ANNEX – Republic of Serbia

A. Overview of the banking sector

Institutional and legal framework

1. The National Bank of Serbia (NBS) is the central bank of the Republic of Serbia that performs the function of the regulator and supervisor for the major part of the Serbian financial sector. The NBS is in charge for prudential supervision and regulation of banks, as well as insurance companies, financial leasing companies, voluntary pension fund management companies, payment institutions and electronic money institutions.

2. Regarding its function as a bank supervisor, the tasks of the NBS are:
   a. Issuance and revocation of bank operating licenses and prudential supervision of bank operations;
   b. Other areas of supervision (for example AML);
   c. Protection of rights and interests of the consumers of services provided by banks.

3. The Administration for Supervision of Financial Institutions has been formed as an organisational part of the NBS (but it has no legal personality) in order to enable more effective performance of activities related to the supervision of banks, payment institutions, insurance companies, financial leasing companies, and voluntary pension fund management companies. Besides supervision, the NBS is also the regulatory authority – it can propose laws on matters within the scope of its tasks, and it has a right to adopt binding secondary regulations (by-laws) which regulate operations of supervised entities.

4. The NBS is also the bank resolution authority but activities pertaining to prudential supervision and regulation are organizationally separated from bank resolution activities.

5. In addition to the NBS, the Securities Commission is authorized to license and supervise operations of investment firms. It is also competent for conducting prudential supervision and the adoption of by-laws with regard to the operations of such companies.

6. Serbia’s legal framework governing the banking sector consists of the following:
   a. <u>Law on Banks</u> that regulates the establishment, operation and organisation of banks, the manner of bank management, bank supervision, bank resolution and termination of banks’ operations;
   b. <u>Law on the Protection of Financial Service Consumers</u>, which regulates the rights of consumers of financial services provided by banks, financial lessors and vendors;

c. Law on the Prevention of Money Laundering and the Financing of Terrorism;

d. Law on Payment Services that regulates the conditions and manner of providing payment services, electronic money, payment systems.

7. In addition, the NBS has implemented Basel II and Basel III Standards. The most important ones are: [1]

a. The Decision on Capital Adequacy of Banks, which governs the method of calculating the capital of banks, their risk weighted assets and capital adequacy ratio;

b. The Decision on Risk Management by Banks (amended to implement Basel III);

c. The Decision on Liquidity Risk Management by Banks.

Overview of the Serbia's financial system

8. The financial sector of the Republic of Serbia is very bank-centric – the share of banks in total financial sector assets at the end of 2017 was around 91% .The banking system is characterized by a rather low degree of concentration, which help foster competition: the market share of the top five (ten) banks is 54.9% (78.4%) for assets, 53.6% (77.7%) for lending, and 55.6% (79.5%) for deposits. However, a progressive concentration is under way, aimed at reducing the number of employees and branches, so to achieve more cost-efficiency. The prevailing business model is mainly given by traditional banking, aimed a retail and corporate clients, and financed mostly by domestic deposits.

9. As of 31 December 2017, net assets of the Serbian banking sector, consisting of 29 banks, amounted to RSD 3,369 billion (EUR 28.4 billion). For the supervisory purposes, the NBS divides banks into four peer groups (D-SIBs, medium, small and micro banks); seven banks are systemically important. Banks in foreign ownership (members of banking groups from 13 countries, mainly from EU) accounted for 76.9% of total assets, 82.5% of total loans and 74.7% of total deposits. More details on the ownership structure of the banking sector are in Table 1:

[1] Other provisions include the Decision on Terms and conditions of identification, monitoring and management of bank compliance risk; the Decision on Disclosure of data and information by banks; the Decision on Reporting requirements for banks (amended to implement Basel III); the Decision on Consolidated supervision of a banking group; the Decision on Detailed terms and manner of performing bank supervision and special bank audit.

Table 1. Serbian banking sector – Ownership structure

Banking sector by ownership structure	YoY	end-2017	Domestic banks		Foreign banks			D-SIBs
					EU			
			State	Private	SSM	non-SSM	Other	
Banks	↓	29	6	3	9	4	7	7
Number of								
Bussiness units	↓	1,627	27%	8%	46%	14%	5%	49%
Employees	↓	23,055	23%	7%	51%	14%	5%	51%
in EUR million								
Total net assets	↑	28,440	16%	9%	61%	11%	3%	66%
Equity	↑	5,631	13%	12%	60%	12%	3%	65%
State securities	→	5,323	29%	6%	57%	6%	2%	74%
Gross Loans	↑	17,028	11%	9%	64%	13%	3%	64%
Deposits	↑	18,267	20%	9%	58%	11%	3%	66%
in EUR million								
Net Result in 2017	↑	566	15%	24%	60%	0%	1%	85%

