

BANK SUPERVISION DEPARTMENT
INTERPRETATION OF REGULATIONS ON BANK OPERATIONS

1. Law on Banks (“RS Official Gazette“, Nos 107/05 and 91/10) – hereinafter: the Law

1. Article 124, paragraph 2 of the Law sets out that **subordinated companies** of a bank may only be financial sector entities. Article 2, paragraph 17 of the same Law defines a subordinated company of a legal entity as the subsidiary or associated company of such entity. In line therewith, there is no legal possibility for a bank as the sole founder to found a company which is not a financial sector entity.

2. Article 37 of the Law sets out that, in the course of its operations, a bank may not approve such conditions to a **related person of the bank** that are more favourable than the conditions approved to other persons that are not related persons of such bank. Article 2, paragraph 24, indent 2) of the Law sets out that bank employees are, inter alia, related persons of the bank.

The purpose of Article 37 of the Law is to prevent the bank from approving more favourable conditions for credit and deposit transactions, and other operations it performs in line with the law, to related persons of the bank. According to interpretation of the Ministry of Finance, loans for the purchase of heating materials, winter preserves and school books do not constitute a credit transaction, and may be approved to employees from the viewpoint of implementation of Article 37 of the Law.

3. Article 26 of the Law sets out, inter alia, that a bank **may acquire own shares** using funds originating from the bank’s profits on condition that such shares were offered by bank shareholders in secondary sale and the sale of such shares to other persons would cause significant losses for bank shareholders.

Section 26, paragraph 1, indent 4) of the Decision on Implementing the Provisions of the Law on Banks Relating to Granting of a Provisional Bank Founding Permit and Subsequent Issuing of a Full Operating License to a Bank, as well as on Implementing Specific Provisions Relating to Granting Approvals of the National Bank of Serbia (“RS Official Gazette”, No. 51/2006) sets out that, together with the request containing the reasons for issuing prior approval of acquisition of own shares, the bank shall, in addition to prescribed data, submit the statement of the president of the bank’s executive board that the bank did not use retained earnings from the preceding year for the acquisition of own shares.

Pursuant to the above, the bank may not use funds constituting retained earnings for the current year for acquisition of own shares. Namely, pursuant to provisions of Article 66, paragraph 1, indent 3) of the Law, the bank’s assembly shall be responsible for adopting the bank’s annual statement of accounts and deciding on the use and distribution of recorded earnings. Pursuant to Article 76, paragraph 2, indent 1) of the Law, the bank’s executive board is responsible for implementing decisions of the bank’s assembly, which

represents the basis for issuing the above statement of the president of the bank's executive board.

4. In view of the remit of the bank's **Audit Committee** as defined in Article 80 of the Law, we believe there are no impediments for the same committee to act as the committee for the audit of related legal entities operating in the Republic of Serbia.

5. Article 133, paragraph 3, indent 4) of the Law sets out that the **bank merging with another bank** shall submit to the National Bank of Serbia, along with application for approval of merger, analysis of economic feasibility of such merger produced based on most recent reports submitted by banks in compliance with Article 51 of the Law. Reporting Guidelines for Banks ("RS Official Gazette", No. 57/06, 88/06 and 56/07) set out the manner, form and deadlines for reporting on individual performance indicators relating to risk management as well as the content and form of operating reports that banks are obliged to submit to the NBS in relation to implementation of Article 51 of the Law. The bank merging with another bank shall make an analysis of economic feasibility based on the most recent reports submitted to the National Bank of Serbia and prescribed in the above Guidelines relative to the day of submission of the application.

A bank may agree on the date of merger after submitting the most recent reports prescribed in Article 51 of the Law. The prescribed reports shall be submitted with balance as at the date of merger.

For instance, if the application is submitted after 30 September 2007, the date of merger can be 30 September 2007, but the analysis of economic feasibility of such merger must be made with reference to the most recent reports submitted by banks in line with Article 51 of the Law, which means with balance as at 30 June 2007 or as at 30 September 2007, if reports were submitted to the National Bank of Serbia with balance as at such date.

6. In the event of status change, each legal entity participating in status change shall compile an extraordinary financial statement in compliance with Article 379 of the Law on Companies ("RS Official Gazette", No. 125/04) on the date specified in decision on such change, in compliance with Article 24, paragraph 3 of the Accounting and Auditing Law ("RS Official Gazette", No. 46/06), and submit such statement to the National Bank of Serbia – Public Registers and Enforced Collections Department within 60 days from the day it was compiled, as prescribed by Article 31, paragraph 5 of the Accounting and Auditing Law.

