Credit Committee.

Upon checkup of the loan request analysis with the proposed decision to the competent Credit Committee, the Crediting Department checks the classification of the activity that is to be financed according to the environmental risk level, checks the information on the impact of the client and the client's activity subject to financing on the natural and social environment.

The Bank's loan and other contracts contain provisions and clauses regarding the protection of the natural and social environment to be observed by both the clients and the Bank.

The Bank monitors the balances of loans and receivables per client industry, business activity and environmental risk category through preparation and analysis of the relevant risk reports.

Breakdown of corporate loans per environmental risk category

	Number of customers		Loan and receivable amounts (on and off balance)		
Risk category	**December 31, 2017**	**December 31, 2016**	**December 31, 2017**	**December 31, 2016**	**Increase / decrease**
High – exclusion list	-	-	-	-	-
High – category A	8	7	70,640	112,766	(42,126)
High	244	204	7,682,454	6,576,746	1,105,708
Medium	1,048	956	11,748,016	10,979,399	768,617
Low	1,975	1,923	13,960,351	12,053,862	1,906,489
Total	**3,275**	**3,090**	**33,461,461**	**29,722,773**	**3,738,688**

As of December 31, 2017 and 2016 the Bank had no exposure to the customers with activity being financed in the high risk – exclusion list category.

All amounts expressed in thousands of RSD, unless otherwise stated.

28. SEGMENT OPERATIONS

	December 31, 2017		December 31, 2016	
Segment	**ASSETS**	**LIABILITIES**	**ASSETS**	**LIABILITIES**
Corporate customers and SME clients	20,199,089	10,574,480	17,368,912	8,840,748
Public sector and public companies	5,320,919	5,913,552	5,128,725	6,746,676
Retail - individuals	8,231,928	12,274,066	6,145,050	10,290,613
Banking sector and other excessive	7,697,241	12,687,079	6,343,124	9,107,774
Total:	**41,449,177**	**41,449,177**	**34,985,811**	**34,985,811**

Within the segment “other“, the largest portion of RSD 4,839,851 thousand (2016: RSD 4,090,612 thousand) relates to funds held with the National Bank of Serbia (cash, mandatory reserve in local and foreign currencies), while the same item within the liabilities refers to the Bank's equity in the amount of RSD 6,119,707 thousand (2016: RSD 5,883,585 thousand).

The Bank has 4 operating segments, corporate and SME clients, retail clients, public companes and banking sector. Loans and other placements to Corporate and SME clients are under responsibility of Corporate and SME Marketing Division, while to retail clients are under responsibility of Division of Retail Marketing and ADC.

Loans and other placements to Public companies and Banking sector are mostly under responsibilities of Treasury Division. Most significant placement to Public companies relates to placement in debt securities (State bonds). Deposits and borrowings are under responsibilities of Treasury Division.

Types of products and services from which each reportable segment derives its revenues are as follows:

- Corporate and SME: loans for working capital, investment loans, revolving loans, loans covered by deposit, overdraft, loans from IFIs credit lines. Most important loans in 2017 were loans from EFSE credit line for working and investment capital plus overdraft (so called Easy Bizz) and micro loans for SME for supporting small enterprices.
- Retail: cash loans, refinancing loans, housing loans, energy efficiency from GGF credit line and car loans. Most important loans in 2017 were cash loans, then housing loans.
- Public sector and public companies: public debt securities, t-bills, mostly in RSD and EUR.
- Banking sector: money market transactions and SWAP.

The basis for segmentation is main income and expenses related to main banking operations which are realized from these segments, i.e. interest income and interest expenses which is followed and supported by organizational structure. Each of these segments bears interest income and income expenses as presented in table below.

Interest income and expenses as well fees and commissions are directly allocated to each segment. Other expenses are allocated by share in total net interest income. Impairment allowances both in 2016 and 2017 have significant influence on Net profit of Corporate and SME segment, as well as Retail segment. However, in 2017 the Bank realized positive net result both from retail and coprportae and SME segment.

The Bank does not have investments in associate and joint venture companies.

All amounts expressed in thousands of RSD, unless otherwise stated.

28. SEGMENT OPERATIONS (Continued)

December 31, 2017	Corporate and SME clients	Public sector and public companies	Retail - Individuals	Banking sector and other	Total
OPERATING INCOME / (EXPENSES)					
Interest income	928,173	212,997	604,283	9,540	1,754,993
Interest on loans	898,205	-	604,283	9,124	1,511,612
Interest income on marketable securities	-	212,997	-	-	212,997
Interest received from banks	29,968	-	-	-	29,968
Other interest income	-	-	-	416	416
Interest expenses	(132,289)	-	(84,468)	(48,931)	(265,688)
Interest on deposits	(44,134)	-	(84,468)	(48,931)	(177,533)
Interest on borrowings	(88,155)	-	-	-	(88,155)
Net interest income/(expenses)	795,884	212,997	519,815	(39,391)	1,489,305
Net fee and commission income	440,756	-	163,589	-	604,345
Net trading gains	-	31,523	-	-	31,523
Dividend income	-	-	-	759	759
Other income	12,879	2,956	8,385	132	24,352
Impairment allowance of loans and receivables	(249,315)	-	(20,450)	-	(269,765)
Depreciation and amortization	(80,160)	(18,395)	(52,188)	(824)	(151,567)
Other expenses	(811,466)	(186,215)	(528,311)	(8,240)	(1,534,321)
Income before taxes	**108,579**	**42,866**	**90,850**	**(47,664)**	**194,631**
Net profit for the year	**108,579**	**42,866**	**90,850**	**(47,664)**	**194,631**

December 31, 2016	Corporate and SME clients	Public sector and public companies	Retail - Individuals	Banking sector and other	Total
OPERATING INCOME / (EXPENSES)					
Interest income	952,988	175,457	455,867	20,521	1,604,833
Interest on loans	926,765	-	455,867	19,932	1,402,564
Interest income on marketable securities	-	175,457	-	-	175,457
Interest received from banks	26,223	-	-	-	26,223
Other interest income	-	-	-	589	589
Interest expenses	(165,231)	-	(75,430)	(19,210)	(259,871)
Interest on deposits	(55,822)	-	(75,430)	(19,210)	(150,462)
Interest on borrowings	(109,409)	-	-	-	(109,409)
Net interest income	787,757	175,457	380,437	1,311	1,344,962
Net fee and commission income	433,972	-	142,584	-	576,556
Net trading gains	-	12,144	-	-	12,144
Dividend income	-	-	-	3,144	3,144
Other income	10,600	1,952	5,071	228	17,851
Impairment allowance of loans and receivables	(386,336)	-	(2,953)	-	(389,289)
Depreciation and amortization	(63,489)	(11,689)	(30,370)	(1,367)	(106,915)
Other expenses	(785,256)	(144,576)	(375,632)	(16,909)	(1,322,373)
Income before taxes	**(2,752)**	**33,288**	**119,137**	**(13,593)**	**136,080**
Net profit for the year	**(2,752)**	**33,288**	**119,137**	**(13,593)**	**136,080**

NOTES TO THE FINANCIAL STATEMENTS
December 31, 2017
All amounts expressed in thousands of RSD, unless otherwise stated.

29. COMPLIANCE WITH NBS REGULATIONS

Performance/adequacy ratio	Values prescribed by NBS	Values achieved at December 31, 2017	Values achieved at December 31, 2016
Amount of the Bank's capital	min EUR 10,000,000	EUR 42,585,634	EUR 32,192,443
Capital adequacy ratio	min 8% (in 2016: min 12%)	17.11%	15.64%
Core capital Tier 1 ratio	Min 6%	17.11%	-
Common equity Tier 1 capital ratio	Min 4.5%	13.04%	-
Foreign exchange risk ratio	max 20%	2.51%	2.28%
Liquidity ratio	min 1	1.51	1.76
Rigid (cash) liquidity ratio	min 0.7	1.26	1.38
Total exposure to the entities related to the Bank	-	13.18%	10.93%
Exposure to a single entity/a group of related entities	max 25%	10.38%	11.13%
Sum of all large Bank's exposures	max 400%	10.38%	17.92%
Investments in non-FSI entities	max 10%	0.00%	0.00%
Total investments in non-FSI entities and the Bank's fixed assets	max 60%	18.74%	23.77%

30. RECONCILIATION OF OUTSTANDING BALANCES RECEIVABLE AND PAYABLE WITH COUNTERPARTIES

In accordance with Article 18 of the Law on Accounting (Official Gazette of RS no. 62/130), the Bank reconciled its balances of receivables and payables with its legal entity customers and creditors as of December 31, 2017. The aggregate balances of receivables and payables for which balance confirmations were requested amounted to RSD 30,935,610 thousand and RSD 21,807,680 thousand, respectively. The amount of reconciled receivables represents 93% of the total amount of receivables for which the balance confirmation requests were responded to by the clients. The total amount of unreconciled receivables is immaterial. All of the Bank's liabilities were reconciled with counterparties.

31. EVENTS AFTER THE REPORTING PERIOD

On February 20, 2018 the Bank increased its share capital by issuing a new issue of shares (XXXI) - 236,412 ordinary shares with a par value of RSD 10,000 per share. The share capital was thereby increased from RSD 4,248,483 thousand to RSD 6,612,603 thousand.

32. LITIGATION

As of December 31, 2017, there were 23 legal suits filed against the Bank (2016: 17 lawsuits) filed against the Bank, with claims totaling RSD 31,486 thousand (2016: RSD 25,049 thousand). The Bank expects a partially adverse outcome in once case. Accordingly, provision was made in this respect in the amount of RSD 7,149 thousand.

NOTES TO THE FINANCIAL STATEMENTS
December 31, 2017
All amounts expressed in thousands of RSD, unless otherwise stated.

33. EXCHANGE RATES

The official middle exchange rates for certain major currencies determined on the Interbank Foreign Exchange Market, and used for translation of the statement of financial position components denominated in foreign currencies into RSD were as follows:

	December 31, 2017	In RSD December 31, 2016
USD	99.1155	117.1353
EUR	118.4727	123.4723
CHF	101.2847	114.8473

Belgrade
February 28, 2018

Vesna Petrović	Erturk Sumer	Kenan Bozkurt
Head of the Financial Management and Planning Division	Member of the Executive Board	Chairman of the Executive Board

AKCIONARSKO DRUŠTVO HALKBANK II BEOGRAD

HALKBANK
Beograd

ANNUAL OPERATING REPORT FOR 2017

Belgrade, March 2018

CONTENTS

I DEVELOPMENT, ORGANISATIONAL STRUCTURE AND BUSINESS ACTIVITIES

1. ESTABLISHMENT

HALKBANK a.d. Beograd has been operating in the Republic of Serbia since 2015 when Turkiye Halk Bankasi A.S. became the major owner of Cacanska banka (operating since 1956).

The Bank was registered with the Serbian Business Registers Agency under Decision no. BD 54244 dated 13 September 2005.

The Bank has been operating under the name of Halkbank a.d. Beograd since 22 October 2015 when the change of its legal name was registered in the Serbian Business Registers Agency under Decision no. BD 89155/2015.

2. ORGANISATION OF OPERATIONS

HALKBANK a.d. Beograd is a universal bank which offers all types of banking products and services to corporate clients, entrepreneurs and retail clients. The Bank encourages and finances growth and development of the domestic economy, but is also a safe place for savings deposits of all clients. The Bank’s primary goal is to create products that will completely satisfy all customers’ expectations.

The Bank is registered in the Republic of Serbia for performance of payment operations and credit and deposit operations in the country and abroad and it operates in compliance with the Law on Banks.

HALKBANK a.d. Beograd has successfully expanded its business network and client base. Today the Bank offers services and products through a network of 23 branches, 9 sub-branches and 4 cash desks. As at 31 December 2017 the Bank was comprised of 6 branches in Belgrade, 2 branches in Čačak and branches located in the towns of Jagodina, Gornji Milanovac, Kraljevo, Užice, Kragujevac, Kruševac, Aranđelovac, Valjevo, Šabac, Niš, Novi Sad, Pančevo, Novi Pazar, Zemun and Subotica and 9 sub-branches in Paraćin, Požega, Topola, Ivanjica, Vrnjačka Banja, Leskovac, Mladenovac, Tutin and Čačak.