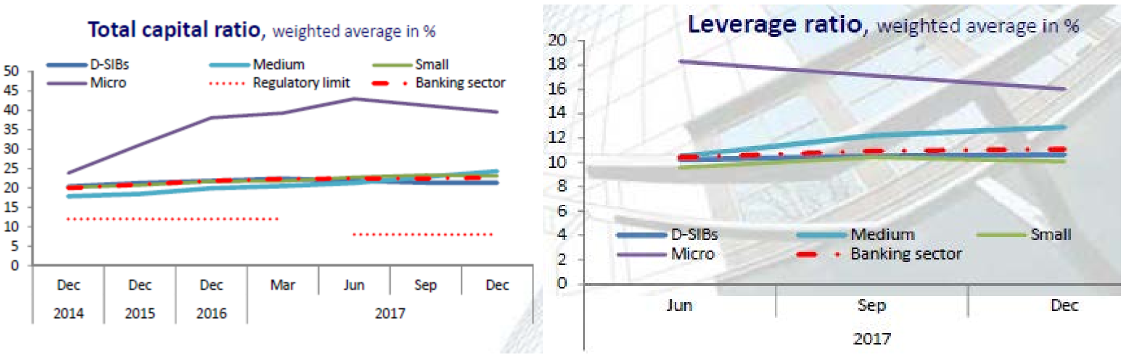
Source: NBS

Structure and performance of the Serbian banking sector

Capital adequacy

10.During 2017 the banking sector remained highly capitalized. Capital adequacy ratio was 22.6% at the end of December 2017 (see Figure 1 below), which is sufficiently above regulatory minimum in Serbia (8%). The high solvency of the banking sector is also indicated by the leverage ratio, which stood at 11.1% at end-2017.

Figure 1. Serbian banks - Total capital ratio and leverage ratio

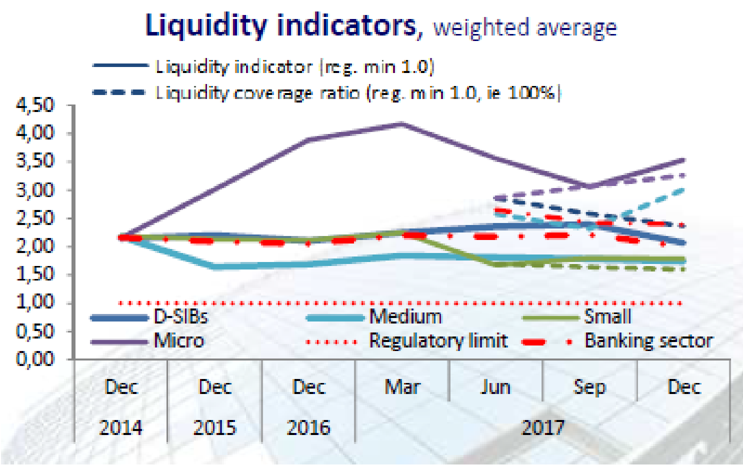


Source: NBS

Liquidity

11.Along with adequate capitalization, liquidity indicators and term structure of assets were also at very safe levels. Average liquidity ratio in December 2017 was 2.0 (regulatory minimum is 1.0) and was above 2 during whole 2017, meaning that liquid assets (first-degree and maturing in the next 30 days) were twice as large as sum of liabilities without maturity and liabilities maturing within 30 days. Liquid assets as of 31 December 2017 made 36.7% of total assets and 53.1% of short-term liabilities. 19% are low-risky and highly liquid Bonds of the Republic of Serbia. Recently introduced liquidity coverage ratio (LCR) with its value of 240% indicates also high liquidity of Serbian banking sector (see Figure 2).

Figure 2. Serbian banks – liquidity indicators



Source: NBS

12. Decreasing trend of the loans to deposits ratio that at the end of 2017 amounted 93.2% indicates funding stability.

Profitability

13. The profitability of the banking sector improved significantly in 2017, primarily due to lower indirect write-offs of balance sheet positions and higher other operating income. Total net pre-tax profit at the end of December 2017 amounted to RSD 68.7 billion (EUR 579.8 million), 22 banks operated with profit totaling RSD 73.9 billion, while 7 banks operated with loss totaling RSD 5.2 billion. On average, RoA and RoE at the end of 2017 stood at 2.1% and 10.6%, respectively.

Non-Performing Loans (NPLs)

14. The recent implementation of the NPL Resolution Strategy and other supervisory measures led to a significant improvement of banks portfolio quality. The share of NPLs decreased to the lowest level since 2008, mainly thanks to write-off and transfer (sales) to third parties. According to data as at end of December 2017, gross NPL ratio reached 9.85%, which is lower by 12.4 p.p. than in the period of Strategy adoption.

15. The most significant channels in reduction of NPLs at Serbian banks were: direct write-offs and assignment of receivables. According to end of 2017 data, considering from the period of the Strategy adoption the total NPL decrease which is owed to direct write-offs was 150.7 billion RSD (1.3 billion EUR). Despite the significant amount of write-offs and sales, NPL coverage in

Serbian banking sector is maintained on reliable levels, observing in term of coverage with IFRS provisions (58.1% of NPL’s was provisioned) and regulatory loan-loss reserves (133.3%).

Implementation of Basel III standards

16. In recent years, the NBS have undertaken several initiatives designed to strengthen the prudential framework relating to bank capital and their supervisory framework and also to align requirements with the CRR. The Basel III were implemented at the end of 2017 and is now considered in line with the CRR. The NBS has also regulations regarding Pillar 2 that stipulate the new requirements for banks’ internal capital adequacy assessment process (ICAAP), as well as the framework for the supervisory review and evaluation process (SREP).