At the end of the business year, the legal entity which continued operating after the status change or which is registered in the business entities register as at 31 December shall compile an annual statement showing financial position and business changes during the entire business year. Such annual financial statement shall be compiled in the manner referred to in Section 7 of the Decision on Detailed Requirements and Method of Receiving, Reviewing and Processing of Financial Statements and Provision of Data from Such Statements ("RS Official Gazette", No. 116/06), which means that such legal entity should also include data relating to legal entities which ceased to exist following

status change and to show data on a consolidated basis for the entire reporting period, in net amount, after offsetting results before and after status change.

Pursuant to Article 24, paragraph 4 of the Accounting and Auditing Law, business changes in a legal entity which ceased to exist after status change, which have occurred in the period between the balance date of the extraordinary financial statement and the date of entry of status change in the register of the Business Registers Agency, may be recorded either in the business books of such legal entity (which ceased to exist following status change) or in the business books of the legal entity which continued operating following status change, which the management body shall specify in the decision on change (the managing body may take a decision on the retroactive accounting clause).

Hence, the obligation of a legal entity which loses legal entity status to submit financial statements to the National Bank of Serbia in compliance with the Accounting and Auditing Law will cease to exist after such legal entity submits the extraordinary financial statement compiled on the date specified in the decision on status change.

However, pursuant to Article 129, paragraph 1, indent 3) of the Law, a bank's operating license shall cease to be valid by status change of the bank. As status change is deemed completed by entry in the business entities register, the bank merging with another bank is to continue submitting to the National Bank of Serbia – Bank Supervision Department statements prescribed by the Law during the entire period of validity of its operating license, i.e. until it is deleted from the register of the Business Registers Agency.

7. A bank must completely integrate the merging bank into its system by the date of entry of status change in the Business Registers Agency at the latest.

8. A bank may not acquire 20 or more percent of capital of a company which is a nonfinancial sector entity, even if such investment does not exceed 10% of such bank's capital. Namely, subordinated companies of a bank may only be financial sector entities, in compliance with Article 124, paragraph 2 of the Law. If a bank acquired a 20% participation in the capital of a company which is a non-financial sector entity, it would hold significant participation in such company and such company would be an associated and/or subordinated company of the bank, which is contrary to the above provision; -in view of the above, **a bank may not be the only founder of a non-financial sector entity**, as a bank can hold neither significant nor controlling participation in a nonfinancial sector entity, as defined in Article 2 of the Law; -the term “subordinated companies“ is defined in Article 2 of the Law and is not limited to financial sector entities, but a bank may have a subordinated company in the financial sector only.

9. Articles 46 to 49 of the Law prescribe in detail the concept of banking secret, including in particular: which data are deemed to constitute a **banking secret**, which entities are required to keep such banking secret, exemptions from keeping a banking secret and handling of data which represent a banking secret.

The provision of Article 47 of the Law sets out that a bank and members of its bodies, shareholders and bank employees, external auditor and other persons which, due to the nature of the activities they perform, have access to data deemed to constitute a banking secret, may not disclose such data to third persons or use them to the prejudice of the interests of the bank or its clients, nor may they allow access to such data to third persons.

In conformity with Article 11 of the Law, founders (shareholders) of a bank may be domestic and foreign legal entities and natural persons. If a shareholder is a foreign legal entity – foreign bank, for instance – it shall be required to guard the banking secret just like all other entities that, due to the nature of the activities they perform, have access to data deemed to constitute a banking secret.

Transferring the database to a central server outside the territory of the Republic of Serbia must not hinder the meeting of a bank's obligations to its clients and to the supervisory authority nor may it hinder efficient conduct of supervision by the supervisory authority.

Namely, at the request of the supervisory authority, the bank is to immediately submit or allow access to any information requested. In view of the above, we believe that the transfer of the database to a central server abroad is only possible if the protection of all data deemed to constitute a banking secret subject to applicable regulations is ensured and if such procedure does not prejudice the ability of the supervisory authority to timely obtain all necessary information.

10. Article 83, paragraph 2 of the Law sets out that the manager of the organizational unit in charge of **supervision of compliance of the bank's business activities** shall be appointed and discharged by the bank's board of directors, whereas paragraph 4 of the same Article envisages that the manager of the organizational unit and employees of such unit shall be independent in their work and shall exclusively perform activities specified in paragraph 3 of this Article.