3. BASIC PERFORMANCE RATIOS

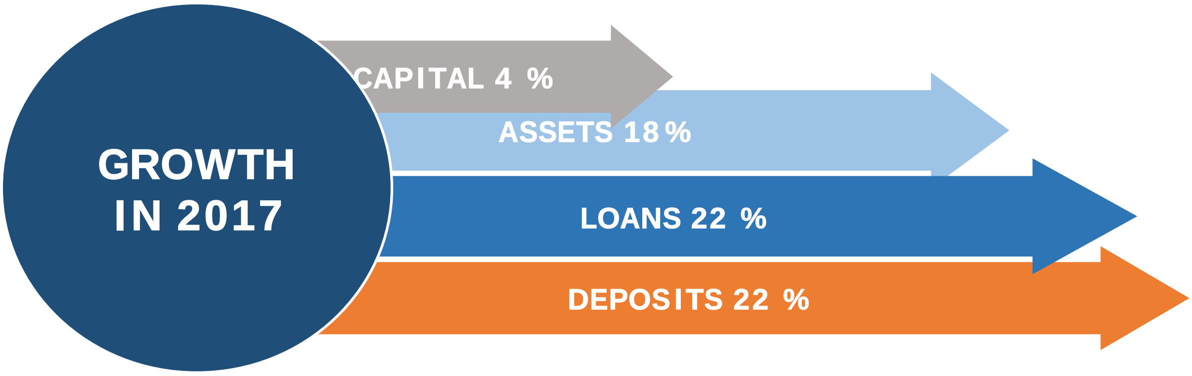
(u 000 RSD)

Income Statement - key items -	31.12.2016	31.12.2017	Revised plan for 2017
Net interest income	1.344.962	1.489.305	1.547.043
Net fee and commission income	576.556	604.345	618.817
Net income/(losses) on impairment of financial assets and credit risk-weighted off-balance sheet times	(389.289)	(269.765)	(224.473)
Operating expenses	(1.429.288)	(1.685.888)	(1.752.102)
Profit before taxes	136.080	194.631	219.619

Balance sheet	31.12.2016	31.12.2017	Revised plan for 2017
Loans due form customers	23.962.060	28.907.976	28.848.102
Deposits due to customers	19.226.690	23.449.090	22.628.286
Capital	5.883.585	6.119.707	5.859.660
Total assets	34.985.811	41.449.177	39.688.355

Key performance ratios	31.12.2016	31.12.2017	Revised plan for 2017
Costs to income ratio (CIR)	74,38%	79,38%	80,00%
Non-interest income to operating costs ratio	41,45%	37,26%	36,70%
Capital adequacy ratio (CAR)	15,64%	17,11%	15,01%
ROA	0,42%	0,52%	0,59%
ROE	2,25%	3,20%	3,73%
NIM	5,48%	5,12%	-

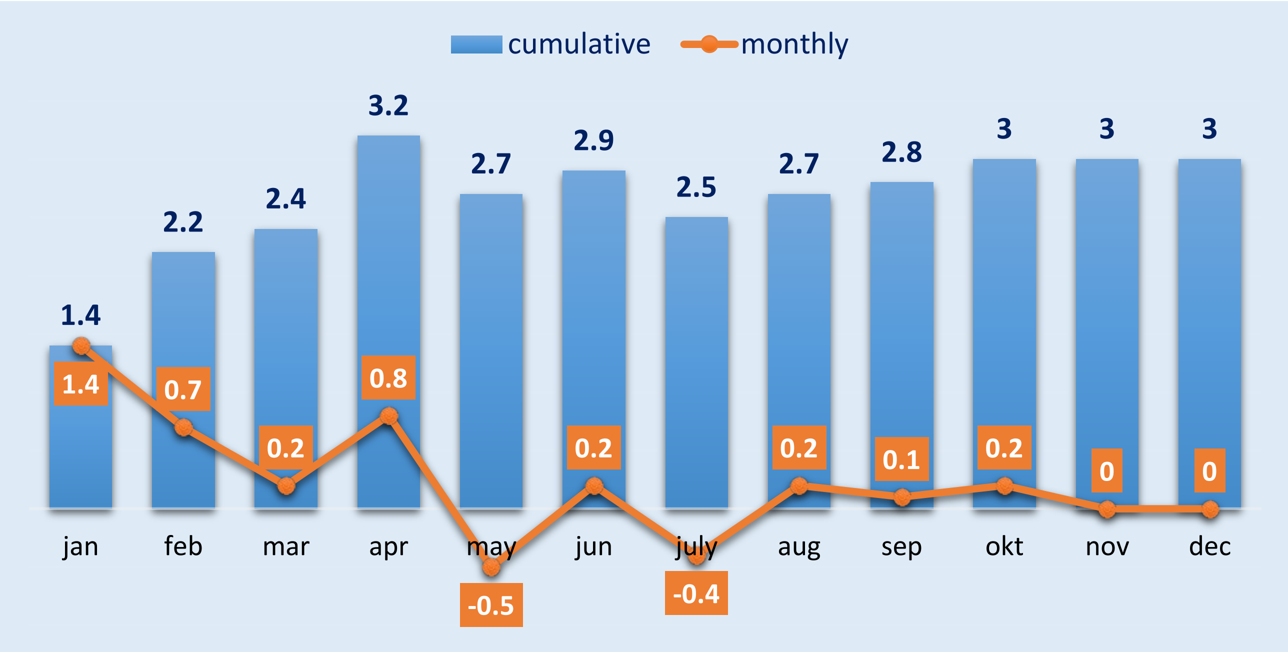
In order to calculate the cost-to-income ratio, cost of provisions for liabilities have been excluded from the other expenses item in the statutory statements. Income from the 'other income' item, with the exception of Reversal of provisions for liabilities, have been included within revenues along with net interest and fee income.



II FINANCIAL POSITION AND OPERATING RESULTS

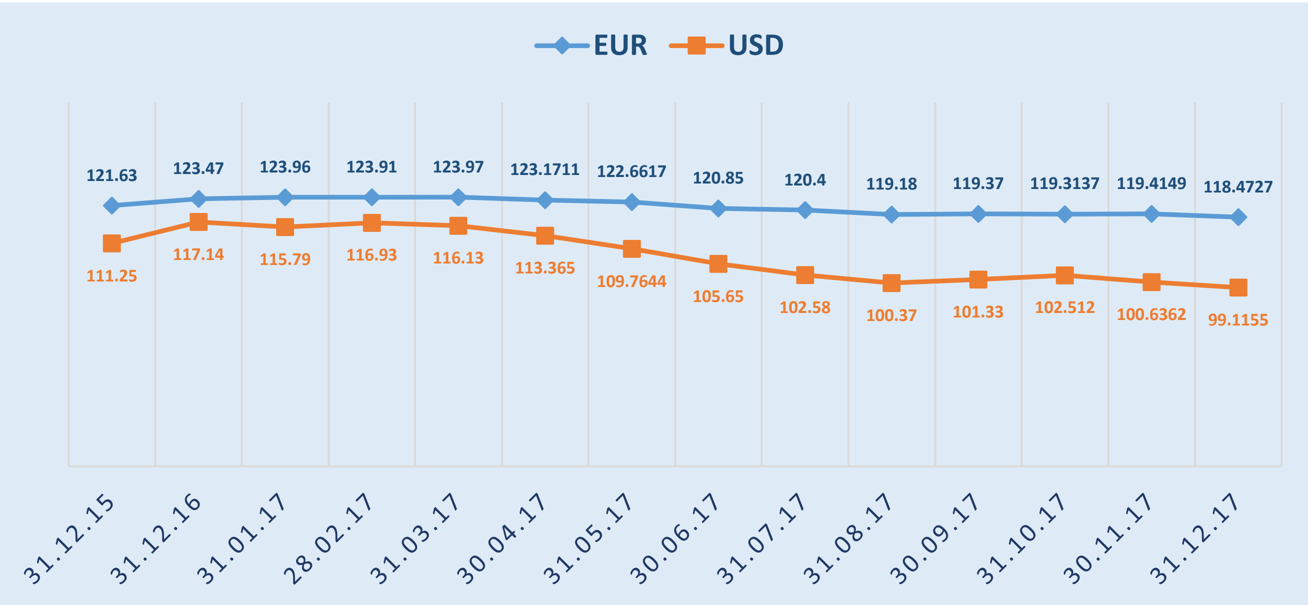
1. MACROECONOMIC ENVIRONMENT

Consumer prices growth in Serbia during 2017



In 2017, cumulative growth of consumer prices equaled 3%. The highest monthly increase was in January - 1.4%.

FX trend during the 2017

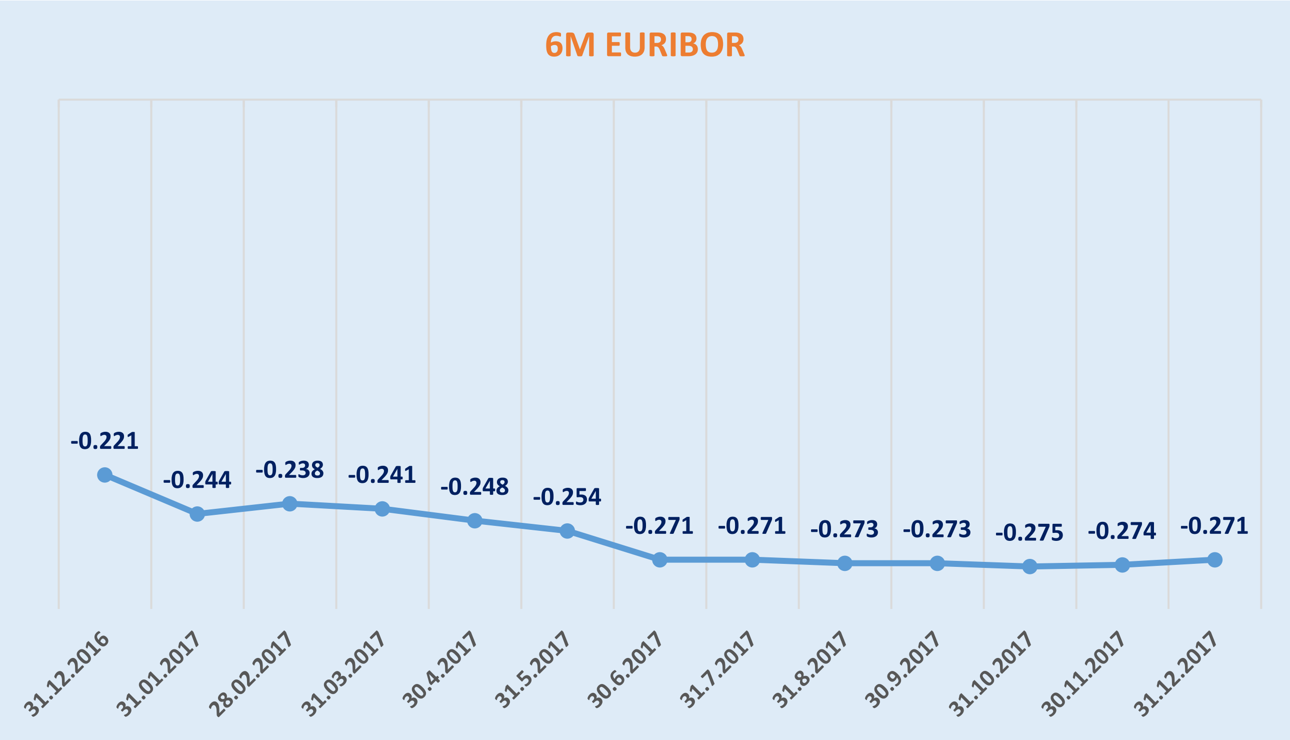


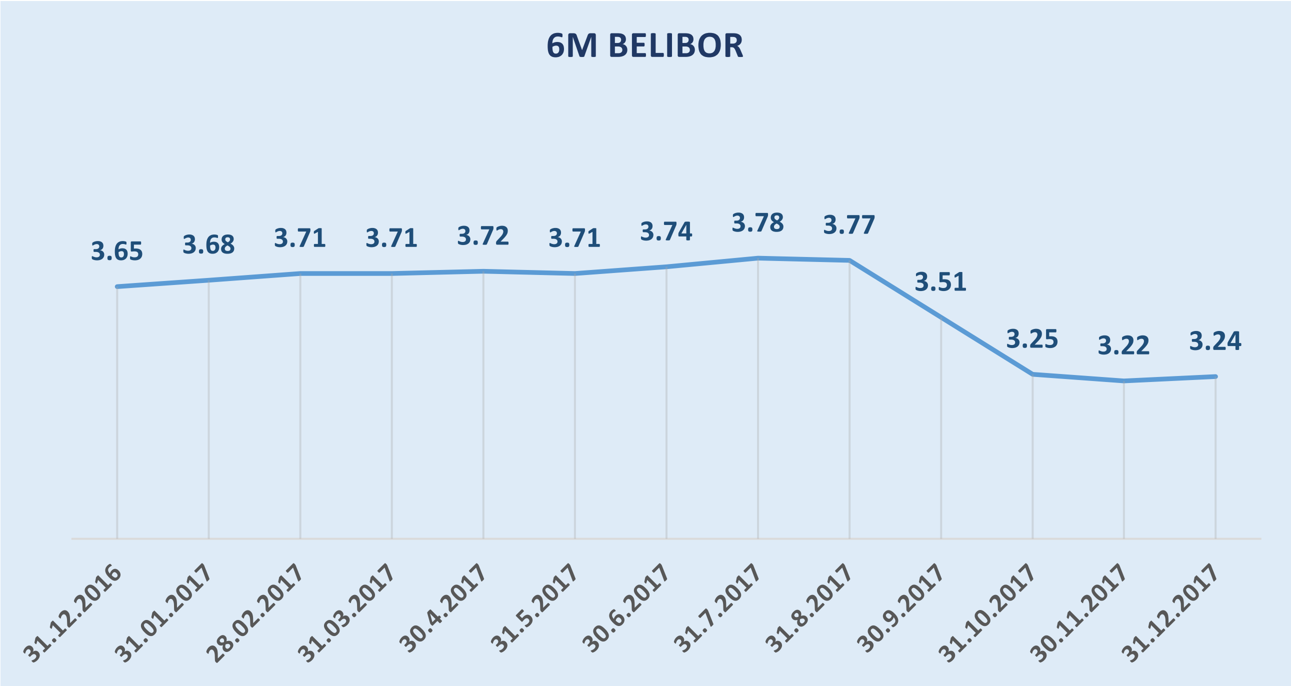
In 2017 RSD appreciated against EUR and USD by 4.05% and 15.38%, respectively.

Movements of the National Bank of Serbia's Key Policy Rate

NBS Executive Board reduced the key policy rate twice in 2017. At the meeting held on 7 September 2017 the value of the key policy rate was decreased by 0.25 percentage points, from the previous 4.00% to 3.75%. The second time the value of the key policy rate was reduced to 3.50%, at the meeting held on 9 October 2017.

Fluctuations of the interest rates on the financial markets





2. ACHIEVEMENT OF BASIC OPERATING TARGETS

The targets set out in the Bank's Business Policy for 2017 were achieved through the following activities:

1. The Bank planned wide expansion of its branch network, especially in the region of Belgrade, and regions where it had not been present in prior periods. In line with these targets, in 2017 the Bank opened a new branch in Zemun, a branch in Makedonska Street in Belgrade, a branch in Subotica and a sub-branch in Tutin. Moreover, the branch in Leskovac was moved to a more attractive location.

2. The Bank's realized values of liquidity ratios were far better than the set targets, as shown in the following table:

Indicators	31.12.2017	Plan 2017 (minimum)
The average liquidity ratio	1,71	1,2
The average quick (acid) liquidity ratio	1,45	0,9
The liquid asset ratio	26,51%	20%

3. In 2017 the Bank achieved a positive financial result in the amount of RSD 194.631 thousand, with net loss from impairment of financial assets and credit risk off balance sheet items in the amount of RSD 269.765 thousand.