B. Detailed Assessment of Republic of Serbia

<table>
<tr><th colspan="3">Country: Republic of Serbia</th><th></th></tr>
<tr><td colspan="4">Assessment of particular topics and sections</td></tr>
<tr><td colspan="2">Topic I</td><td>Supervisory Framework</td><td>Topic Assessment
Largely Equivalent</td></tr>
<tr><td colspan="2">Rationale for overall topic assessment</td><td colspan="2">The supervisory framework has been assessed as "largely equivalent" to the EU framework. The National Bank of Serbia recently introduced Basel III International Regulatory Standards for Banks and associated supervisory standards in the Republic of Serbia. Moreover, significant steps in harmonization of domestic regulation with the relevant EU banking regulation have been taken through the adoption of several provisions that are largely based on EU Guidelines and Technical Standards. Clear provisions are in place for the supervisory rights and powers of the NBS, its independence and autonomy; the NBS is legally empowered to impose a set of administrative measures and penalties towards institutions including the right to withdraw the operating licence. The supervisory review process is aligned with the SREP procedures governing supervision in the EU.</td></tr>
<tr><td rowspan="2"></td><td>Section 1</td><td>General questions</td><td>Section Assessment
Equivalent</td></tr>
<tr><td>Rationale for section assessment</td><td colspan="2">Prudential supervision

Supervisory activities in the financial sector are performed by the National Bank of Serbia (NBS) and by the Securities Commission. The primary objectives of NBS is the maintenance of price stability, but it is also entrusted with three main supervisory tasks:

a. Regulator and supervisor for the major part of the Serbian financial sector;
b. Prudential supervision and regulation of banks, insurance companies, financial leasing companies, voluntary pension fund management companies, payment institutions and electronic money institutions;
c. Maintaining and strengthening of the stability of the financial system.
On the other hand, the Securities Commission is authorised to grant to or withdraw licenses from investment firms, and to regulate, supervise and monitor compliance with the provisions and violations of laws, Commission bylaws and enactments of investment firms.

Prudential regulation

All principal financial institutions in Serbia are subject to prudential regulation. Credit institutions are subject to prudential regulation by the NBS. Investment firms are regulated by the Securities Commission. Both the NBS and the Securities Commission can issue binding secondary regulation and additional guidance to the institutions in their capacity as regulatory authorities. All relevant laws and regulations are legally binding and enforceable for all institutions established in Serbia.

The laws and regulations in the field of prudential supervision are supplemented in various ways:

- Additional technical instructions or guidelines, which are binding;

- Official interpretative opinions on questions posed by banks. These opinions are not binding per se, but as they are related to regulation issues, banks are expected to abide by them, and not following them could result in a breach of a regulatory provision.

- NBS publishes the frequently asked questions and related answers concerning laws and regulation in the field of prudential supervision on its website.

Recent developments

As part of its efforts to continuously improve the regulatory framework for banking operations in line with international standards and EU regulations, the NBS introduced Basel III International Regulatory</td></tr>
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<table>
<tr><td></td><td></td><td colspan="2">Framework for Banks and associated supplementary standards in the Republic of Serbia in 2017. Moreover, significant steps in harmonisation of domestic regulation with the relevant EU regulation in the field of banking have been taken through the adoption of several provisions that are largely based on the EU Guidelines and Technical Standards.</td></tr>
<tr><td rowspan="2"></td><td>Section 2</td><td>Competencies of supervisory authorities</td><td>Section Assessment
Largely Equivalent</td></tr>
<tr><td>Rationale for section assessment</td><td colspan="2">
Supervisory rights and powers
Clear provisions are in place for the supervisory rights and powers of the NBS, its independence and autonomy. The NBS’s institutional independence is established by law, while the operational independence of supervision is ensured by the establishment of the Administration for Supervision of Financial Institutions, i.e. an organisational part of NBS which has no legal personality, formed in order to enable more effective performance of activities relating to the supervision of banks and other financial institutions.
Requirements about expertise and professionalism of supervisory staff are also in place. Unlike in the EU framework, there is no explicit provision in the legislation with regards to the necessary resources to carry out the supervisory functions. However, the Law on the National Bank of Serbia prescribes conditions regarding educational level and adequate professional experience necessary for being eligible to be appointed to the position of the Governor, Vice-governors, and Director of the Administration of supervision of the financial institutions.
Licensing of credit institutions
The NBS has the power to issue and revoke banking licenses. The provisions for the authorisation of credit institutions are largely equivalent to the CRD. The initial minimum capital requirements for banks are higher in the Serbian legislation than the 5 million EUR foreseen in the EU regime – banks are required to have a minimum capital of the dinar equivalent of EUR 10 million. Regulatory provisions are largely equivalent with regards to:

Licensing criteria/permissible activities;
Suitability of largest shareholders;
Local headquarter;
Programme of operations and structural organisation;
Prior consultation with competent authorities of third countries;
Possibility to reject or withdraw the banking license under certain specified conditions.