Section 4, paragraph 1 of the Decision on the Manner and Conditions of Identification, Monitoring and Management of Bank Compliance Risk ("RS Official Gazette", No. 86/2007) sets out that, inter alia, the bank shall in its internal acts specifically govern the function and scope of responsibilities of the organizational unit and measures ensuring its independence, whereas Section 5, paragraph 1 of the Decision prescribes that the bank, in setting up the organizational unit, shall assure that its size, organizational and qualifications structure are commensurate with the bank's size, and/or scope and type of bank's activities, and that the number and profile of employees in the organizational unit shall be such so as to enable effective compliance risk management.

Given the above said, the importance and complete organizational and functional independence of this organizational unit of the bank are indisputable. However, if the manager of the organizational unit in charge of supervision of compliance of the bank's business activities and employees in that organizational unit are independent and perform

only activities of compliance risk identification, monitoring and management, we believe that such compliance organization would be fully aligned with the Law.

11. Articles 46-49 of the Law regulate bank secrets – data considered to be bank secrets (Article 46), persons obligated to guard bank secrets (Article 47), exceptions from the obligation to guard bank secrets (Article 48), as well as handling data representing a bank secret (Article 49). In accordance with Article 48, paragraph 2 of the Law, a bank has the right to disclose data representing a bank secret to the public prosecutor.

Pursuant to Article 20 of the Law on Seizure and Confiscation of the Proceeds from Crime (“RS Official Gazette“, No. 97/2008), the public prosecutor may order the banking group or other financial organisation to submit data on the status of the owner’s business and private accounts, and safety deposit boxes.

Hence, we think that the Law on Seizure and Confiscation of the Proceeds from Crime practically prescribes the manner of obtaining data representing banking secret, i.e. it authorizes the public prosecutor to request those data, which is in line with the above mentioned Article 48, paragraph 2 of the Law. This, however, has nothing to do with authorizing a particular person for the submission of data to the Financial Investigation Unit in the above legally prescribed way.

12. Bank secrets are regulated by the provisions of Articles 46–49 of the Law. Pursuant to Article 48, paragraph 1, item 5) of the Law, the obligation to keep a bank secret does not exist if data are provided to regulatory authorities of the Republic of Serbia for the purpose of performing activities within their scope of competence.

The Anti-Corruption Agency is a regulatory authority in the Republic of Serbia. We think that the question whether and in what way the collection of data from banks, which are considered bank secrets, falls within the scope of competence of the Anti-Corruption Agency should be addressed to the ministry of the Government of the Republic of Serbia that is responsible for giving opinion about the implementation of the provisions of the Law on Anti-Corruption Agency.

13. Amending the provisions of **Article 75, paragraph 3 of the Law** represents the “narrowing of the four-eye principle” in the sense that this principle must be applied only when concluding legal transactions and performing other legal activities coming under the remit of the executive board.

14. The aim of the newly introduced competence of the **board of directors** from Article 73, paragraph 3, item 16a, is to ensure a division of duties, competences and responsibilities in the manner which prevents conflict of interest and ensures a transparent and documented process of decision-making and –implementation. The board of directors determines internal organisation, i.e. bank’s organisational structure by issuing an act setting out the principles of organising the bank into organisational units, the level and coordination of management, and the main principles, which ensure the division of responsibilities, competences and responsibilities of employees in the manner preventing the conflict of interest and ensuring a transparent and documented process of

decision-making and -implementation, while the executive board implements those principles by establishing a list of key activities, i.e. key responsibilities of the organisational units concerned (it operationalises the board of directors' act).

As the Law does not prescribe minimum mandatory elements of the wage policy, this is under the scope of competence of the board of directors. So, the board of directors must determine the policy framework for wages and other remuneration of bank employees, by taking into account the bank's business policy and strategy, i.e. operational results.

15. The bank decides on the number of its organisational units in accordance with the volume and complexity of its operations, but the risk management in the performance of those operations must be independent and autonomous. At the same time, the manner of organising risk management within organisational units has no impact on the above.

16. In response to the initiative launched by banks and the Serbian Association of Banks regarding the application of Basel II standards, and taking into account the need for significant investment into IT systems and human resources, as well and the time necessary for adjusting banks' business processes to the new regulatory framework, the National Bank of Serbia decided to defer the initially planned start of full implementation of Basel II from 1 January 2011 to 31 December 2011, with a trial reporting period in accordance with the new regulatory framework beginning from 30 September 2011.