Realized values regarding this goal for the year of 2017 are shown in following table:

(u 000 RSD)

Indicators	31.12.2017	Revised plan for 2017	Realisation of Revised plan for 2017
Net interest and fee income	2.093.650	2.165.860	96,67%
Net losses on impairment of financial assets and credit risk-weighted off-balance sheet items	(269.765)	(224.473)	120,18%
Operating costs (staff costs, depreciation charge and other expenses)	(1.685.888)	(1.752.102)	96,22%
Profit	194.631	219.619	88,62%

4. The Bank has developed an software solution for the implementation of the Basel III Standards in accordance with the regulations of the National Bank of Serbia. Also, the Bank has implemented the most significant part of the necessary activities for the timely application of IFRS 9 standards. In order to fulfill the SPPI criteria documentation of problematic contract clauses was conducted. After all the tests were carried out, with the adoption of the necessary acts at the end of 2017, it was concluded that the entire existing loan portfolio should be valued at amortized cost. At the beginning of 2018 a procedure that defines the process of classification of financial instruments was developed.

The Bank has implemented a new impairment calculation methodology in accordance with the IFRS 9. The IFRS 9 becomes effective as at January 1st 2018 and the first effects of the implementation will be recorded in the first quarter of 2018. A tool has been developed in order to successfully implement the adopted methodology and the first results of the tool were given at the beginning of the current year. Continuation on the development of the tool is expected in 2018.

5. In the last quarter of 2017, the Bank continued to perform the activities planned within the scope of the Tesla Project. At the beginning of Q4 2017, the Bank started the certification process with the DinaCard payment system and successfully completed the part relating to the card acquirer and the Bank HOST. Testing of application solutions was continued in order to prepare the system for certification with VISA and MasterCard payment institutions. Direct communication with VISA and MasterCard systems was established and verified, after both parties confirmed that the communication through new equipment was successful.

In order to become more accessible to the customers, in the last quarter, the Bank significantly increased the number of ATMs in several cities throughout Serbia, having in total 75 ATMs, which accept all payment cards issued under the VISA or DinaCard system. The number of ATMs at the end of 2016 was 35.

6. The main assumption for preparation of the Bank's Business Policy for 2017 was a capital increase in the amount of EUR 20 million by mid-2017, and further borrowings from the International Financial Institutions in the amount of EUR 25 million.

The first EUR 5 million from EFSE long-term credit line totaling EUR 10 million was drawn down on 17 July and the other EUR 5 million drawn on 29 September 2017. GGF long-term credit line in the amount of EUR 5 million was drawn down on 14 August 2017.

The planned capital increase of EUR 20 million was not realized in 2017, as well as the total additional borrowing from the International Financial Institutions in the amount of EUR 25 million, so the Bank revised its budget, and projections of the key financial indicators were corrected and presented as revised targets in this Report.

New projections were included as new planned values for 2017 in the Bank's Annual Report for 2017. After purchase of the Bank's shares at the Belgrade Stock Exchange followed by squeeze-out, Halkbank Turkey (Türkiye Halk Bankası A.Ş.) became owner of 99.89% of the Bank's shares. After the acquisition, at the meeting held on 27 December 2017, the Bank's Assembly enacted a decision on a new share issue in the amount of RSD 2.400 million (about EUR 20 million), with payment deadline until 31 March 2018. On February 20, 2018, the Bank increased its share capital through a new share issue (31st share issue) of 236,412 common stock shares with the par value of RSD 10,000 per share. Thereby the Bank's share capital increased from RSD 4.248.483 thousand to RSD 6.612.603 thousand.

3. BALANCE SHEET

As at 31 December 2017 the Bank's total assets amounted to RSD 41.449.177 thousand and accounted for 18.47% increase compared to the end of 2016.

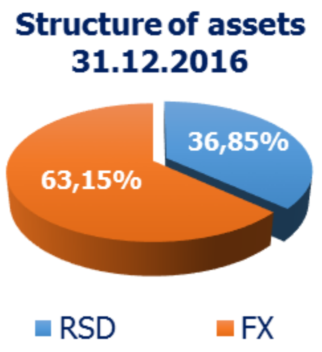
3.1 Assets

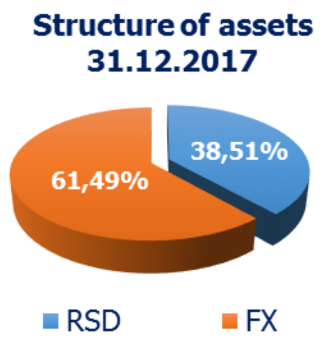
(u 000 RSD)

ASSETS	31.12.2016	31.12.2017	Revised Plan for 2017
Cash, cash equivalents and balances held with the central bank	4.090.612	4.839.851	4.028.072
Financial assets	4.644.904	4.857.500	4.620.435
Loans due from banks and other financial organizations	1.018.760	1.524.613	805.614
Loans due from customers*	23.962.060	28.907.976	28.848.102
Intangible assets, property, plant and equipment and investment property	1.018.759	1.044.516	1.178.803
Other assets*	250.716	274.721	207.327
TOTAL ASSETS	**34.985.811**	**41.449.177**	**39.688.355**

* The item 'loans due from customers' differs from the item 'loans and receivables due from customers' which is presented in the statement of financial position, for the amount of receivables for accrued interest, fees, accrued interest receivable and accrued income (which are measured using the effective interest method), which are presented within the 'other assets' in the statement of the financial position.

The following graphs present the currency structure of assets as at 31 December 2016 and 31 December 2017:





3.1.1 Loans to clients

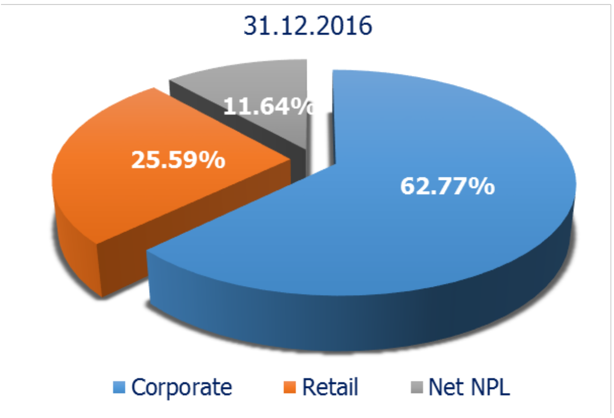
The breakdown of the loans due from customers as at 31 December 2016 and 31 December 2017 is provided in the following table:

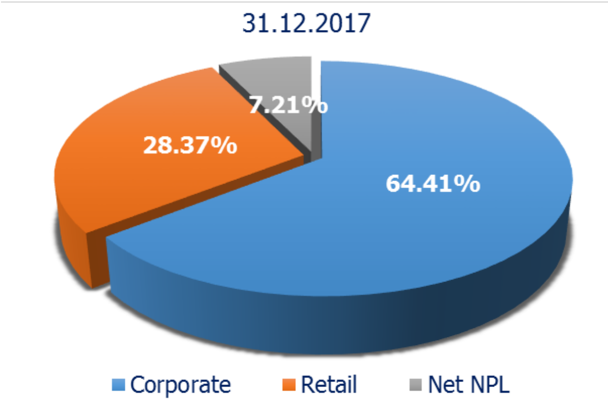
(u 000 RSD)

Loans to clients	31.12.2016	31.12.2017	Revised Plan for 2017	% change
Loans:	**23.962.060**	**28.907.976**	**28.848.102**	**20,64%**
Corporate clients without NPL, net	15.041.077	18.620.433	17.889.378	23,80%
Retail clients without NPL, net	6.132.787	8.202.223	8.648.507	33,74%
NPL, net	2.788.196	2.085.320	2.310.218	-25,21%

* The item 'loans due from customers' differs from the item 'loans and receivables due from customers' which is presented in the statement of financial position, for the amount of receivables for accrued interest, fees, accrued interest receivable and accrued income (which are measured using the effective interest method), which are presented within the 'other assets' in the statement of the financial position.

The Bank's net loan portfolio increased during 2017 by 20.64%.





In 2017 the Bank approved to its corporate and retail customers loans totaling RSD 19.875.889 thousand, of which RSD 5.533.241 thousand relates to loans of up to one-year maturity and RSD 14.342.648 thousand to loans with over one-year maturities.

Gross loans - Corporate

Gross corporate loans, including gross NPL as at December 31, 2017 and excluding interest receivables, commission receivables and accrued commissions amounted to RSD 23.246.865 thousand with the following structure:

(u 000 RSD)

Loan type	31.12.2016.	31.12.2017.	% change
Loans from the Bank's resources	15.255.123	18.503.811	21,30%
Loans from IFI's credit lines	5.203.152	4.743.054	-8,84%
Total	**20.458.275**	**23.246.865**	**13,63%**

The most important activities of Corporate and SME Marketing Division in 2017 are as follows:

- The Bank advanced EUR 135 million to Corporate and SME customers through 3,600 loan facilities, while in the same period EUR 120 million of the loans were repaid to the Bank.
- The Bank actively promoted the "Micro Loans" for SME clients through the entire branch network, focused on acquisition of new clients and continuing cooperation with the existing clients, with cross-selling and increasing the number of products per client. During this campaign the Bank disbursed EUR 8 million through 489 loans.
- Bank distributed 450 loans through EFSE loan and Easy bizz loans campaing in total amount of EUR 8,6 million. Loans from EFSE credit lines will be one of the core products of the Bank during next year.
- In 2017 the Bank took an active role in the program of the Government of the Republic of Serbia for investments in small and medium enterprises, with a partial subsidy from the Government in the final investment. The Bank came second in the number and amount of loans granted. During the campaign of subsidized loans, the Bank disbursed EUR 1.6 million through 52 loans.
- In the third quarter of 2017 the Bank executed the Intermediary Financing Agreement for APEX III/B and started promoting investment loans from EIB APEX funds. Such credit funds were intended for financing investment projects in SME segment and market mid-capitalization companies, as well as priority projects of local municipalities and public companies. A portion of funds were dedicated to financing SME projects of hiring young people without prior employment, which will be one of the most important credit products in the next year as well.
- In late November 2017, the Bank executed a contract with the European Investment Fund for participation in the COSME Program - EU program for SME competitiveness. Through COSME Program of guarantees the Bank will ensure easier access to credit funds for more SME companies. Next year loans securitized with COSME guarantee facilities will be one of the Bank's core products in SME segment.
- In 2017 trainings were held for the Sales staff on the topic of sales of guarantees and letters of credit. Focus on this items resulted in issue of 1,650 guarantees and letters of credit totaling EUR 47.9 million.
- With active participation in organization of business forum, the Bank increased recognition of Halkbank among corporate clients.

Gross loans - Retail

Gross retail loans as of December 31, 2017, including gross NPL amounted to RSD 8.321.738 thousand with the following structure:

(u 000 RSD)

Loan type	31.12.2016	31.12.2017	% change
Cash loans	2.761.504	4.529.143	64,01%
Housing loans	2.530.638	2.989.251	18,12%
Consumer loans – EE/RE	361.660	261.769	-27,62%
Consumer loans – other purposes	326.756	271.847	-16,80%
Allowed overdraft	105.163	125.995	19,81%
Due loan receivables	108.429	55.952	-48,40%
Consumer loans – vehicle purchase	31.609	54.689	73,02%
Overdraft	19.962	26.338	31,94%
Receivables related to Dina Card credit card	10.265	6.754	-34,20%
Total	**6.255.986**	**8.321.738**	**33,02%**

The Bank's Retail Marketing and ADC Department achieved significant growth in all fields of activity in the previous year.

In 2017 total EUR 37,8 million in more than 8.500 loans were realized, and loan portfolio increased for 39,3%, and increased market share from 0,84% at the end of 2016 to 1,04% at the end of 2017. Most important placements were realized through cash loans in amount of EUR 29,1 million and housing loans in the amount of EUR 7 million.

In the first half of the year promotional campaigns for cash loans "With us, you know where you stand" and approved current account overdraft "Minus that turns your budget into a plus" were conducted, aimed at expanding the customer base and rewarding loyalty of the long-standing clients. In the third and fourth quarter of the year the Bank successfully conducted a new campaign for cash loans "20 for 5'', with established more efficient way of communication between clients and the Bank through a new contact form at the Bank's website.

During the last quarter, the implementation of the new credit line GGF was successfully launched through the realization of consumer loans for investing in energy efficient projects, but also through the implementation of housing loans intended for the purchase of housing units in buildings that meet the latest building standards in terms of energy efficiency. Gross placements from this credit line as of December 31st 2017 amounted to EUR 1,2 million.

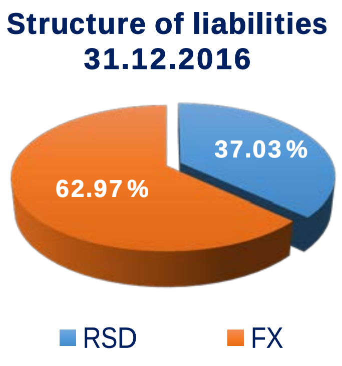
3.2 Equity and liabilities

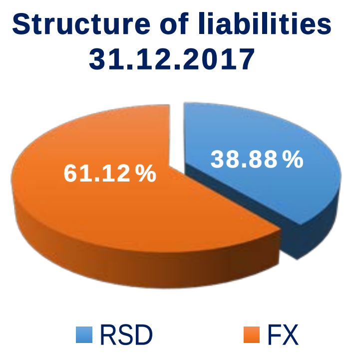
Total equity and liabilities as of December 31, 2017 amounted to RSD 41.449.177 thousand, with the following structure:

(u 000 RSD)

EQUITY AND LIABILITIES	31.12.2016	31.12.2017	Revised Plan for 2017
Deposits from banks and other financial organizations	1.715.327	3.190.355	2.843.345
Deposits from other clients	19.226.690	23.449.090	22.628.286
Funds borrowed	7.362.344	7.585.899	7.707.834
Other liabilities	797.865	1.104.126	649.230
TOTAL LIABILITIES	**29.102.226**	**35.329.470**	**33.828.695**
Share capital	4.248.483	4.248.483	4.076.409
Profit	138.153	194.631	219.619
Reserves	1.496.949	1.676.593	1.563.632
TOTAL CAPITAL	**5.883.585**	**6.119.707**	**5.859.660**
TOTAL	**34.985.811**	**41.449.177**	**39.688.355**

The following graphs present the currency structure of liabilities as of December 31, 2016 and December 31, 2017:





3.2.1 Deposits from banks, other financial organizations and central bank

The breakdown of deposits from banks, other financial organizations and central bank and a comparative analysis as of December 31, 2016 and December 31, 2017 is presented in the following table:

(in 000 RSD)

Position	31.12.2016	31.12.2017	% change
Transaction and other deposits	**1.715.327**	**3.190.355**	**85,99%**
- transaction deposits	15.544	14.956	-3,78%
- other deposits	1.699.783	3.175.399	86,81%

Total increase of deposits from banks, other financial organizations and central bank in RSD amounted to 85,99%.