Fit and Proper
Overall the fit and proper regime appears in line with the EU framework. There are some slight divergences; for instance, one which relates to the number of directorships that can be held. The number of directorships while restricted to five in Serbia, allows more latitude than Article 91 of the CRD, which contain more onerous restrictions. However, in terms of authorisations, approvals and reappointments, the laws are generally in line with those of the EU.
Qualifying shareholder participations
Similar to the EU framework, the Serbian legislation provides for a verification of the suitability of founding shareholders during the authorisation procedure as well as cooperation with foreign authorities in this respect. There are also similar provisions for the notification and assessment of increases in participation. A lower threshold is used in the general definition of a qualifying holding. The general definition of a qualifying holding refers to 5% of the voting rights or capital in Serbian law whereas the general definition in the EU regime uses a threshold of 10% of the capital or voting rights in an undertaking.
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<tr><td rowspan="4"></td><td>Section 3</td><td>Prudential Supervision</td><td>Section Assessment
Largely Equivalent</td></tr>
<tr><td>Rationale for section assessment</td><td colspan="2">
Supervisory scope
With regards to the supervisory scope, the NBS exercises supervision both at the consolidated level and at the level of the individual institution. The qualitative criteria for institutions that do not need to be included in the (prudential) consolidation scope are similar to the ones in CRD:

When the subordinated company concerned does not interfere with unimpeded consolidated supervision;
When inclusion of the subordinated company concerned in consolidated financial statement could be misleading in respect of conclusions of the consolidated supervision;
When the subordinated company concerned is headquartered in a third country and there are legal obstacles for the provision of necessary information.

There is a small difference in the quantitative criterion used for determining the entities that can be excluded from the prudential scope. The Serbian regulation provides for such an exclusion if the total amount of balance-sheet assets of the subordinated company concerned is less than 1% of the balance sheet total of the ultimate parent company or bank, whereas the CRD foresees for entities to be excluded if the total amount of assets and off-balance sheet items is less than the smaller of EUR 10 million or 1% of the total amount of assets and off-balance sheet items of the parent undertaking or the undertaking that holds the participation. To this extent, the NBS explained that this is due to the relatively small size of the Serbian banking sector.
Supervisory powers
The NBS is legally empowered to impose a set of administrative measures and penalties on institutions including the right to withdraw the operating licence. Unlike in the EU framework, there are no similar provisions for public statements or publication of administrative penalties.
The Serbian legislation provides for the same reporting duty as foreseen in the EU framework for persons responsible for the legal control of annual and consolidated accounts to inform the supervisory authorities about their findings related to any material breach of laws or regulations. In particular, external auditors are bound to notify the bank's managing and executive board, and/or a member of the banking group, as well as the NBS any of the following: 1) breach of the law and regulations of the NBS; 2) materially important change in the financial result in unaudited annual financial statements; 3) breach of internal procedures or acts of the bank or the group the bank belongs to; 4) any circumstances that could result in a material loss for the bank.
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<tr><td>Section 4</td><td>Supervisory Review Process</td><td>Section Assessment
Equivalent</td></tr>
<tr><td>Rationale for section assessment</td><td colspan="2">
ICAAP
Banks operating in Serbia need to have an Internal Capital Adequacy Assessment Process (ICAAP) in place determining the amount of total internal capital requirements in accordance with their risk profile, and determining the available internal capital and carrying out its distribution. Within the ICAAP, a bank shall carry out stress testing for all materially significant risks. The internal audit of the bank shall assess the ICAAP at least once a year.
Governance
The Serbian legislation has similar provisions to the CRD for banks to have an adequate governance arrangements, internal control mechanisms, and an independent risk management function in place. Specifically, a bank shall identify, measure, assess and manage the risks it is exposed to in its operations, and also set up a special organisational unit to be in charge of risk management. Also, a bank shall provide for functional and organisational separation of risk management activities and
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regular business activities. Risk management shall be adjusted to the size and organisational structure of the bank, the volume of operations, and types of activities it performs.

While there is no explicit requirement for banks to establish a separate risk committee, the main functions of the risk committee as defined in the CRD are covered by the audit committee. Moreover, a bank is required to set up a special organizational unit in charge of risk management that has to regularly report on risk management to the bank's governing bodies and to the regulatory authority. The NBS also explained that through the assessment of ICAAP, it has required some banks to establish a dedicated risk committee. Thus, a separate risk committee has now been established in one quarter of the banks operating in Serbia.

SREP

The Supervisory Review and Evaluation Process (SREP) has been designed in a way that mirrors the EBA SREP guidelines, and constitutes the continuous process encompassing the results of all supervisory activities regarding the comprehensive assessment of an individual bank, performed by Off-site and On-site supervision divisions in the NBS. The Supervisory Manual designed by the Bank Supervision Department to implement the SREP will be revised in order to align it with the revised EBA SREP Guidelines. The supervisory assessment process includes the Business Model Analysis, governance and controls, risks to capital (including credit risk, market risk, operational risk, IRRBB), and risks to liquidity.

Through the SREP capital assessment the NBS assesses whether the own funds held by the bank provide sound coverage of risks to capital to which the bank is or might be exposed, if such risks are assessed as material to the bank. During this assessment, the NBS determines if additional own funds are required, reconciles P2R and P2G with macroprudential requirements, decides on TSCR and OCR and how these can be met in stressed conditions.

Supervisory powers to levy higher capital/liquidity requirements

The legislation empowers the NBS to levy higher capital requirements if this is necessary for the bank's safe and sound operations and/or fulfilment of obligations to creditors based on the type and level of risk and operations of the bank. To this extent, internal acts of the NBS prescribe in detail which aspects should be considered when imposing higher capital requirements, i.e. the bank's internal controls system, its policies, procedures and mechanisms, with the main aim of determining an adequate level of the bank's own funds. Such aspects are set in line with the EBA SREP Guidelines.