In view of the above, already as of the third quarter (1 July 2011), and not in 2012, banks should be ready to implement the new standards, that is, to harmonise their operations with the amendments and supplements to the Law on Banks.

Banks are obliged to issue the harmonised acts that must be consented to by the National Bank within the time limits set by the Law. Once those acts are issued, banks may issue their other internal acts which require no consent from the National Bank.

17. Article 73, paragraph 3, item 12) of the Law prescribes, inter alia, that the board of directors determines the risk management policies and strategy, and Article 76, paragraph 2, item 6) of the Law prescribes that the executive board implements those policies and strategy.

We are of the opinion that the ALKO board may issue decisions operationalising its work, i.e. it may order the bank to implement measures that will contribute to a more adequate and independent risk management it monitors, provided however that it does not assume activities under the competence of the above bodies of the bank, and that those activities are stipulated by the bank's acts.

II. Decision of Risk Management by Banks ("RS Official Gazette", No. 129/2007 and 63/2008)

1. As prescribed by Section 24, paragraph 3 of the Decision on Risk Management by Banks, **the bank's management board has a duty to supervise the classification of such bank's business activities.** The management board is to supervise the classification of business activities in line with the powers and responsibilities granted under Article

73, paragraph 2 of the Law on Banks ("RS Official Gazette", No. 107/2005). Namely, pursuant to Article 73, paragraph 2 of the Law, the bank's management board is responsible for the implementation and supervision of a uniform risk management system, for ensuring that the executive board identifies all risks to which the bank is exposed, and for controlling such risks in compliance with the adopted policies and procedures. Considering the said powers, including the powers defined under Article 73, paragraph 3 of the Law on Banks, the role of the management board is to confirm (approve) the classification of business lines already performed by the bank's executive board.

New activities and products from Section 24, paragraph 2, indent 3 of the Decision on Risk Management by Banks refer to new types of activities and/or products that the bank is beginning to perform and/or offer. New activities and/or products, of course, include only those specified under Article 4 of the Law on Banks.

2. Section 23 of the Decision of Risk Management envisages, inter alia, the bank's obligation to identify the events that may represent sources of **operational risk** and to classify them into the categories given in the form – Annex I which is integral to the Decision.

Section 24 of the said Decision envisages, inter alia, the bank's obligation to monitor the event categories from Section 23, in accordance with its organization and activity, for individual transactions, and/or business lines prescribed in Section 24, and to classify them according to the form – Annex 2 which is integral to the Decision.

The bank shall perform prior identification of events that may represent sources of operational risk and shall classify and monitor these events by business lines, in the prescribed manner.

3. Business continuity and business contingency plans from Section 27 of the Decision on Risk Management are intended to ensure smooth and uninterrupted functioning of all significant systems and processes in the bank, as well as to contain losses in contingency situations. These plans stipulate, inter alia, technical and organizational measures for resuming the bank's operations in the shortest possible time and contain description of all types of communication channels to be made use of in extraordinary circumstances. They also imply a well-equipped disaster recovery site. Banks are required to periodically test the plans in order to assess their effectiveness and adequacy.

4. Section 11, paragraph 3 of the Decision on Risk Management by Banks prescribes the following "To mitigate credit risk and the likelihood of adverse effects on the financial result and capital of the bank on account of the borrower defaulting on its obligations, a bank may assign the matured receivables to a legal entity in the Republic of Serbia engaged primarily in financial activity in the Republic, if the bank had previously made an effort to collect such receivables from the borrower and the bank and such legal entity are not related parties within the meaning of the law on banks. The bank may not assign such receivables to several legal entities at a time."

Hence, receivables can be assigned only if they are due for payment and efforts were made to collect such receivables, and only to a legal entity that is duly registered for the performance of financial activity in the Republic of Serbia and is not a related party to the bank.

III. Decision on the Classification of Bank Balance Sheet Assets and Off-Balance Sheet Items ('RS Official Gazette', No. 129/2007 and 63/2008) – hereinafter: the Classification Decision.