3.2.2 Deposits from other customers

The structure of deposits from other customers and comparative analysis as of December 31st 2016 and December 31st 2017 is presented in the following table:

(in 000 RSD)

Position	31.12.2016	31.12.2017	% change
Transaction and other deposits	**19.226.690**	**23.449.090**	**21,96%**
- transaction deposits	8.446.234	10.134.074	19,98%
- other deposits	10.780.456	13.315.016	23,51%

***The item 'Transaction and other deposits' differs from 'deposits and other liabilities due to customers' for the amount of liabilities for interest, fees, accrued liabilities for calculated interest and other financial liabilities due to customers, which were not included in the aforesaid item.**

The total deposit base of the Bank, comprising of corporate and retail deposits, amounted to RSD 23.449.090 thousand as of 31, December 2017 is presented as follows:

(in 000 RSD)

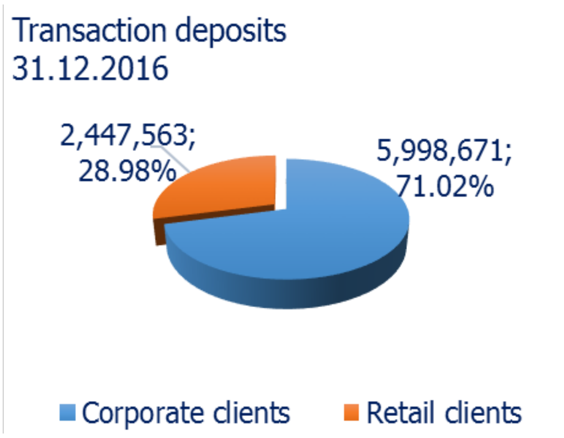
Deposit base	31.12.2016	30.09.2017	Plan 2017	% change
Corporate clients	8.975.876	11.217.654	10.781.016	24,98%
Retail clients	10.250.814	12.231.436	11.847.270	19,32%
Total	**19.226.690**	**23.449.090**	**22.628.286**	**21,96%**

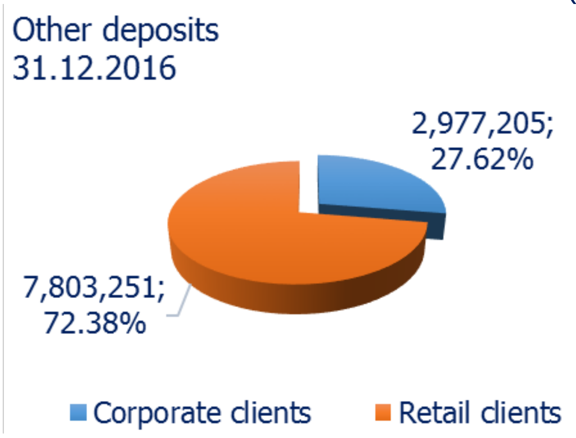
With constant monitoring of market trends, individual and proactive approach to corporate clients, the Bank managed to increase corporate deposits for 24,98% and what is important to mention is that level of transaction deposits increased for 19,98% despite the fact that in February 2017 the Bank cancelled interest payment on transaction deposits.

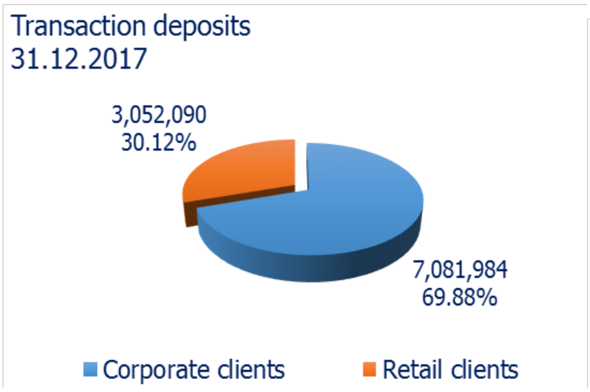
With a wide range of saving products, the Bank enable its clients adequate managing of funds and as a result, retail deposits increased for 19,32% and market share increased from 0,91% at the end of 2016 to 1,08% at the end of 2017.

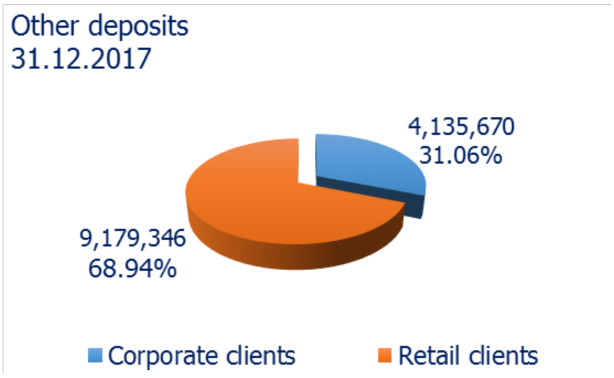
The structure of positions deposits from other customers of the Bank is presented as follows:

(u 000 RSD)









Funds borrowed

(in RSD thousand)

Position	31.12.2016	31.12.2017	% of change
Borrowed loans in foreign currency	**7.362.344**	**7.585.899**	**3,04%**
- EIB	4.892.052	3.719.147	-23,98%
- European Fund for Southeast Europe	-	1.184.727	100%
- EAR long-term revolving line	1.268.190	1.085.062	-14,44%
- KfW	336.743	215.405	-36,03%
- Italian Republic Government	23.895	89.614	275,03%
- GGF	224.102	699.581	212,17%
- Demir-Halk Bank (Nederland) N.V.	617.362	592.363	-4,05%

In 2017, the Bank repaid the principal of long-term borrowings to IFIs on a regular basis in the total amount of EUR 15,760 thousand. In the same period, the Bank drew down EUR 20,163 thousand of IFIs funds, of which the most significant were EFSE credit line in the amount of EUR 10,000 thousand and Green for Growth Fund in the amount of EUR 5,000 thousand.

Repayments were made to EIB in the amount of EUR 8,228 thousand, to KfW in the amount of EUR 909 thousand, to GGF in the amount of EUR 910 thousand, to the Italian Republic Government in the amount of EUR 88 thousand (withdrawals amounted to EUR 650 thousand). In respect of EAR long-term loan, the Bank repaid EUR 5.625 thousand (withdrawals amounted to EUR 4,513 thousand).

3.2.3 Capital

The capital of the Bank as of December 31st 2017 amounted to RSD 6.119.707 thousand and comprised of the following:

(in 000 RSD)

Position	31.12.2016	31.12.2017
Share capital – ordinary shares	1.819.820	1.819.820
Share capital – preference cumulative shares	1.340	1.340
Share capital - preference non-cumulative shares	600.000	600.000
Share premium	1.827.323	1.827.323
Revaluation reserves	322.675	364.162
Reserves from profit	1.174.274	1.312.431
Profit of the current year	138.153	194.631
Total capital	**5.883.585**	**6.119.707**

Comparison between realised and planned values of the capital is presented in the table below:

(u 000 RSD)

Position	31.12.2016	31.12.2017	Revised plan for 2017
Share capital	4.248.483	4.248.483	4.076.409
Profit of the current year	138.153	194.631	219.619
Reserves	1.496.949	1.676.593	1.563.632
Total capital	**5.883.585**	**6.119.707**	**5.859.660**

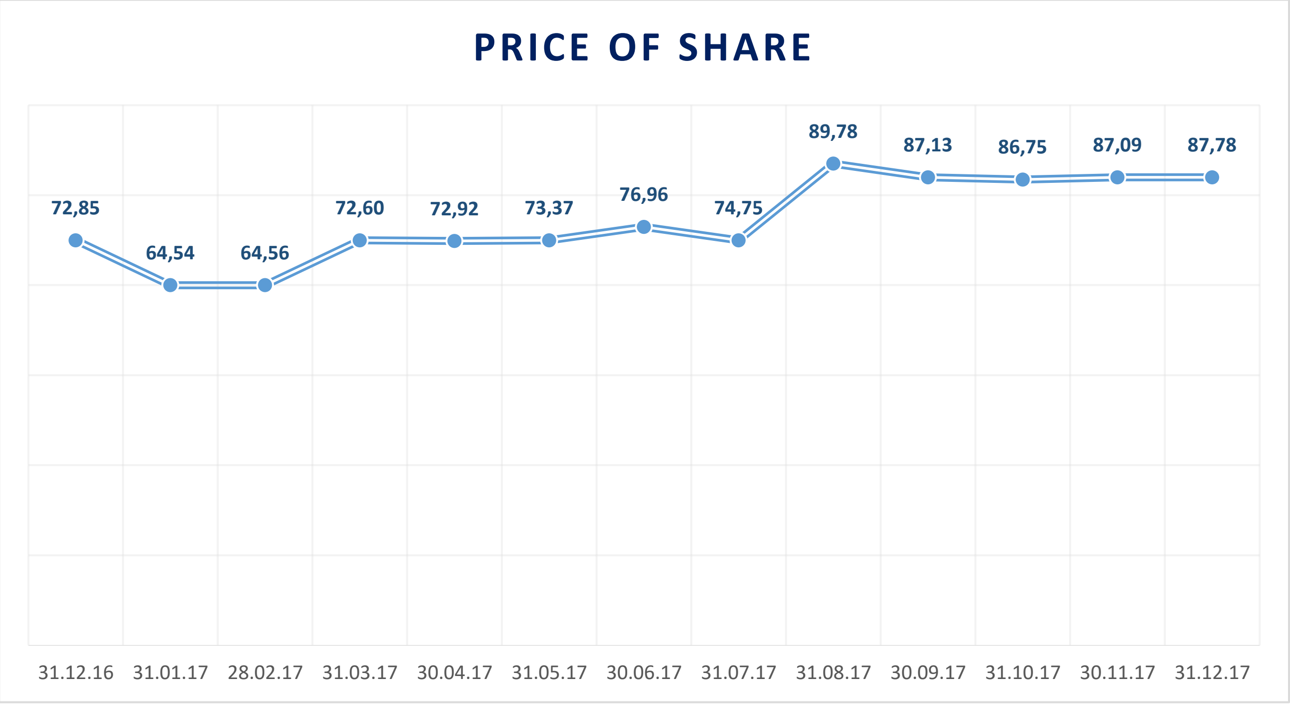
The information about the number of shareholders and the basic information of shares is presented in the following table:

Information on shares	31.12.2016	31.12.2017
Number of shareholders	407	6
Number of shares	242.116	242.116
Nominal value per share in RSD	10.000	10.000
Book value per share (in RSD)	24.300,69	25.275,93

During 2017, there was a significant change in the structure of share capital of the Bank. The majority owner, T. Halk Bankasi A.S. on the August 24, 2017 bought 18.200 ordinary shares on the Belgrade Stock Exchange, and then, in following takeover bid approved by the Securities Commission in the period from September 7, 2017 to 27, September 2017 acquired additional 6.118 ordinary shares. After this takeover bid, on November 15, 2017 majority owner carried out the procedure of forced purchase of shares from the remaining shareholders. At the end of 2017, T. Halk Bankasi A.S. owned 99,88% of ordinary shares or 99,89% of the total capital of the Bank.

31.12.2016	Total	Turkiye Halkbankasi	% Turkiye Halkbankasi	31.12.2017	Total	Turkiye Halkbankasi	% Turkiye Halkbankasi
Ordinary shares	181.982	139.680	76,75%	Ordinary shares	181.982	181.764	99,88%
Preference shares	60.134	60.000	99,77%	Preference shares	60.134	60.090	99,93%
Total	242.116	199.680	82,47%	Total	242.116	241.854	99,89%

The price of Bank's shares as of December 31, 2017 was RSD 10,400 which represents an increase of 15,62% compared to the beginning of the year.



4. OFF-BALANCE SHEET ITEMS

During 2017, the Bank issued performance and payment guarantees and opened letters of credit for its customers. The breakdown of off-balance sheet items as at 31 December 2016 and 31 December 2017 is presented in the following table:

(in 000 RSD)

Item	31.12.2016	31.12.2017	Revised Plan for 2017
Commitments (per guarantees, acceptances and irrevocable commitments)	5.735.364	6.400.560	5.690.244
Managed funds	295.879	278.305	290.258
Other off-balance sheet items	50.903.080	45.955.946	49.166.170
Total	**56.934.323**	**52.634.811**	**55.146.672**

The following table compares the breakdown of the item guarantees, acceptances and irrevocable commitments as at 31 December 2016 and 31 December 2017:

(in 000 RSD)

Guarantees, acceptances and irrevocable commitments	31.12.2016	31.12.2017	% change
Performance guarantees	2.475.221	3.313.643	33,87%
Payment guarantees	1.436.821	1.384.362	-3,65%
Irrevocable commitments per undrawn loans	1.182.820	1.259.108	6,45%
Issued foreign currency letters of credit with Banks' confirmation	500.062	385.037	-23,00%
Issued unsecured letters of credit	50.440	58.410	15,80%
Pledged securities	90.000	-	-100,00%
Total	**5.735.364**	**6.400.560**	**11,60%**

The following table presents the breakdown of the other off-balance sheet items:

(in 000 RSD)

Other off-balance sheet items	31.12.2016	31.12.2017	% change
Assets (real estate, land, automobiles, etc.) received by the Bank as collateral securitizing loan repayment	38.411.093	32.438.723	-15,55%
Broken period interest receivables	4.081.544	4.542.059	11,28%
Write-off of receivables in accordance with IAS 39	2.042.043	2.333.854	14,29%
The undrawn amount of combined framework loans (revolving loans plus off-balance sheet exposures)	1.585.658	2.245.606	41,62%
The undrawn amount of revolving loans	1.838.612	1.564.945	-14,88%
Received guarantees and other sureties as collateral in favor of the Bank	1.282.965	1.402.964	9,35%
Other off-balance sheet items	1.371.284	1.309.062	-4,54%
The unused amount of off-balance framework exposures	289.881	118.733	-59,04%
Total	**50.903.080**	**45.955.946**	**-9,72%**

5. STATEMENT OF PROFIT AND LOSS FOR THE PERIOD

The Bank calculated items of the Income Statement for the period from 1 January to 31 December 2017 in compliance with the Law on Accounting, IFRS and NBS regulations.