While there is not an explicit provision for specific liquidity requirements like Art. 105 of the CRD, the Law on Banks refers to the possibility of introducing more stringent liquidity requirements, such as requirements on the concentration of the liquid assets, restrictions on short-term contractual or behavioural maturity ALM mismatches, more frequent reporting on liquidity positions, or activities to be taken by the bank to address deficiencies in liquidity risk management. Also, with regard to bank's funding profile, measures are foreseen to reduce banks' dependency/concentration on certain funding types.

Supervisory review of internal models

Credit institutions must require approval from the NBS for using internal models for the calculation of risk-weighted assets. The NBS has the power to revoke the authorisation for the use of an internal model if the institution fails to comply with the requirements for its use. The NBS can review the internal models, and does so, for example, during on-site examinations.

While there is no fixed frequency to review internal models, the NBS clarified that no bank operating in Serbia has ever submitted an application to use the IRB approach for calculation of RWAs in Pillar 1 at local level, although the NBS has been involved in a number of joint on-site examinations with the EU competent authorities to assess conditions to use internal models at consolidated level for a number of local banks. Moreover, the NBS conducted the first on-site examination for one bank as

		part of the preliminary assessment of the conditions for use of IRB model in Pillar 1 on local level during the first quarter of 2018.	
	Section 5	**Professional Secrecy and International Cooperation**	Section Assessment Equivalent
	Rationale for section assessment	**Professional secrecy** The NBS has professional secrecy provisions in place, which are similar to the EU regime in terms of the definition of confidential information, the existence of professional secrecy obligations for persons working on behalf of NBS extending beyond the employment or engagement at the NBS, and the unauthorized disclosure of confidential information being regarded as a criminal offence. There are provisions for the disclosure of confidential information in court proceedings, which are less detailed than those provided in the EU regime. **International cooperation** Legal provisions are in place for the NBS's cooperation with international regulatory and resolution authorities in view of exercising its supervisory function and resolution-related activities, and exchanging information in this respect if these authorities are subject to confidentiality requirements at least equivalent to the Serbian legislation. The NBS has Memorandums of Understanding (MoU) in place with 15 jurisdictions, as well as a Memorandum of Cooperation between the EBA and SEE countries and several multilateral MoU relating to supervisory colleges of banking groups.	
Topic II		**Own Funds**	Topic Assessment Largely Equivalent
Rationale for overall topic assessment		Overall, the Serbian provisions related to own funds is on par with CRR. Provisions on the quality of capital have been implemented. The composition and quality of capital now mirrors the CRR requirements, the deductions and prudential filters pertaining to that are also the same. Moreover, AT1 Instruments have been introduced, in line with the CRR, and the T2 criteria is the same. A law on minority interests has recently been introduced, which has closed the last remaining gap. In relation to capital requirements, all types of risks are covered and the reporting requirements are very close to the CRR. Minor differences were found in the reporting of mortgage lending losses and asset encumbrance.	
	Section 6	Own Funds	Section Assessment Equivalent
	Rationale for section assessment	**Own funds requirements** The own funds requirements are structured as follows: • 4.5% CET1 • 6% T1 • 8% Total Capital In terms of capital composition, core capital items are the same as in CET1 as per CRR (paid-in share capital, excluding cumulative preferential shares, reserves from profit and profit of the bank and other items that are perpetual) and can be used to cover losses on a going concern without delay. The quality of capital is consistent with that prescribed by the CRR, thus it can be considered fully equivalent to the ones envisaged at the EU level. **Adjustments and deductions** Most of the provisions in the Serbian regulation are equivalent to the EU framework. With regard to prudential filters the provisions mirror those of Article 32-35 CRR. Deductions also are similar to those required under the CRR, e.g. losses from the current financial year, intangible assets, deferred tax	