1. The bank is obligated to define, through its enactments, the **procedures for establishing and continuous updating of a credit file for each borrower**. The credit file is to contain complete and accurate data needed for the assessment of the likelihood of the collection of receivables from a specific borrower. As provided by Section 15, paragraph 5 of the Classification Decision, credit file on a borrower - natural person has to contain, among other things, evidence of employment and earnings or pension of such borrower in the past three months, issued and certified by the employer (pay slip), along with the statement that such evidence can be used for the verification of paid taxes and contributions, and if the borrower is a tax payer within the meaning of the law governing personal income tax, the credit file must also contain data on such borrower's average annual earnings submitted to the Tax Administration. Evidence of employment and earnings may in addition to the pay slip include any other document, issued and certified by the employer, containing data on the level of earnings before and after deduction of taxes and contributions paid out therefrom, for the past three months, as well as the number of employee's bank account and the name of the bank with which such account is opened and to which the earnings are credited, in which case, the borrower also has to enclose a statement confirming that such document may be used for the verification of paid taxes and contributions.

In terms of data on the financial position of a borrower - natural person, the dynamics of credit file updating after loan approval and/or in the course of credit repayment, is to be determined by the bank in its enactments so as to enable an adequate assessment and management of credit risk involved.

2. As defined under Section 3, paragraph 3 of the Classification Decision, in case of entrepreneurs, farmers and natural persons, the **default status** may be assigned to individual items on the receivables side or to all receivables from one borrower. Hence, the bank may decide whether to establish the default status for the above persons at the level of individual receivables or at the level of all receivables from one borrower. The terms “to all receivables from one borrower“ and “all receivables due from one and the same borrower“ from Section 3, paragraph 3 and paragraph 4 of the Classification Decision have the same meaning.

3. As provided by Section 15, paragraph 1, indent 4 of the Classification Decision, **timeliness in the settlement of obligations** is analyzed for the period of the preceding 12 months, except for the bank's new borrowers.

4. As provided by Section 10, paragraph 4 of the Classification Decision, **total monthly credit obligations of a natural person** represent the sum of such person's monthly obligations under credit and credit cards (monthly payment due under total credit card loan), 5% of total authorized current account overdraft, obligations in respect of activated loan sureties, obligations under financial lease contracts, and 50% of the amount of given loan sureties. In line with the above, total monthly obligations of a natural person (30%, 50%), also include 5% of total authorized current account overdraft, regardless of whether the overdraft was granted before 1 July 2008.

5. As defined under Section 11, paragraph 3, provision 1) of the Classification Decision, **adequate collateral** is a guarantee, if the guarantor is of good financial standing and willing to guarantee for the settlement of receivables – the guarantor provides the collateral.

6. The categories from Section 11, paragraph 6 of the Classification Decision refer to categories from Section 6 of that Decision, and not to sub-categories determined by the bank's enactments. A receivable eligible for classification in category B may be classified in category A provided it is secured by adequate collateral e.g. mortgage.

7. "Balance sheet total" mentioned in Section 18, paragraph 2 of the Classification Decision in connection with the establishing of the **a group of small receivables** refers to balance sheet total in net amount, which is the indicator of the bank's size.

8. Section 7, paragraph 1, subparagraph 1, item 2 of the Classification Decision envisages that the bank shall classify in category A the receivables from legal entities that are secured by prime collateral at the level of the secured amount. Paragraph 2 of Section 7 envisages an exception to the rule – such receivables shall not be classified in category A if more than 90 days have elapsed from the original maturity date of such receivables. Sections 9 and 10 of the Classification Decision prescribe, inter alia, the manner of classification of receivables from entrepreneurs, farmers and natural persons, in accordance with the criteria of timeliness, and/or past due status from Section 7 of this Decision. Provisions of Section 7, paragraph 2 of this Decision also apply to entrepreneurs, farmers and natural persons.

9. Pursuant to Section 7, paragraph 1, subparagraph 5, item 5 of the Classification Decision, receivables from a borrower – natural person undergoing liquidation or bankruptcy proceedings shall be classified in category D. Section 22, paragraph 1 of the Classification Decision envisages that special reserves for estimated losses shall be calculated on the reserving base, as the sum of the established percentage of receivables classified in the particular category.

Article 133, paragraph 6 of the Law on Bankruptcy Proceedings (“RS Official Gazette”, No. 84/2004 and 85/2005) prescribes that upon the adoption of the reorganization plan in bankruptcy proceedings, which comprises reorganization, the designation “under bankruptcy” in the title of the bankruptcy debtor shall be deleted. Pursuant to paragraph 1

of this Article, the adopted reorganization plan has the power of an enforceable document, and is considered a new contract for the settlement of receivables specified in it.