The Bank's profit for 2017 amounted to RSD 194.631 thousand.

(in 000 EUR)

Item	31.12.2016	31.12.2017	Revised Plan for 2017	% of plan
Interest income	1.604.833	1.754.993	1.820.051	96,43%
Interest expenses	(259.871)	(265.688)	(273.008)	97,32%
Net interest income	**1.344.962**	**1.489.305**	**1.547.043**	**96,27%**
Fee and commission income	663.889	710.404	715.887	99,23%
Fee and commission expenses	(87.333)	(106.059)	(97.069)	109,26%
Net fee and commission income	**576.556**	**604.345**	**618.817**	**97,66%**
Net gains on financial assets held for trading, available for sale and foreign exchange	12.144	31.523	6.067	519,58%
Other operating income	20.995	25.111	24.267	103,48%
Net losses on impairment of financial assets and credit risk-weighted off-balance sheet items	(389.289)	(269.765)	(224.473)	120,18%
TOTAL NET OPERATING INCOME	**1.565.368**	**1.880.519**	**1.971.721**	**95,37%**
Staff costs	(584.536)	(648.765)	(668.565)	97,04%
Amortization/depreciation charge	(106.915)	(151.567)	(157.738)	96,09%
Other expenses	(737.837)	(885.556)	(925.799)	95,65%
TOTAL OPERATING EXPENSES	**(1.429.288)**	**(1.685.888)**	**(1.752.102)**	**96,22%**
NET PROFIT	**136.080**	**194.631**	**219.619**	**88,62%**

Net profit realized in 2017 is for 43,03% higher than profit realized in 2016. Net interest income in 2017 is higher for 10,73% than net interest income realized in 2016, while net income from fees and commissions is higher for 4,82%. In 2017 realization of net interest income is 96,27% and realization of net income from fees and commissions is 97,66%.

Net losses from impairments in 2017 are lower for 30,70% than in 2016. Realized losses from impairements in 2017 are higher than planned because of additional impairments for NPL clients, which increased NPL coverage with total impairment provisions from 55% at the end of 2016 to 60% at the end of 2017.

Profitability Indicators	31.12.2016	31.12.2017	Plan 2017
Costs to Income Ratio (CIR)	74,21%	79,38%	80,00%
Non-interest income to operating costs ratio	41,45%	37,26%	36,70%

The most significant influence on decrease in these two performance indicators in 2017 was that of an increase in expenses in 2017 comparing to 2016 in line with the Bank's intention to achieve growth and increased the presence and recognition of the Halkbank name in this new market. The operating expenses incurred were below the planned expenses by 3.78%, since, despite increase in expenses, the Bank continuously controlled all operational expenses and did not allow spending in excess of the budgeted amounts per all budget lines of expenses with the constant focus on more efficient spending.

The breakdown of interest income is presented in the following table:

(in 000 RSD)

Interest income	31.12.2016	31.12.2017	% Change
Corporate clients	839.314	828.002	-1,35%
Retail clients	451.982	600.356	32,83%
Securities	175.457	212.996	21,39%
Unwinding*	111.704	83.660	-25,11%
Other	26.376	29.979	13,66%
Total	**1.604.833**	**1.754.993**	**9,36%**

*Interest income on impaired loans that are measured at amortized cost in line with IAS 39

The breakdown of the fee and commission income is presented in the following table:

(in 000 RSD)

Fee and commission income	31.12.2016	31.12.2017	% change
Fees from payment operations	403.984	438.884	8,64%
Fees from guarantees	83.301	83.397	0,12%
Fees from FX changes	76.099	91.831	20,67%
Fees from loan processing	31.246	34.723	11,13%
Fees from checks and payment cards	29.011	37.971	30,88%
Fees from SWAP	27.393	9.211	-66,37%
Brokers fees	3.452	5.248	52,03%
Other fees	4.091	3.981	-2,69%
Fees from Bank-insurance	2.634	2.771	5,20%
Fees from Western Union	2.678	2.387	-10,87%
Total	**663.889**	**710.404**	**7,01%**

The breakdown of the interest expense is presented in the following table:

(in 000 RSD)

Interest expense	31.12.2016	31.12.2017	% change
Deposits – retail	74.584	84.468	13,25%
Deposits – corporate	58.231	72.406	24,34%
Banks deposits	17.647	20.659	17,07%
Borrowings FI's	109.409	88.155	-19,43%
Total	**259.871**	**265.688**	**2,24%**

The structure of fee and commission expense is presented in the following table:

(in 000 RSD)

Fees and commission expense	31.12.2016	31.12.2017	% change
Payment operations	62.925	70.784	12,49%
Credit biro	9.596	12.101	26,10%
VisaCard and MasterCard	7.995	22.486	181,25%
Credit lines	6.817	688	-89,91%
Total	**87.333**	**106.059**	**21,44%**

The most significant expenses within other operating expenses are presented in the following table:

(in 000 RSD)

Other operating expenses	31.12.2016	31.12.2017	% change
Rental costs	138.937	193.853	39,53%
Taxes on salaries and salary compensations on behalf of employer	100.727	112.649	11,84%
Deposits insurance premium	84.394	106.900	26,67%
PR Marketing costs	92.826	71.810	-22,64%
Maintenance of equipment (IT, security and other)	43.893	47.401	7,99%
Telecommunications	38.111	38.269	0,41%
Legal services	13.142	34.622	163,45%
Insurance premium for Cash Loans	9.577	27.628	188,48%
Electricity, heating and water supply costs	22.168	20.681	-6,71%
Other costs	194.062	231.743	19,42%
Total	**737.837**	**885.556**	**20,02%**

Operating expenses increased mostly due to the higher rental costs, primarily because the Bank opened new branches in line with the Bank's main goal to expand its branch network and presence in the Serbian market. Increase in deposits insurance premium is in line with the growth of the Bank's deposit capacity. Lawyer fees increased because of activities of the external law firms engaged in collecting NPLs and insurance premium for cash loans increased because of significant increase of cash loans extended to pensioners in 2017.

6. CASH FLOWS

Cash flows from operating activities during 2016 and 2017 are presented in the table below:

(in 000 RSD)

Item	I – XII 2016	I – XII 2017	Change
Cash inflows from operating activities	**2.103.275**	**2.334.414**	**231.139**
Interest	1.433.910	1.615.643	181.733
Fees	662.217	712.474	50.257
Other operating income	4.004	5.538	1.534
Dividend and share in profit	3.144	759	(2.385)
Cash outflows from operating activities	**(1.769.790)**	**(1.907.513)**	**137.723**
Interest	(283.866)	(245.085)	(38.781)
Fees	(80.365)	(121.289)	40.924
Salaries	(650.582)	(651.930)	1.348
Taxes and contributions	(122.546)	(142.180)	19.634
Other operating expenses	(632.431)	(747.029)	114.598
Net cash inflows from operating activities	**333.485**	**426.901**	**93.416**

Cash inflows from operating activities in 2017 increased for RSD 231.139 thousand comparing to 2016. The main reason for increase of inflows from interest year on year was higher interest income on loans in 2017 on one side and, on the other side, interest on securities higher by RSD 138.805 thousand due to collection of coupons on Treasury bills maturing in 2017.

Cash outflows from operating activities increased by RSD 137.723 thousand comparing to 2016. Cash outflows from interest decreased by RSD 38.781 thousand, mostly because of lower interest paid to IFIs for credit lines in use. Cash outflows from fees increased for RSD 40.924 thousand, mostly related to fees for EFSE credit line in the amount of RSD 11.972 thousand and GGF credit line in the amount of RSD 5.961 thousand, while the other portion of the increase relates to payment operation fees for Visa and MasterCard.

Cash outflows from other operating expenses in 2017 increased for RSD 114.597 thousand mostly due to higher rental costs for business premises, ATMs and new vehicles in use, which caused increase of RSD 54.916 thousand, increase of deposit insurance costs by RSD 22.506 thousand, then costs of lawyer services which were RSD 21.480 thousand higher and costs of insurance premium for cash loans that rose by RSD 13.589 thousand.

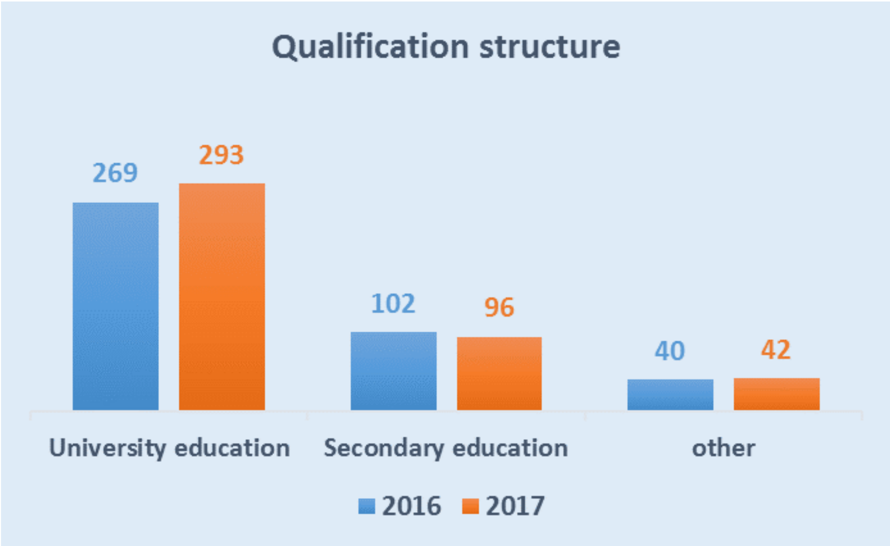
Net cash inflows from operating activities in 2017 amounted to RSD 426.901 thousand, which is an increase of RSD 93.416 thousand comparing to 2016.

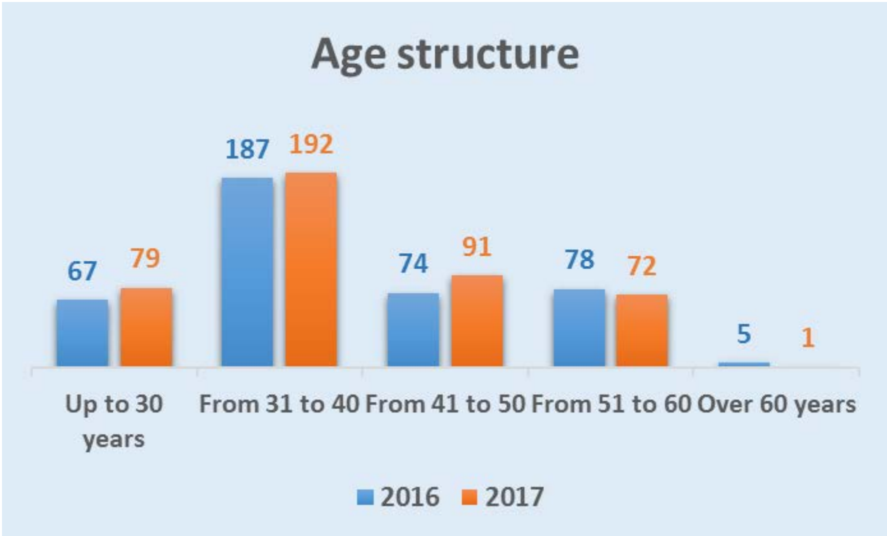
7. HUMAN RESOURCES

Number of employees in the HQ and branches as of December 31, 2016 and December 31, 2017 is presented in the following table:

Number of employees	31.12.2016	31.12.2017	Plan for 2017
Headquarter	190	187	210
Branches	221	248	240
Total:	**411**	**435**	**450**

The following graphs presents the qualification and age structure of employees as of December 31st 2016 and December 31st 2017:





Regarding the qualification structure of employees at the end of 2017, the Bank has share of employees with university degree equal to 67,36% of the total. The share of staff younger than 40 years was 62,30%.

Expenses for salaries, salary compensation and other personal expenses in 2017 amounted to RSD 648.765 thousand and accounts for 97,04% of the budget which was planned for 2017.

8. INVESTMENT PLAN

During 2017 total investments in fixed assets, investment property and intangible investments amounted to RSD 177.324 thousand.

Changes at these balance sheet items are presented in the following table:

(in 000 RSD)

Investments	Buildings	Equipment	Investment property	Intangible investments	Total	Revised Plan for 2017
Balance 01.01.2017	**491.358**	**327.088**	**126.337**	**73.976**	**1.018.759**	**1.018.759**
Increase:	**1.535**	**94.517**	**5.170**	**76.101**	**177.324**	**358.261**
IT	0	28.508	0	76.101	104.609	272.487
Adaption of business premises	1.535	39.759	5.170	0	46.465	47.034
Other	0	26.250	0	0	26.250	38.740
Decrease:	**(17.730)**	**(78.926)**	**(3.780)**	**(51.130)**	**(151.567)**	**(198.217)**
Depreciation	(17.730)	(78.927)	(3.780)	(51.130)	(151.567)	(157.738)
Sell	0	1	0	0	0	3.033
FX effects*	0	0	0	0	0	37.446
Balance 31.12.2017	**475.163**	**342.679**	**127.727**	**98.947**	**1.044.516**	**1.178.803**

The majority of the investments in business premises and other equipment relates to investments in new branches: Makedonska Branch (RSD 9.591 thousand), Zemun Branch (RSD 8.749 thousand); Branch in Subotica (RSD 7.424 thousand) and Tutin Sub-Branch (RSD 6.449 thousand). Additional to this, investment in relocation of Leskovac Branch was RSD 7.301 thousand. Increase in investment property relates to adaptation of two flats in Prote Mateje Street in Belgrade in the amount of RSD 5.170 thousand.