		assets and all deductions set out in Article 36 of the CRR are included. There was some concern that AT1 and T2 deductions were not included in the law, however, the NBS clarified these points and demonstrated provisions in the law. **Other provisions** AT1 instruments have been implemented into Serbian law and their eligibility criteria and deductions, as clarified, are consistent with that of the CRR, similarly the write-down criteria as set out in Article 54 of the CRR are provided for in Sections 24 of the DCA. The Tier 2 items and criteria are analogous to the provisions of the CRR. Amortisation, consequences of conditions for Tier 2 instruments ceasing to be meet and deductions are also similar to that of the CRR. Conditions for the reduction of own funds and supervisory permission for reducing own funds are similar to Article 77 and 78 of the CRR.	
	Section 7	General requirements	Section Assessment Largely Equivalent
	Rationale for section assessment	Own funds requirements cover credit, market and operational risk. The provisions on reporting and disclosure are similar to those envisaged by the CRR. All banks are included with no exemptions. It was queried whether the Serbian legislation contains similar provisions to Articles 99-101 of the CRR. In particular, whether mortgage lending losses and asset encumbrance are assessed and reported was examined. These are not provided for in the law but mortgage losses are monitored in both monthly and quarterly reports, with asset encumbrance being monitored through the balance sheet.	
Topic III		**Credit Risk Requirements**	Topic Assessment Equivalent
Rationale for overall topic assessment		Serbian regulations on credit risk, credit risk mitigation and securitisation are “Equivalent” to the EU framework. Most of their regulations are identical to the CRR provisions and in some cases more conservative (resulting in higher risk weights or not allowing for derogations to some institutions). Serbia’s regulation includes provisions on Credit risk Standardised Approach and IRB Approach as well as on Credit risk mitigation techniques. Serbia implemented Basel III by the end of 2017 that included some changes to the credit risk framework and notably changed securitisation framework making their regulation fully aligned with the CRR.	
	Section 8	Capital requirements for credit risk	Section Assessment Equivalent
	Rationale for section assessment	**Regulatory framework for credit risk** Credit risk requirements and the calculation of own funds for credit risk are identical to the CRR requirements for the Standardised and IRB approaches. Banks can apply the SA or IRB Approaches (FIRB and AIRB) subject to the approval of the NBS. With the implementation of Basel III requirements at the end of 2017, Serbia also introduced provisions on securitisation positions throughout the credit risk section. The treatment on exposures to CCPs as well as credit risk adjustments under both approaches are fully aligned with the CRR. **Standardised Approach** Serbian regulation includes the same exposure classes and risk weights as in the CRR (identical). With the implementation of Basel III, Serbia introduced three new exposure classes (exposures in the form	

		of securitisations, exposures to banks and companies with short-term credit assessment, and equity exposures) and some novelties, for example: i) exposures to territorial autonomies or local government units have the same treatment; ii) irrevocable standby letters of credit not having the character of credit substitutes and which are trade related are in medium/low-risk category; and iii) exposures fully secured by mortgages on commercial immovable property shall be assigned a risk weight of 50%. Rules for the nomination of credit assessment institutions and the rules for using external credit ratings assigned by eligible assessment institutions are identical to the CRR. **IRB**: Banks can use IRB approach if they have obtained the consent from the NBS, under the conditions and manner specified in that consent. Both IRB approaches, FIRB and AIRB, can be used, and the rules implementing the IRB approaches are identical to the CRR. Serbia expanded the definition of default with the adoption of Basel III to match it with the CRR. The regulation on the application of SA and IRB Approaches is equivalent to the CRR. However, until the date of its accession to the EU, a bank may assign the risk weight of exposures to the Republic of Serbia and NBS, including exposures to the EU member states and their central banks which are expressed and settled in the currency of any member state, in the same manner as it assigns the risk weight of exposures to those persons that are expressed and settled in their national currencies (according to the CRR, this provision was applied in the EU until 31 Dec 2017).	
	Section 9	Credit Risk Mitigation	Section Assessment Equivalent
	Rationale for section assessment	It was observed that Serbian regulation is more restrictive than the CRR in certain aspects regarding credit risk mitigation (CRM). Serbian regulation stipulates the same principles and general conditions for the recognition of CRM techniques for credit protection (funded and unfunded). **Funded credit protection** - Individual instruments, conditions for recognition of on-balance sheet netting and master netting agreements and protection instruments are compliant with the CRR. **Unfunded credit protection** Similarly to the CRR: - Specific rules for eligible forms of CRM techniques (guarantees, counter-guarantees, credit derivatives, credit linked notes); - Eligibility of protection providers and eligible types of credit derivatives; - Detailed requirements for each eligible form of unfunded CRM. Most of the provisions of the Serbian regulation exactly match the CRR provisions. The provisions on credit risk mitigation are Equivalent.	
	Section 10	Securitisation	Section Assessment Equivalent
	Rationale for section assessment	Serbian regulation on securitisation include minimum requirements for the recognition of significant credit risk transfer in both traditional and synthetic securitisation, use of credit assessments of an assessment institution to determine the credit risk weight of a securitisation positon, and calculation of the risk-weighted exposure amounts for securitisation positions framework. Provisions on securitisation positions under other risks (e.g. credit risk) were added with the adoption of Basel III at the end of 2017 and that section is identical to the CRR. However, banks may not perform	