In view of the above, we believe that a bank may, taking into account the newly-arisen circumstances, reclassify the borrower's receivables according to the criteria for classification prescribed by the Classification Decision, and calculate the appropriate amount of special reserves in line with the classification. However, as the borrower has serious problems in operations, and as the adoption of the reorganization plan does not imply its successful execution, we note that the bank, in this situation, should estimate the borrower's financial standing and creditworthiness with utter circumspection, bearing in mind the level of credit risk that the bank is exposed to. Furthermore, the bank should monitor and dispose of information on success in execution of the reorganization plan, and such information should be integral to the borrower's credit file, pursuant to Section 15 of the Classification Decision.

10. Section 11, paragraph 3, item 2 of the Classification Decision prescribes the conditions under which mortgage on real estate is considered the adequate means of collateral of receivables from the borrower who is a legal entity, entrepreneur, farmer and natural person.

Mortgage is treated in line with the Law on Mortgage ("RS Official Gazette", No. 15/2005) envisaging that for the purposes of securing one receivable, mortgage may encumber more items of real estate, regardless of whether they belong to one or several different owners. The value of real estate with mortgage, according to the assessment of an authorized appraiser, shall not be less than the total amount of the bank's receivables and other receivables secured by the first right pledge over the same property.

11. The credit file of the borrower who is not a natural person shall contain data prescribed by Section 15, paragraph 5 of the Classification Decision. We believe that, in addition to the pay slip as evidence of employment and earnings, the bank may use any other document, issued and certified by the employer, containing data on the level of earnings before and after deduction of taxes and contributions paid out therefrom, for the past three months, as well as the number of employee's bank account and the name of the bank with which such account is opened and to which the earnings are credited, in which case, the borrower also has to enclose a statement confirming that such document may be used for the verification of paid taxes and contributions. Furthermore, to assess the borrower's creditworthiness, the bank may take into account the borrower's revenue from real estate on the basis of the lease or sublease contract, as well as all other revenue pursuant to the personal income tax (temporary service contract, membership of a management board and other boards of the legal entity, etc), on the condition that these revenues constitute monetary inflow credited to the borrower's account for the last three months, that the borrower is a tax payer, and that they stem from the contract whose validity coincides with the period of using the approved loan. Given the above said, the credit file of the borrower should contain the documents that clearly and unambiguously prove that the conditions have been met.

12. Pursuant to Article 11 of the Law on Cheques (“FPRY Official Gazette“, No.105/46, “SFRY Official Gazette“, No. 12/65, 50/71, 52/73 and “FRY Official Gazette“, No. 46/96), cheques are payable on demand and are considered invalid if the payment date is indicated otherwise. Article 12 of the Law prescribes, inter alia, that the cheque payable in our country must be presented to the drawee for payment within eight days from the date of cheque issue if the place of issue and payment in our country is one and the same, and within fifteen days if the place of issue and payment are not the same.

In line with the above, household cheques can not be used as collateral for household loans. They are used exclusively as a means of payment and are payable only on demand and at a date specified in advance.

IV. Decision on Capital Adequacy of Banks ("RS Official Gazette", No.129/2007 and 63/2008)

1. As prescribed by the Decision on Capital Adequacy of Banks, **borrowers are obligated to provide inflow in the same foreign currency**, and/or with the same type of indexation, before or during the maturity of their obligations so as to ensure sufficient funds for the settlement of obligations on the date they fall due for payment.

Under the terms of the Decision on Capital Adequacy, a matched foreign currency position means that the borrower’s expected inflow in foreign currency or in dinars but indexed to a foreign currency clause covers at least 80% of its obligations denominated in foreign currency or in dinars, but indexed to a foreign currency clause.

The bank is obligated to regulate in its enactments the manner of identifying borrowers with a matched and/or unmatched foreign currency position, and to apply such enactments in compiling the prescribed reports.

If the client can not provide a certificate of the level of earnings in the foreign currency to which the credit is indexed nor provide any other type of evidence (accepted by the bank as a relevant proof of matched foreign currency position in line with its procedures), the client's foreign currency position shall be considered unmatched.

2. Pursuant to Section 17, paragraph 2 of the Decision on Risk Management, total costs of replacement of derivatives not traded in the stock exchange market are included in the calculation of the bank’s exposure to one person or a group of related persons (original exposure of a derivative or the sum of current and potential credit exposure of such derivative, depending on the method applied by the bank for the calculation of the amount of derivatives not traded in the stock exchange market which is included in the credit risk-weighted assets, in accordance with the decision on capital adequacy of banks).