Other investments in majority relates to purchasing of furniture and other (not IT related) equipment for Headquarters (RSD 5.559 thousand), Makedonska Branch in Belgrade (RSD 3.652 thousand), Tutin Sub-Branch (RSD 3.398 thousand), Leskovac Branch (RSD 2.128 thousand), Belgrade Branch in Cara Dusana street (RSD 2.128 thousand), Zemun Branch (RSD 3.664 thousand) and Subotica Branch (RSD 3.013 thousand).

Investments in IT equipment relates to ICT equipment, computer and printer in the amount of RSD 9.613 thousand, investment in IP telephone amounted to RSD 2.121 thousand, while RSD 7.315 thousand related to the IT equipment received in 2017 by agreements contracted in 2016. Investments in CISCO equipment, computers and other equipment for “TESLA” project in 2017 amounted to RSD 9.312 thousand.

Investments in intagible assets relates to purchase of Microsoft licenses in the amount of RSD 31.954 thousand, investments in card management system within “TESLA” project in the amount of RSD 15.985 thousand, implementation of MasterCard licenses in the amount of RSD 11.820 thousand and Banksoft licenses in the amount of RSD 6.306 thousand. Additional to this, in 2017 the Bank had investment in AML software in the amount of RSD 7.591 thousand.

9. COMPLIANCE OF OPERATIONS WITH THE NBS REGULATIONS AND IFI AGREEMENTS

Compliance with the NBS regulations

As of December 31, 2017 all the operating ratios of the Bank were within the limits prescribed by the Law on Banks and NBS regulations.

Ratio	The values prescribed by the NBS regulations	Values as at 31st December 2017
Bank's equity	Min 10.000.000 €	42.585.634€
Capital adequacy ratio	min 8%	17,11%
Foreign exchange risk ratio	max 20%	2,51%
Liquidity ratio	Min 1	1,51
Narrow liquidity ratio	Min 0,7	1,26
Exposure to one person or group of related persons	max 25%	10,38%
Total exposure to group of related persons	-	13,18%
Sum of large exposures	max 400%	10,38%
Investing into non-financial persons	max 10%	0%
Total investments into non-financial persons and fixed assets of the Bank	max 60%	18,74%

Business policy for 2017 as one of the main goals in the risk management process defines maintenance of indicators of capital adequacy above 15%.

On December 31, 2017 the capital adequacy ratio was above the stated target (17,11%).

By the Decision on the Minimum Requirement for Capital and Eligible Liabilities of a Bank, National Bank of Serbia defines ratio of Capital and Eligible Liabilities to total asset for the Bank equal to 20,87%.

The Bank is obliged to comply with the minimum requirement for capital and eligible liabilities in the following way:

- by 31, December 2016 - with 25% of the established requirement;
- by 31, December 2017 - with 50% of the established requirement;
- by 31, December 2018 - with 75% of the established requirement.

According to the data as of June 30, 2017 this ratio was 12,83% (61,47% of total requirement). The ratio as of December 31, 2017 will be calculated by the end of March 2018.

By the Decision of National Bank of Serbia dated on 8, February 2018, National Bank of Serbia changed ratio of Capital and Eligible Liabilities to total asset for the HALKBANK a.d. Belgrade, from 20,87% to 6,20%.

Compliance with the covenants from the agreements concluded with the international financial institutions (IFIs)

Pursuant to the defined limits in the agreements concluded with the international financial institutions (IFIs) - German Development Bank (KfW), Green for Growth Fund (GGF), the Bank is required to comply with certain financial covenants until the final repayment of the loans. As at 31 December 2017 the Bank is aligned with all indicators except with open credit exposure ratio limit defined by agreement concluded with German Development Bank (KfW) because of amendments on Decision of National Bank of Serbia on classification of balance sheet and off-balance sheet items referring to the part where coefficient for decreasing of required reserve is used.

Financial institution	Indicator	Prescribed value	Value at 31 December 2017
KfW	Open credit exposure ratio	20,00%	25,23%

According to the loan agreements, the Bank regularly reports to the IFIs of its financial ratios, with detailed elaboration on each exceeded limit. The Bank does not expect a negative response from the IFIs on this basis.

10. REPORT ON BOARD OF DIRECTORS MEETINGS IN 2017

In 2017 (in period 01 January -31 December 2017), Board of Directors of HALKBANK a.d. Beograd held on 13 meetings as follows:

- **16th meeting of the Board of Directors** was held on 27th January 2017 in premises of Türkiye Halk Bankası A.Ş., Istanbul, Barbaros Mahallesi Şebboy Sokak br. 4 Atasehir/ Istanbul and HALKBANK a.d. Beograd, via conference call

  Agenda

1. Adoption of the Minutes of the previously meeting;
2. Making decision on adoption Report Bank on inventory of assets and assets' resources of the Bank on 31st December 2016;
3. Making decision on dismissal and appointment member of the Audit Committee;
4. Making Decision on adoption amendments and supplements of the Rules of Procedure of the Board of Directors;
5. Making Decision on adoption amendments and supplements of the Rules of Procedure of the Audit Committee;
6. Information of the Decisions passed by the Executive Board under the Authorization of the Board of Directors in period 01 January 2016 to 31 December 2016;
7. Adoption Report on activities of the Audit Committee for period 01 November 2016-30 November 2016;
8. Information on the activities in the field of payment cards project - TESLA project;
9. Miscellaneous.

- **17th meeting of the Board of Directors** was held on 24th February in business premises of the HALKBANK a.d. Beograd, Belgrade, New Belgrade, Milutina Milankovića 9e

  Agenda

1. Adoption of the Minutes of the previously meeting;
2. Making Decision on adoption amendments and supplements of the Rules of Procedure of the Credit Committee;
3. Making Decision on adoption amendments and supplements of the Rules of Procedure of the Assets and Liabilities Management Committee
4. Adoption Report on activities of the Audit Committee for period 01 December 2016- 31 January 2017;
5. Information of the Decisions passed by the Executive Board under the Authorization of the Board of Directors in period 01 January 2017 to 31 January 2017;

6. Information for the implementation of the budget for 2016;
7. Making Decision on adoption amendments and supplements of the Decision on appointment President and Member of Credit Committee and Assets and Liabilities Management Committee No. 4318 of 14 October2016;
8. Miscellaneous;

- **18th meeting of Board of Directors** was held on 16th March 2017 in premises of Türkiye Halk Bankası A.Ş., Istanbul, Barbaros Mahallesi Şebboy Sokak br. 4 Atasehir/ Istanbul and HALKBANK a.d. Beograd, via conference call

Agenda

1. Adoption of the Minutes of the previously meeting;
2. Making decision proposal for dismissal President of the General Meeting of Shareholders;
3. Adoption the Operating report of the Bank for 2016;
4. Making Decision proposal on adoption financial statements of the Bank for 2016.
5. Making Decision proposal on reviewing Report of the external auditor on performed audit of financial statements for 2016. and submitting to the Banks Shareholders Assembly;
6. Making Decision proposal on use and distribution of profit under financial statements for 2016;
7. Making Decision proposal on adopting the Business Policy for 2017 with accompanying decisions and submitting to the Banks Shareholders Assembly;
8. Making Decision proposal on appointing external auditor for the audit of Financial statements for 2017;
9. Making decision proposal on re-appointment members of the Board of Directors and independent member of the Board of Directors;
10. Making Decision proposal on amendments and supplements of the Statute;
11. Making Decision proposal on amendments and supplements of the Shareholders Assembly Rules of Procedure;
12. Consideration Information about remuneration of members of the Board of Directors and Executive Board of the Bank in 2016. and proposal of remuneration for 2017;
13. Decision on providing approval for conclusion of legal transactions of the Bank with persons related to the Bank;
14. Making decision for scheduling XXXV Regular General Meeting of the Banks Shareholders of the Bank Opening of the meeting and election of Voting Commission and person for the Minutes verification;

14.1. Opening of the meeting and Election of Voting Commission and person for the Minutes verification;

14.2. Report of the Voting Commission;

14.3. Resolution on discharging president of the Shareholders Assembly;

14.4. Resolution on appointment President of Assembly for presiding on the XXXV Regular Meeting of Shareholders Assembly of the Bank;

14.5. Adopting the Minutes from the 10th Extraordinary Meeting of Shareholders Assembly of HALKBANK a.d. Beograd;

14.6. Resolution on adopting Operating Report of the Bank for 2016;
14.7. Resolution on adopting Financial statements of the Bank for 2016;
14.8. Reviewing Report of the external auditor on performed audit of Financial statements for 2016;
14.9. Resolution on use and distribution of profit under Financial statements for 2016;
14.10. Resolution on adopting the Business Policy for 2017 with accompanying decisions;
14.11. Resolution on appointing external auditor for the audit of Financial statements for 2017;
14.12. Resolution on re-appointing members of the Board of Directors and independent member of the Board of Directors;
14.13. Resolution on amendments and supplements of the Statute;
14.14. Resolution on amendments and supplements of the Shareholders Assembly Rules of Procedure;
14.15. Review Information about remuneration of members of the Board of Directors and Executive Board of the Bank in 2016. and proposal of remuneration for 2017;
14.16. Miscellaneous
15. Miscellaneous.

- **19th meeting of the Board of Directors** was held on 28th April 2017 in premises of Türkiye Halk Bankası A.Ş., Istanbul, Barbaros Mahallesi Şebboy Sokak br. 4 Atasehir/ Istanbul and HALKBANK a.d. Beograd, via conference call

  Agenda

1. Adoption of the Minutes of the previously meeting;
2. Annual Report of Risk management adequacy for 2016;
3. Report on internal capital adequacy assessment process of the Bank ICCAP for 2016;
4. Annual report for 2017 on compliance controls and activities;
5. Adoption supplements of Training plan and program for 2017;
6. Consideration Report on the Internal Audit activities in the period 01 July – 31 December 2016 with focus on the implementation of the Annual Internal Audit Plan for 2016 and monitoring discrepancies in 2016;
7. Adoption of the Information Security Policy;
8. Adoption of amendments of the Guidelines Policy of Lending;
9. Making decision on giving prior consent to the Bank to participate in the purchase of real estate in court proceedings - apartment in Belgrade, Majke Jevrosime Street, which is the subject of a mortgage to secure the Bank's claims towards FAD a.d. Gornji Milanovac, in bankruptcy;
10. Making decision on giving prior consent for the Bank’s total exposure towards group of related persons KOMPANIJA JOVANOVIĆ DOO ŠABAC may be higher than 2.500.000,00 EUR, i.e. up to maximum amount EUR 4.500.000,00;
11. Making decision on the sale of the Bank's receivables towards legal entity Europolis doo Mesarci;
12. Making decision on authorization borrowings from EFSE - European Fund for Southeast Europe up to a maximum amount of EUR 10 million;
13. Making Decision on reappointment members of Audit Committee;
14. Report on Stress test for basic and additional liquidity ratios in the period 01 December 2016 – 31 March 2017;
15. Adoption Report on activities of the Audit Committee for period 01 February 2017 – 28 February 2017;
16. Information of the Decisions passed by the Executive Board under the Authorization of the Board of Directors in period 01 February 2017 to 31 March 2017;
17. Information on the letter of the National Bank of Serbia No. 176/1/17 of 18 April 2017 and the Decision of the National Bank of Serbia No. 3143 of 11 April 2017.
18. Miscellaneous.

- **20th meeting of Board of Directors** was held on 18th May 2017 in premises of Türkiye Halk Bankası A.Ş., Istanbul, Barbaros Mahallesi Şebboy Sokak br. 4 Atasehir/ Istanbul and HALKBANK a.d. Beograd, via conference call

  Agenda

1. Adoption of the Minutes of the previously meeting;
2. Making decision on giving prior consent for the Bank’s total exposure towards group of related persons KOMPANIJA JOVANOVIĆ DOO ŠABAC may be higher than 2.500.000,00 EUR, i.e. up to maximum amount EUR 4.500.000,00;
3. Making Decision on giving approval to the Executive Board for opening new branches;
4. Making decision on giving prior consent to the Bank to participate in the purchase of real estate-apartment in Kraljevo – possession of the pledger Zoran Milašinović, in the case of collection of claims by the Bank towards legal entity Vojvoda Prijezda doo, in bankruptcy;
5. Adoption the Operating report of the Bank for period 01 January -31 March 2017;
6. Miscellaneous.

- **21st meeting of the Board of Directors** was held on 29th June in business premises of the HALKBANK a.d. Beograd, Belgrade, New Belgrade, Milutina Milankovića 9e

Agenda

1. Adoption of the Minutes of the last meeting;
2. Supplements of General Operating terms and conditions of HALKBANK a.d. Beograd of 21st April 2015;
3. Amendments of:

3.1. General terms and conditions for opening, maintenance and termination of dinar and foreign currency current accounts for entrepreneurs and provision of payment services under these accounts;

3.2. General terms and conditions for opening, maintenance and termination of dinar and foreign currency current accounts for legal entities and provision of payment services under these accounts;

3.3. General operating conditions for Visa business cards for legal entities and entrepre-neurs;

4. Making decision on reappointment President and Member of the Executive Board;
5. Making decision on disposal of fixed assets - apartments in Belgrade, Prote Mateje Street, owners of the HALKBANK a.d. Beograd;
6. Making decision for release of receivables based on Loan Agreement no 20114414 of 27 June 2011, 50-618-0073470.0, concluded with legal entity TRGOMEN PV DOO Kraljevo;
7. Making decision on selling Bank's receivables towards legal entity KOMPANIJA NOVI DANI AD ZA GRAFIČKO-IZDAVAČKU DELATNOST ČAČAK;
8. Introduction to the management letter for 2016 issued by the external auditor KPMG doo Beograd;
9. Information regarding decisions passed by the Executive Board under the authorisation of the Board of Directors in the period 01 April 2017-31 May 2017;
10. Report on the Audit Committee Activities for period 01 March -30 April 2017;
11. Report on the liquidity ratios stress tests in the period from 01 April 2017 – 31 May 2017;
12. Making decision proposal for dismissal and appointment president of the Board of Directors;
13. Making decision proposal on supplements of the Statute of the Bank;
14. Making decision proposal on intention to include Revaluation reserves and other unrealized gains in calculation of Common Equity Tier 1 Capital;
15. Making decision for scheduling XI Extraordinary General Meeting of the Banks Shareholders of the Bank and establishing draft of agenda for the Assembly:

15.1 Opening of the meeting and appointment President of Assembly for presiding on the XI Extraordinary Meeting of Shareholders Assembly of the Bank;

15.2. Election of Voting Commission and person for the Minutes verification;

15.3. Report of the Voting Commission;

15.4. Adopting the Minutes from the 35th Regular Meeting of Shareholders Assembly of HALKBANK a.d. Beograd;
15.5. Resolution on dismissal and appointment president of the Board of Directors;
15.6. Resolution on supplements of the Statute;
15.7. Resolution on intention to include Revaluation reserves and other unrealized gains in calculation of Common Equity Tier 1 Capital;
15.8. Miscellaneous.
16. Adoption Liquidity Risk Management Policy and Capital Management Strategy and Plan;
17. Miscellaneous.