		the activities of the originator, sponsor or original lender until a separate law on securitisation is adopted (expected in 2018). The Serbian law on Securitisation is Equivalent to the CRR.	
	Section 15	Exposure to transferred credit risk	Section Assessment Equivalent
	Rationale for section assessment	Minimum requirements for recognition of significant credit risk transfer in both traditional and synthetic securitisation were introduced at the end of 2017 and these provisions are identical to the CRR.	
Topic IV		**Market Risk**	Topic Assessment Equivalent
Rationale for overall topic assessment		Serbia's capital adequacy regulation takes into account both the counterparty credit risk and all risks under market risk. They have provisions in place also for settlement risk, CVA risk and commodities risk. In general, the legal provisions are based on the same ideas and principles (building block approach) as the CRR provisions for these types of risks and their regulation is identical to the CRR. Serbia has now implemented the Basel Committee's recent changes to the counterparty credit risk and CVA risk frameworks, including internal models, which are already considered in the CRR. Market risk and counterparty credit risk regulations are both equivalent to the CRR.	
	Section 11	Counterparty Credit Risk	Section Assessment Equivalent
	Rationale for section assessment	In general, Serbia's rules for the treatment of counterparty credit risk (CCR) are identical to the respective rules of the CRR. All four models that are in the CRR have been implemented in Serbian regulation as well, including the Original Exposure Method (OEM), which is not in Basel. Similarly to the CRR, OEM cannot be used if the institution is not eligible for the small trading book derogation. All four methods eligible to calculate own funds requirements are identical to the CRR with regard to the calculation methodology and accompanying operational requirements (e.g. requirements for the management system when the institution uses internal model, IMM). Preconditions for and effects of the recognition of contractual netting agreements are aligned with those of the CRR. Some minor differences were observed though, where Serbian regulation is less specific, e.g. no requirement for relevant CAs to be satisfied that the contractual netting is legally valid and enforceable under the law of each jurisdiction. Adoption of Basel III at the end of 2017 introduced changes to the treatment of IMM regarding EAD stressed measure, wrong way risk, Asset Value Correlation and separate requirements for transactions with Central Counterparties (CCPs) making it fully aligned with the CRR. Serbia's regulation on CCR is equivalent to the CRR; however, Serbia's supervisory authority does not consider counter-party credit risk as threat to the financial system due to the degree of development of derivatives markets.	
	Section 13	Own funds requirement for market risk, settlement risk and CVA risk	Section Assessment Equivalent
	Rationale for section assessment	Serbia has a **trading book** concept in place, which is similar to CRR's trading book concept both with regard to the instruments assigned to it and the requirements for its management; also the conditions for the small trading book derogation and principles of prudent valuation. Following the	

		implementation of Basel III, the capital requirement for the breach of exposure limits in the bank's trading book has been introduced. Serbia's **market risk** provisions are based on a building block approach taking account of position risk for trading book activities, foreign exchange risk and commodities risk for all business activities. Regarding the approaches to calculate own funds requirements, Serbia's regulation allows both for the application of the standardised approach (SA) and internal models (IM) and the calculations of capital requirements are identical to the CRR. In case of IM, the qualitative and quantitative requirements of general character or related to the VaR calculation are also identical to the CRR. Regarding the implementation of Basel III at the end of 2017, Serbia has implemented the provisions on **Stressed-VaR and Incremental Risk Charge (IRC)** that are mandatory for banks using IM. It is also required that IRC needs to be in place to capture trading book positions not covered by the VaR parameter. Serbian regulation also includes capital requirements for the correlation trading portfolio. These requirements are fully aligned with the CRR. The calculations for the **settlement risk** includes different factor of 8% in period from 5 to 15 working days after due settlement date and 1250% for free delivery exposures until the extension of the contract are identical with the CRR provisions. Serbia's capital adequacy regulation imposes own funds requirement for **CVA risk** and both methods, Standardised and Advanced, have been introduced in their framework following the implementation of Basel III at the end of 2017. Considering the fact that Serbia's regulation on own funds requirements for market and related risks comprises all the elements, which are part of the CRR market risk rules and the rules on CVA risk, and that these rules are identical to the CRR, the provisions are considered equivalent to those of the CRR.	
Topic V		**Operational Risk**	Topic Assessment Equivalent
Rationale for overall topic assessment		The Serbian framework for operational risk can be assessed as "equivalent" to the EU regime, as the regulations are driven by the same principles and follow the same direction. The framework is overall in line with the European regulation. The NBS also has practical experience with the supervision of all three approaches – BIA, TSA and AMA.	
	Section 12	Operational Risk	Section Assessment Equivalent
	Rationale for section assessment	**Definition** Operational risk is defined in Serbian legislation as the risk of possible adverse effects on financial results and capital of the bank caused by omissions in employees' work, inadequate internal procedures and processes, inadequate management of information and other systems, as well as by unforeseeable external events. Operational risk also includes legal risk. A bank is obliged to identify and assess events and sources that may lead to operational losses, considering all significant internal and external factors. **Regulation** According to the Serbian law, a bank may calculate the capital requirement for operational risk by using following approaches: 1) Basic Indicator Approach, 2) Standardised Approach, with the previous notification of the NBS, or the Alternative Standardised Approach, subject to prior consent of the NBS, 3) Advanced Approach, subject to prior consent of the NBS.	

<table>
<tr><td></td><td></td><td colspan="2">Also, subject to prior consent of the NBS, a bank may calculate the capital requirement for operational risk by using one of the following combination of approaches:

1) Advanced and Standardised Approach,
2) Advanced and Basic Indicator Approach,
3) Standardised and Basic Indicator Approach.

A bank using the Standardised or the Advanced Approach may revert to another, less complex approach, or a combination of approaches only subject to prior consent of the NBS. All the approaches allowed in the Serbian legislation are in line with the CRR quantitative requirements and qualitative criteria.

Supervision

The NBS has practical experience with the supervision of all three approaches (BIA, TSA and AMA), and has established a comprehensive unified supervisory practice with the emphasis on basic principles for the implementation of all elements of the supervisory process.