As provided by Section 23, paragraph 2 of the Decision on Capital Adequacy, banks do not include in their credit risk-weighted assets contracts on foreign currencies (derivatives) not traded in the stock exchange markets whose original maturity is up to 14 calendar days.

It follows from the above that currency forward and swap transactions with original maturity up to 14 calendar days are not shown in the VIB and VIPL reports. What these reports do show under item total replacement costs are currency forward and swap transactions with original maturity over 14 calendar days.

Section 5 of the Decision on the Classification of Balance Sheet Assets and Off-Balance Sheet Items prescribes that exemptions from classification include those off-balance sheet items which expose the bank predominantly to market risk and other types of risk other than credit risk (items entered in the trading book within the meaning of the decision on capital adequacy). It follows from the above that only those off-balance sheet items exposing the bank to credit risk are subject to classification (items not entered in the trading book within the meaning of the decision on capital adequacy).

Currency forwards and swaps meeting requirements for inclusion in the trading book defined by the Decision on Capital Adequacy are not shown on the KA4 form. Currency forward and swap transactions not meeting the requirements for inclusion in the trading book defined by the Decision on Capital Adequacy (derivatives for the risk hedging of banking book positions, on condition that the bank has formally disclosed its intention of acquiring such derivatives within the meaning of IAS 39 for hedge accounting - at the moment of their acquisition) are shown on the KA4 form only if they represent net financial asset of the bank in accordance with IAS 39 (if the bank's claims on the same person under the same transaction are higher than its liabilities to that person). Valuation and recording of currency forward and swap transactions is performed by applying the relevant International Accounting Standards depending on which category the financial assets belong to.

3. Section 11 of the Decision on Capital Adequacy prescribes that the trading book comprises positions in financial instruments held either with trading intent or in order to hedge positions in other financial instruments on the trading book. Such financial instruments must be free of any restrictions on tradability or suitability for hedging.

To exclude a financial instrument from the trading book on account hedging a position in another financial instrument by it, the position to be hedged must meet the requirements for inclusion into the banking book defined by Section 14 of the Decision on Capital Adequacy, and:

- there must be a hedging relationship qualifying for hedge accounting under IAS 39, paragraph 88,
- the hedge instrument must meet the conditions under IAS 39, paragraphs 72–77,
- the position to be hedged must meet the conditions under IAS 39, paragraphs 78-84.

4. –In line with Section 17, paragraph 5 of the Decision on Capital Adequacy, when calculating total bank operations, derivatives are expressed at nominal or market value of the underlying financial instrument. In Schedule 8 of the Reporting Guidelines for Banks in Relation to Capital Adequacy Ratio, Capital Requirements and Trading Book (“RS Official Gazette”, No. 59/2008) – hereinafter: Guidelines, i.e. Report on the daily valuation of items on the trading book and total bank operations (DKT form), currency swap transactions are shown at the nominal value of the subject of the agreement, i.e. the currency whose amount remains unchanged for the duration of agreement, re-calculated in the dinar equivalent by applying the middle exchange rate as at the reporting date.

-In Schedule 3 of the Guidelines, i.e. Report on the elements of trading book (KT form), currency swap transactions are shown at the market value of the agreement calculated as prescribed by Section 15, paragraphs 1–3 of the Decision on Capital Adequacy. In columns 4 (long position) and 5 (short position) of the KT form, amounts with a plus sign are entered, while the amount in column 6 (total) is derived as the sum of amounts specified in columns 4 and 5.

V. Decision on Temporary Measures for Preserving Financial Stability in the Republic of Serbia (“RS Official Gazette”, No. 116/08 and 12/09) – hereinafter: The Decision on Temporary Measures

1. The Decision on Temporary Measures envisages, inter alia, a bank’s obligation to timely inform the NBS Bank Supervision Department of any planned early repayments of all loans taken from abroad (credits, deposits, etc), specifying the exact amount and the reasons for such early repayment. The repayment of the overnight loan within the agreed maturity deadline to the parent company is not treated as early, but as due repayment of borrowed funds, and the NBS Bank Supervision Department does not have to be informed of thereof.

2. The new Section 2a. of the Decision on Temporary Measures prescribes that in case of receivables from natural persons approved and disbursed after 1 January 2009, banks are not obliged to require from these persons to make a downpayment or deposit of less than 30% of the loan, for classification of such receivables into the most disadvantaged category D. This means that banks need not ask from natural persons to make a downpayment or deposit for loans approved and disbursed after 1 January 2009, but they may, in line with their business policy, require from natural persons to make a downpayment or deposits for the said loans. Given the above said, banks shall, in concrete cases, act in line with their business policy.