- **22nd meeting of the Board of Directors** was held on 17th August 2017. in premises of Türkiye Halk Bankası A.Ş., Istanbul, Barbaros Mahallesi Şebboy Sokak br. 4 Atasehir/ Istanbul and HALKBANK a.d. Beograd, via conference call

Agenda

1. Adoption of the Minutes from the last meeting;
2. Making decision proposal on dismissal and appointment members of the Board of Directors;
3. Making decision on dismissal and appointment president and member of the Audit Committee;
4. Making decision for scheduling XII Extraordinary of Bank's Shareholders' Assembly meeting and establishing draft of agenda for the Assembly:

4.1. Opening of the meeting and appointment President of Assembly for presiding on the XII Extraordinary Meeting of Shareholders Assembly of the Bank;
4.2. Election of Voting Commission and person for the Minutes verification;
4.3. Report of the Voting Commission;
4.4. Adopting the Minutes from the 11th Extraordinary Meeting of Shareholders Assembly of HALKBANK a.d. Beograd;
4.5. Resolution on dismissal and appointment members of the Board of Directors;
4.6. Miscellaneous.

5. Miscellaneous.

- **23rd meeting of Board of Directors** was held on 07th September 2017 in premises of Türkiye Halk Bankası A.Ş., Istanbul, Barbaros Mahallesi Şebboy Sokak br. 4 Atasehir/ Istanbul and HALKBANK a.d. Beograd, via conference call

Agenda

1. Adoption of the Minutes of the last meeting;
2. Making decision for cancelling XII Extraordinary of Bank's Shareholders' Assembly meeting;
3. Making decision on scheduling XII Extraordinary of Bank's Shareholders' Assembly meeting and establishing draft of agenda for the Assembly:

3.1. Opening of the meeting and appointment President of Assembly for presiding on the XII Extraordinary Meeting of Shareholders Assembly of the Bank;
3.2. Election of Voting Commission and person for the Minutes verification;
3.3. Report of the Voting Commission;
3.4. Adopting the Minutes from the 11th Extraordinary Meeting of Shareholders Assembly of HALKBANK a.d. Beograd;
3.5. Resolution on dismissal and appointment members of the Board of Directors;
3.6. Miscellaneous.

4. Miscellaneous.

- **24th meeting of Board of Directors** was held on 29th September 2017 in business premises of the HALKBANK a.d. Beograd, Belgrade, New Belgrade, Milutina Milankovića 9e

Agenda

1. Adoption of the Minutes of the previously meeting of the Board of Directors;
2. Adoption the Operating report of the Bank for period 01 January -30 June 2017;
3. Adoption Amendments and Supplements of Accounting Policy;
4. Adoption Amendments and supplements of Strategy for NPL Management and Collection;

5. Making decision on giving prior consent for the exposure of the Bank towards Consortium or member of Consortium, which consist of legal entities IC Ictas Altyapi Yatirimlari ve Isletme A.S., Turkey (33,3%), Incheon International Airport Corporation, South Korea (33,4%) and VTB Capital Infrastructure Holdings Limited, Cyprus (33,3%), in amount of EUR 3.000.000,00, for the purpose of issuing a tender guarantee;
6. Miscellaneous.

- **25th meeting of the Board of Directors** was held on 9th October 2017 in premises of Türkiye Halk Bankası A.Ş., Istanbul, Barbaros Mahallesi Şebboy Sokak br. 4 Atasehir/ Istanbul and HALKBANK a.d. Beograd, via conference call

Agenda

1. Adoption the Minutes of the previously meeting;
2. Making proposal of decision on shares' price in proceeding of compulsory redemption (squeeze out);
3. Making proposal of decision on compulsory redemption (squeeze out);
4. Making decision on scheduling XIII Extraordinary Meeting of Shareholders' Assembly and establishing draft of agenda for the Assembly:

4.1. Opening of the meeting and appointment President of Assembly for presiding on the XIII Extraordinary Meeting of Shareholders Assembly of the Bank;
4.2. Election of Voting Commission and person for the Minutes verification;
4.3. Report of the Voting Commission;
4.4. Adopting the Minutes from the 12th Extraordinary Meeting of Shareholders Assembly of HALKBANK a.d. Beograd;
4.5. Making Resolution on shares' price in proceeding of compulsory redemption (squeeze out);
4.6. Making Resolution on compulsory redemption (squeeze out);
4.7. Miscellaneous.

5. Miscellaneous.

- **26th meeting of the Board of Directors** was held on 3 th November 2017 in premises of Türkiye Halk Bankası A.Ş., Istanbul, Barbaros Mahallesi Şebboy Sokak br. 4 Atasehir/ Istanbul and HALKBANK a.d. Beograd, via conference call
  Agenda

1. Adoption the Minutes of the previously meeting;
2. The annual update of the Banks Recovery plan;
3. Miscellaneous.

- **27th meeting of the Board of Directors** was held on 28 th November 2017 in premises of Türkiye Halk Bankası A.Ş., Istanbul, Barbaros Mahallesi Şebboy Sokak br. 4 Atasehir/ Istanbul and HALKBANK a.d. Beograd, via conference call

Agenda

1. Adoption of the Minutes of the previously meeting;
2. Adoption Decision on revision of financial projection in Business Policy for 2017 (Budget revision for 2017);
3. Adoption of the Decision proposal of the Business Policy and strategy of the Bank for 2018-2022;
4. Making decision on increasing the Bank's exposure towards Erste Bank Group;
5. Amendments of the Operational Annual Internal Audit Plan for 2017;
6. Semi-annual internal audit report for the period of 01 January-30 June 2017, with the realization of Operational Annual internal audit Plan in the period of 01 January-30 June 2017 with the monitoring of findings for the period 01 January- 30 June 2017;

7. Information on the Letter of warning G.br. 5228 of 22th June 2017, issued by National Bank of Serbia regard to the control of the risk management of money laundering and terrorist financing and payment control;
8. Information on the Decision on orders and measures G no 9423 of 02th November 2017, issued by the National Bank of Serbia regarding supervision of credit risk management, supervision on capital adequacy ratio as on 31 December 2016 and supervision of managing of the Bank;
9. Information regarding Contract concluded with GGF and EFSE and granting approval on concluded agreement;
10. Adoption of the Decision proposal on the exclusion of the preferential subscription right;
11. Adoption of the Decision proposal on issuing price of the XXXI issue of ordinary shares;
12. Adoption of the Decision proposal on XXXI issuance of ordinary shares;
13. Making decision on scheduling XIV Extraordinary Meeting of Shareholders' Assembly and establishing draft of agenda for the Assembly:
13.1. Opening of the meeting and appointment President of Assembly for presiding on the XIV Extraordinary Meeting of Shareholders Assembly of the Bank;
13.2. Election of Voting Commission and person for the Minutes verification;
13.3. Report of the Voting Commission;
13.4. Adopting the Minutes from the 13th Extraordinary Meeting of Shareholders Assembly of HALKBANK a.d. Beograd;
13.5. Adoption of the Decision on the exclusion of the preferential subscription right;
13.6. Adoption of the Decision on issuing price of the XXXI issue of ordinary shares,
13.7. Adoption of the Decision on XXXI issuance of ordinary shares;
13.8. Adoption of the Decision of the Business Policy and strategy of the Bank for 2018-2022;
13.9. Miscellaneous.
14. Miscellaneous.

- **28 th meeting of Board of Directors** was held on 28th December 2017 in business premises of the HALKBANK a.d. Beograd, Belgrade, New Belgrade, Milutina Milankovića 9e:

Agenda

1. Adoption of the Minutes of the previously meeting;
2. Review and adoption the risk management strategy and policies, strategy and plan for capital management, as well as Country Risk Policy:
2.1. Risk Management Strategy;
2.2. Credit Risk Management Policy;
2.3. Operational Risk Management Policy;
2.4. Strategic Risk Policy;
2.5. Reputation Risk Policy;
2.6. Concentration risk management policy;
2.7. Country Risk Policy;
2.8. Environmental and social Risk Management Policy;
2.9. Strategy and plan for Capital Management;
2.10. Interest Rate Risk Policy;
2.11. Liquidity Risk Policy;
2.12. Market Risk Policy;
3. Adoption of Internal Audit Methodology;
4. Adoption of Internal Audit Procedure;
5. Adoption of Operational Annual Internal Audit Plan for 2018;
6. Adoption of quarterly internal audit report for the period of 01 June -30 September 2017, with the realization of Operational Annual Internal Audit Plan in the period of 01 June-30 September 2017 with the monitoring of findings for the period 01 June – 30 September 2017;
7. Adopting of Compliance annual operating plan for 2018 and training plan and program of employees for 2018;
8. Adoption Rules of Procedure of the Board of Directors;

9. Adoption Rules of Procedure of the Audit Committee;
10. Adoption Report on activities of the Audit Committee for period 01 May – 30 September 2017;
11. Report on Stress test for basic and additional liquidity ratios in the period 01 June 2017 – 31 October 2017;
12. Adoption of Business Continuity regulation;
13. Information of the Decisions passed by the Executive Board under the Authorization of the Board of Directors in period 01 June 2017-30 November 2017;
14. Adoption Lending Policy Guidelines;
15. Making Decision on amendments and supplements of the Decision of the Board of Directors No 4324 of 14 October 2016 on transfer authority from the jurisdiction of the Board of Directors to Executive Board and abrogation of the Decision No 3772 of 28 August2015;
16. Review of the Board of Directors decision for the limit exposure of the Bank for client Aster Textil doo Niš of 14th October 2016;
17. Making decision on giving prior consent for the Bank's exposure towards client Vakif Leasing Istanbul;
18. Making decision on abrogation of the Decision No 5768 of 20 December 2011 on giving prior consent for the Bank's exposure towards Deutche Bank AG Frankfurt;
19. Making Decision on giving approval on concluding agreement between Bank and Stefan Mikić for debt bases on Loan Contract No 20114414 of 27 June 2011, loan party 50-618-0073470.0 concluded between the Bank and Jarčujak Promet;
20. Making Decision for YU POINT;
21. Basic guidelines for the preparation of the Business Policy and Business Plan (Budget) for 2018;
22. Adoption Operating report for period 01 January – 30 September 2017;
23. Miscellaneous.

III INVESTMENT FOR THE PURPOSE OF ENVIRONMENTAL PROTECTION

The Bank is particularly cautious to invest only in the projects that do not cause any environmental and social harm. Environmental and social (E&S) protection includes, besides ecological aspects, the issues of a local community and employee protection.

The aim of managing E&S risk is identification, assessment and control of the risks that may cause E&S harm and it is carried out in accordance with the E&S Risk Management Policy and Procedure BPI-751-503 E&S Risk Management.

The following bodies are responsible for managing the E&S risk in the Bank:

- Board of Directors that establishes and at least once a year reviews E&S Risk Management Policy and identifies the need for any amendments,
- Executive Board that establishes and implements the E&S Risk Management Procedure,
- Credit Committees that make decisions on loan disbursement on the basis of the E&S information available and the opinion of the Corporate and SME Marketing Division,
- The Corporate and SME Marketing Division that assesses the impact of the activity and the project during the process of appraising customers' creditworthiness,
- The Risk Management Department that monitors loans by their activities, industrial sectors and E&S risk categories

When processing individual clients' applications, E&S risk is classified for the basic activity of the client and the activity which is subject to financing.

There are the following E&S risk categories:
- High – Exclusion List
- High – Category A
- High
- Medium
- Low

If the activity which is subject to financing is included in the Exclusion List, the application will be rejected. In the event that they are classified in high risk category A, the Environmental Impact Assessment will be provided from the client, and the person appointed by the Executive Board for the SEMS maintenance will provide a prior consent for financing the project.

When reviewing application with the decision draft for the relevant credit committee, the Corporate and SME Marketing Division verifies classification of the activity with regard to E&S risk and the data about the E&S impact of the client and the financed activity.

In the events anticipated by the Procedure, the integral part of the application analysis will be the opinion of the Corporate and SME Marketing Division about how the client submitting the application complies with E&S regulations and standards. Loan agreements and agreements on other exposures contain E&S provisions that should be obeyed by both the client and the Bank.

Environmental risk

Overview of the Bank's exposures by environmental and social risk categories

(in 000 RSD)

Risk category	Number of clients		Amount of placements (balance and off-balance)		Increase / decrease
	31.12.2016	31.12.2017	31.12.2016	31.12.2017	
High – Exclusion List	-	-	-	-	-
High – Category A	7	8	112.766	70.640	(42.126)
High	204	244	6.576.746	7.682.454	1.105.708
Medium	956	1.048	10.979.399	11.748.016	768.617
Low	1.923	1.975	12.053.862	13.960.351	1.906.489
Total:	**3.090**	**3.275**	**29.722.773**	**33.461.461**	**3.738.688**

In 2017 the Bank did not approve loans to the clients which financed activity is in “High – exclusion list”.