3. The condition for changing the method of calculation of arrears in the collection of bank’s receivables under Section 2 of the Decision on Temporary Measures is not the conversion of receivables into dinars, but compliance with other criteria specified in the same Section.

VI. Decision on Special Facilities Supporting the Country's Financial Stability ("RS Official Gazette", No.34/09 and 36/09) – hereinafter: Decision and Guidelines for Bank Reporting on the Performance of Obligations Arising from the Decision on Special Facilities Supporting the Country's Financial Stability ("RS Official Gazette", No. 43/2009), hereinafter: Guidelines

1. In accordance with Section 2, provision 2) of the Decision and Section 2, provision 3 of the Guidelines, banking group exposure includes the amount of overnight deposits.

2. As provided by Section 2, provision 2 of the Guidelines, no later than 15 days following the entry into force thereof, banks are obligated to submit to the National Bank of Serbia on the KZ-3B form data on loan disbursements and repayments made by 31 December 2008 (for each individual loan).

This means that any bank failing to submit data on loan disbursements and repayments for recording purposes to the National Bank of Serbia within 10 days from the date of change (Section 10 of the Decision on the Procedure, Deadlines and Forms Used in Recording Foreign Credit Transactions, "RS Official Gazette", No.9/2007, 24/2008, 120/2008 and 40/2009) must submit those data by no later than 15 days following the entry into force of the Guidelines, in accordance with Section 5 thereof.

3. A bank, member of a banking group, is obligated to submit to the National Bank of Serbia, for reconciliation purposes, data on the banking group's exposure in respect of credits approved irrespective of whether the credit transaction was recorded through that or some other bank operating in the Republic of Serbia.

The KZ-3B form, prescribed by the said Decision, along with data on disbursements, the relevant repayment schedule and amounts repaid in respect of a specific credit transaction is submitted to the National Bank of Serbia by the bank through which the credit transaction was recorded (Section 8, paragraph 3 of the Decision).

4. The exposure of a banking group is monitored on an ongoing basis and analysed in more detail on a monthly basis. Any decline in exposure, the reasons for the decline and activities planned will be discussed with the bank before the assessment of its compliance with requirements for continued participation in the Financial Stability Support Programme.

5. To use special facilities envisaged by Section 3 of the Decision, the bank must, inter alia, offer to borrowers an option to reschedule the loan repayment terms in line with its regulations and risk management procedures as prescribed by Section 8, paragraph 1, provision 1), indent two of that Decision. The repayment term can be extended by minimum 12 months (if the remaining repayment period is less than five years) and/or by at least one fifth of the remaining repayment period if the extension exceeds 12 months and if the remaining repayment period is over five years. The rescheduling of the terms of repayment may also be effected by way of reducing the borrower's monthly obligation by

minimum 20%. Future monthly repayment installments must be reduced by minimum 20% of the amount of previous installments.

6. The provisions of Section 7 and Section 8, paragraph 1, provision 1), indent two of the Decision may apply to refinanced loans. As provided by Section 9 of the Decision, the bank may use special facilities prescribed thereunder from the moment of receiving the National Bank's notification of compliance with the conditions from Section 8 of the Decision.

7. Provisions of the Decision on Temporary Measures for Preserving the Country's Financial Stability have not been invalidated by the Decision on Special Facilities and banks may continue acting in accordance with them.

8. The calculation of arrears in the collection of receivables based on the subsequently agreed repayment term, envisaged by Section 7 and Section 8, paragraph 1, provision 1), indent two of the Decision on Temporary Measures may also apply to the refinancing of debt of clients coming from other banks.

VII. Decision on Liquidity Risk Management ("RS Official Gazette", No. 129/2007)

Pursuant to Section 11 of the Decision on Liquidity Risk Management, first-degree liquid receivables of a bank are cash and receivables falling due within a month from the date of liquidity ratio calculation (these positions are set out in detail further in the same Section), while second-degree liquid receivables are all other liquid receivables falling due within a month from the liquidity ratio calculation. Treasury bills issued by the Government of the Republic of Serbia are recorded as securities held to maturity and are classified as second-degree liquid receivables if they are falling due within a month from the date of liquidity ratio calculation. Classifying those receivables into second-degree liquid receivables does not result in lower liquidity ratio as the first- and second-degree liquid receivables fall due within a month following the date of liquidity ratio calculation.