IV MATERIAL EVENTS AFTER THE END OF BUSINESS YEAR

Share capital increase

On February 20th 2018 the Bank increased share capital by issuing a new issue of shares (XXXI) in the amount of 236.412 number of ordinary shares with nominal value of RSD 10.000,00 per share. Share capital increased from RSD 4.248.483 thousand to RSD 6.612.603 thousand.

V ANTICIPATED FUTURE DEVELOPMENT

In Basic Guidelines for the Business Policy and Business Plan (Budget) for 2018 planned growth in asset size is EUR 95 million (i.e. 28%). Planned increase in liabilities side is increase in capital for EUR 40 million; additional borrowings from IFI’s in the amount of EUR 11 million and regular repayment of existing borrowings amounting to EUR 9 million and increase in deposits from clients for EUR 62 million.

Planned increase in asset side relates to increase in net loans for EUR 61.5 million and increase in cash and financial asset for EUR 18 million, out of which EUR 9 million relates to cash and EUR 9 million relates to securities.

Expectation is that interest rates on loans and securities will stay stable in 2018 comparing to the end of 2017. Increase in interest income comes from new placements. Interest rates on deposits will stay stable in 2018 comparing to the end of 2017. Increase in interest expense is due to increase in deposits and borrowings.

Planned increase in operating expenses is due to further widening of branch network and presence on Serbian market, higher investments in processing center for payment cards, increase in deposit base and higer cost of deposit insurance.

VI RESEARCH AND DEVELOPMENT ACTIVITIES

The Bank carries out a regular financial market research, analyses customers' financial needs and investigates a degree of satisfaction of the users of financial services.

The Marketing Division of Halkbank continuously develops new products and services and endeavors, on the basis of the information and conclusions acquired upon the market research and customers' needs, to develop and place at the market modified existing products, as well as completely new products and services.

VII INFORMATION ON PURCHASE OF OWN SHARES

The Bank never owned its own shares and did not acquire them during 2016.

VIII EXISTENCE OF AFFILIATES

As of December 31st 2017 the Bank operates in business network of 23 branches, 9 sub-branches and 4 cash desks. As at 31 December 2017 the Bank was comprised of 7 branches in Belgrade, 2 branches in Čačak and 15 branches located in the towns of Jagodina, Gornji Milanovac, Kraljevo, Užice, Kragujevac, Kruševac, Aranđelovac, Valjevo, Šabac, Niš, Novi Sad, Pančevo, Novi Pazar and Subotica and 9 sub-branches in Čačak, Paraćin, Požega, Topola, Ivanjica, Vrnjačka Banja, Leskovac, Mladenovac and Tutin.

IX RISK MANAGEMENT ADEQUACY

The Bank's targets in risk management are identification, measuring, mitigating and monitoring all types of risks and thus minimizing the Bank's exposure to such risks.

Credit Risk

The Bank measures and monitors the credit risk level through assessing the clients' solvency and controlling the loan portfolio through the calculation of a loan loss reserve pursuant to the NBS regulations and impairment and provisions pursuant to the IFRS.

Structure of gross risk-weighted assets in terms of classification categories

(in EUR thousand)

Classification categories	Classified amount as at 31.12.16	% of the share in gross risk-weighted assets		Classified amount as at 31.12.17	% of the share in gross risk-weighted assets	
A	18.835.955	50,85%	75,7%	23.601.471	54,12%	82,7%
B	9.206.761	24,85%		12.454.845	28,56%	
V	3.009.404	8,12%	8,1%	2.070.139	4,75%	4,7%
G	1.619.829	4,38%	16,2%	1.273.389	2,92%	12,6%
D	4.371.762	11,80%		4.207.751	9,65%	
Total:	**37.043.711**	**100,00%**		**43.607.595**	**100,00%**	

Compared to the December 31st 2016 the participation of receivables classified in A and B categories increased by 7,00 p.p. The share of receivables from clients classified in categories G and D decreased in the last quarter for 3,60 p.p. comparing to the end of 2016.

Pursuant to the Procedure for managing credit risk at the portfolio level the Bank's assets as of December 31st 2016 had a high level of credit risk due to the share of receivables classified in categories G and D above 13%, while on December 31st 2017 the structure and quality of assets has been improved through the decrease in the share of receivables classified in categories G and D below 13%, so the credit risk of the Bank's assets is at medium level.

Loan loss reserve pursuant to the NBS Decision on Classification

(in RSD thousand)

	31.12.2016	31.12.2017	Change
Loan loss reserve under balance sheet assets	5.221.921	4.802.763	-8,03%
Loan loss reserve under off-balance sheet items	75.637	69.279	-8,21%
Total:	**5.297.558**	**4.872.042**	**-8,03%**

Required loan loss reserve

(in RSD thousand)

	31.12.2016	31.12.2017	Change
Required reserve NBS	1.648.182	713.002	-56,74%

A required loan loss reserve as deductible item from capital is the sum of positive differences between the estimated loan loss reserve and the established impairment of the balance sheet and provisions for off-balance sheet losses at the borrower's level.

As of December 31st 2017 the calculated required reserve was RSD 2.300.006 thousand but it is further corrected using coefficient for decreasing by 69% on the basis of decreased NPL ratio from non-financing and non-government sector as at 31st December 2017 comparing to 30th June 2016.

Collection and coverage of NPLs

Gross NPLs based on the methodology of reporting to the National Bank of Serbia is shown in the following table:

(u 000 RSD)

Ratio	31.12.2016	31.12.2017	Change
Gross NPL	5.151.898	4.504.911	-12,56%

Gross NPL as of December 31st 2017 was reduced by RSD 646.987 thousand compared to December 31st 2016 due to the collection of non-performing loans and the implementation of new NBS regulation on the accounting write-off of bad balance sheet assets. In 2017 the Bank has collected RSD 510.839 thousand of NPLs: RSD 466.428 thousand from companies and RSD 44.411 thousand from retail clients. Accounting write-off of 100% impaired non-performing receivables in 2017 was a total of RSD 226.636 thousand. By accounting write-off of receivables and transmission to off-balance sheet items the Bank does not waive from the agreed obligations and legal rights arising from loans.

Share of NPLs in total Bank's loans

Ratio	31.12.2016	31.12.2017	Change
Share of gross NPLs in total gross loans	19,48%	14,40%	-5,08 p.p.

The credit risk management policy defined the limit for the level of non-performing loans (NPL ratios) as a ratio of gross NPLs and gross loans in the level of 18%. As of December 31st 2017 the Bank is in line with this indicator.

NPL coverage

Ratio	31.12.2016	31.12.2017
Ratio of NPL coverage with total impairment provisions	54,88%	59,97%
Ratio of NPL coverage with Impairment provisions for loans	49,81%	55,48%
Ratio of NPL coverage with NPL Impairment provisions	47,17%	53,69%
Cost of risk	1,47%	0,86%

The credit risk management policy defined the limit of the cost of risk coefficient as the ratio of the cost of impairment (income statement) and gross loan in the amount of 2%. As of December 31st 2017 the Bank is in line with this indicator.

The Strategy for NPL Management and Collection defines basic ratios and their values for ensuring satisfactory coverage of NPLs, as well as the level of loan loss reserves that enables minimizing negative effects of any deterioration of asset quality on the Bank's capital adequacy. In accordance with this Strategy, the bank's target is to maintain NPL coverage ratio by impairment provisions of total loans above 55%. As of December 31st 2017 the Bank is in line with this indicator.

Accordingly, all of the above mentioned indicators on the NPL are as of 31 December 2017 within the defined limits with evident trend of improvement.

In the Credit Risk Management Policy, the Bank defined the highest acceptable level of bad (NPE) assets in relation to total balance sheet and off-balance sheet assets that are classified at a level that is less than 20%. The share of bad assets as of December 31st 2017 in total classified assets amounts 11,49% and is significantly below the defined limit. Participation decreased compared to December 31st 2016 for 4,6 p.p. due to the reduction of bad assets and in the same time increasing of the loan portfolio.

Liquidity Risk

Liquidity Ratio and Narrow Liquidity Ratio prescribed by NBS in the period from 01.01-31.12.2017

	Liquidity Ratio	Narrow Liquidity Ratio
Value as of December 31st	1,51	1,26
Average	1,71	1,45
Maximum	2,21	1,98
Minimum	1,37	1,04
Daily NBS limit	Min 0,8	Min 0,5
NBS limit on monthly level	Min 1	Min 0,7

Liquidity ratios of the Bank during the period from 01 January -31 December 2017 were in accordance with the prescribed limits by the Decision on risk management.

In order to manage liquidity risk adequately, the Bank monitors internally established indicators of structural liquidity, besides the limits prescribed by the NBS.

Additional liquidity ratios in the period from 01.01-31.12.2017 – internally established

	Min.	Max.	Average	Limit
Liquid assets ratio	23,93%	28,73%	26,51%	Min 20,00%
Net loans to total deposits ratio	108,52%	123,48%	113,05%	Max 200,00%
Customers' deposits to total deposits ratio	88,02%	96,81%	91,06%	Min 75,00%
Deposit concentration ratio	18,13%	23,19%	20,82%	Max 30,00%

The Bank was within internally prescribed liquidity limits during the period from 01 January-31 December 2017.

Foreign exchange risk

FX Risk ratio in the period from 01.01 - 31.12.2017

Value as of December 31st	2,51%
Average	1,94%
Maximum	6,53%
Minimum	0,18%
Limit NBS	Max 20%

Foreign currency risk measured by FX Risk ratio was located in the low risk category in 2017.

Interest rate risk

The impact of changes in interest rates on the economic value of the Bank is monitored through total net weighted position of the banking book.

Total net weighted position of the Bank as of December 31st 2017

(in RSD thousand)

Total net weighted position	-41.650
Equity	5.045.235
Total net weighted position and equity ratio	-0,83%
Internally prescribed maximum	20%

Operational risk

In the period from 01 January 2017 to 31 December 2017 regarding operational risk, 105 events were reported in the Application of Operational risks.

The most of all events of operational risk that were reported, referred to cash shortage or surpluses and have been successfully resolved (39 events of cash shortage and 16 events of cash surpluses).

	For the period from January 1 – December 31, 2017
Number of events	105
Of which: Cash shortage	39
Of which: Cash surplus	16
Of which: Other	50
Gross loss in EUR	1.358.404,51
Net loss in EUR	9.700,18

The majority of gross loss in EUR relates to wrong booking of data during processing of guarantee for Teklas (reported amount of gross loss was 1.092.060,01 EUR). Net loss is zero for this case. This event of operational risk was reported in February 2017.

From other operational risk events, cases of external frauds are more significant with total gross loss in the amount of RSD 7.921 thousand (EUR 66.856,31) and net loss for the Bank in the amount of RSD 1.083 thousand (EUR 9.140,23).

The Bank performs also risk assessment of Outsourcing, on the basis of the contract concluded with third parties which have clearly defined rights and obligations of the parties.
When introducing new products, processes and systems or new business activities the Bank also performs assessment and identification of operational risk.

Exposure risk

The Bank's exposure to persons related to the Bank and its large exposures as of December 31st 2017

	(in RSD 000)	% of equity	Limit NBS
Persons related to the Bank	664.850	13,18%	-
Large exposures	523.714	10,38%	Max 400%

Large exposure limit of the Bank as of December 31st 2017 was within the prescribed limit of the National Bank of Serbia. In terms of internally prescribed limits the sum of all large exposures was in low risk category (up to 200% of regulatory capital).

For all large exposures, the Bank have the decisions of the Board of Directors on loan approval and defining exposure limits.

Concentration risk

The Bank monitors the concentration risk through a concentration ratio that was defined as the ratio of the 20 largest gross exposures at the level of the client or the group of related parties and total regulatory capital.

The policy of credit risk management has determined that the concentration ratio should be maintained at a level below 300,00%.

	31.12.2016	31.12.2017	Prescribed value
Concentration ratio of 20 largest clients/groups of related parties	195,66%	145,95%	Max 300,00% of regulatory capital

The credit risk management policy also defined the exposure limit in relation to certain geographical areas and according to a specific sector / branch of activity defined in the Portfolio Management Credit Risk Procedure (30%). As of December 31st 2017 the largest exposure of the bank was in the mining and processing industry 21,12%.

Investment Risk

The Bank's investments into non-financial institutions were in a low risk category (below 6% of equity). Total investments into non-financial persons and fixed assets were also in a low risk category (below 45% of equity).

Bank's investments into non-financial sector and fixed assets as of December 31st 2017

	Investments into non-financial sectors	Investments into fixed assets	Total
Amount (000 EUR)	-	945.569	945.569
Share in equity	0%	18,74%	18,74%
Limit NBS	Max 10%	-	Max 60%

Country risk - The risk relating to the country of origin of the person to whom the Bank is exposed

Bank establishes a system of countries' classification regarding the level of country risk and is committed to a system of risk classification by categories assigned by international credit agencies (Moody's, Standard&Poors and Fitch).

During December 2017, the Bank had exposures to clients, which operate in countries that are classified as low-risk and medium-risk countries, according to Classification of official international credit rating agencies and The Bank Procedure.

Bank exposure towards countries which are in the category of low risk is without limits. The country from this category as of December 31st 2017 were Germany, Belgium and Austria. Countries in the category of medium risk were Turkey, Macedonia and Croatia. Exposure to countries in the category of medium risk was significantly below adopted internal limits as of December 31st 2017.

Country	Risk category	Limit	Share in Bank capital
Germany	low	without limit	7,18%
Belgium	low	without limit	2,44%
Austria	low	without limit	0,75%
Turkey	medium	100% regulatory capital	6,64%
Macedonia	medium	100% regulatory capital	9,35%
Croatia	medium	10% regulatory capital	0,09%

X CORPORATE GOVERNANCE RULES

Corporate governance rules of Halkbank a.d. Beograd are regulated in the following by-laws:

- Statute;
- Foundation Agreement;
- Corporate Governance Code;
- Business Code of Board of Directors Members;
- Code of Conduct and Ethical Principles;
- Anti-corruption Policy and
- General Operating Conditions.

HALKBANK AD BEOGRAD

Head of Financial Management and Planning Division
Vesna Petrović

AKCIONARSKO DRUŠTVO HALKBANK II BEOGRAD

Member of Executive Board
Ertürk Sumer

President of Executive Board
Kenan Bozkurt