Further, regarding the supervision of operational risk, the NBS has intensified activities towards establishing the function of supervision of information systems in financial institutions in order to ensure the adequacy of risk management systems in this area and to act preventively in financial sector supervision, using the best practices.</td></tr>
<tr><td colspan="2" rowspan="2">Topic VI</td><td rowspan="2">Liquidity</td><td>Topic Assessment</td></tr>
<tr><td>Largely Equivalent</td></tr>
<tr><td></td><td>Rationale for section assessment</td><td colspan="2">The framework for liquidity in Serbia can be assessed as "largely equivalent" to the EU one. Banks must respect a 100% threshold for the Liquidity Coverage Ratio (LCR), which has been recently introduced and is defined in line with the EU regulations. The NBS keeps monitoring shot term liquidity also through the liquidity ratio and the narrow liquidity ratio. Concerning long-term liquidity, the Net Stable Funding Ratio (NSFR) has not yet been introduced in the Serbian legislation, although it is planned for the beginning of 2019. However, risks to long-term liquidity are monitored through the analysis of the maturity mismatch. Following such analysis, the NBS determines if an additional liquidity buffer must be maintained.</td></tr>
<tr><td rowspan="3"></td><td rowspan="2">Section 16</td><td rowspan="2">Liquidity</td><td>Section Assessment</td></tr>
<tr><td>Largely Equivalent</td></tr>
<tr><td></td><td colspan="2">Detailed conditions and ways of managing the liquidity risk by banks, the calculation of liquidity indicators, as well as the limits on the banks' exposure to liquidity risk are prescribed by Decision on Liquidity Risk Management by Banks (DLRMB), which is based on the CRR and the Commission Delegated Regulation (EU) 2015/61.

Short-term liquidity

The Serbian law requires banks to maintain a Liquidity Coverage Ratio (LCR) of 100%. In line with the EU law, the LCR is defined as the ratio of liquidity buffer and net liquidity outflows over a 30-day stress period. The liquidity buffer is the sum of level 1, level 2A and level 2B assets amount; the net liquidity outflow is calculated as a sum of total liquidity outflows reduced by the amount of liquidity inflows over a 30-day stress period. Banks shall calculate their LCR aggregately in dinars and in all other currencies in which their balance sheet positions and off-balance sheet items included in the calculation of the ratio are denominated, as well as individually in each significant currency. There are small differences, mainly related to the treatment of inflows/outflow within IPS, which are not relevant in the Serbian banking market.

Alongside with the LCR, Serbian law also prescribes banks to maintain certain levels for the liquidity ratio and the narrow liquidity ratio. The liquidity ratio is the ratio of the sum of level 1 and level 2 liquid receivables of the bank and the sum of liabilities payable on demand or with no agreed maturity and liabilities falling due within a month. The narrow liquidity ratio is the ratio of Level 1 liquid</td></tr>
</table>

<table>
<tr><td></td><td></td><td colspan="2">receivables of a bank and the sum of liabilities payable on demand or with no agreed maturity and liabilities falling due within a month.

The NBS clarified that, while it is expected to gradually phase out the liquidity ratio and the narrow liquidity ratio, all the three measures are currently prescribed and monitored, with separately prescribed measurement and reporting, so that the conclusions on banks' liquidity levels are made based on all three indicators. Liquidity ratio and narrow liquidity ratio are measured, monitored and reported on daily basis while LCR is measured, monitored and reported on monthly basis. However, no significant consistency issues have been found in the calculation or reporting of these three ratios.

Long-term liquidity

The Net Stable Funding Ratio (NSFR) is currently under development. Namely, the NBS already finalised the preparatory phase, requiring banks to complete the quantitative study on the introduction of the new liquidity ratio. After the completion of quantitative impact study, the NBS will consider the answers and further communicate with banks if necessary. After that, NBS will finalize draft regulation for implementing NSFR in domestic regulatory framework and send it to public consultation. The current plan is to finish the public consultation process and to adopt the regulation regarding NSFR by the end of 2018 (or at the beginning of 2019).

Although NSFR is still not yet a hard requirement, banks that are part of EU banking groups already monitor and report the NSFR, which is monitored and assessed by the NBS during the annual SREP process, as part of the assessment of the liquidity risks.

Risks to liquidity in the long term are however monitored, as banks are required to analyse maturity mismatch of their balance sheet liabilities and receivables and off-balance sheet items for predefined periods. Following such gap analysis, they must determine and maintain an adequate liquidity buffer. During the SREP process, the NBS assesses the adequacy of established maturity buckets and the underlying assumptions, as well as measures to be taken in order to reduce exposure to liquidity risk. The NSFR ratio and maturity mismatch for each bank are monitored based on internal reports that are regularly submitted to NBS.</td></tr>
<tr><td colspan="2" rowspan="2">Topic VII</td><td rowspan="2">Capital buffers and macroprudential tools</td><td>Topic Assessment</td></tr>
<tr><td>Equivalent</td></tr>
<tr><td colspan="2">Rationale for overall topic assessment</td><td colspan="2">The framework for capital buffers and macroprudential tools implemented in Serbia can be regarded as "equivalent" to the EU one. All the capital buffers applied in the EU regime are currently implemented and mandatory in Serbia. While no bank is subject to a G-SII buffer (since there are no global systemic important banks headquartered in Serbia), the law already include such a requirement and the methodology is aligned with the BCBS one. In case a bank does not comply with the buffers' requirement, it will be required to submit NBS a suitable capital conservation plan.

The NBS acts as designated macroprudential authority, and a number of macroprudential tools are already being used reducing risks in the financial system, especially those connected with FX-exposure. The macroprudential framework is designed in line with the ESRB Recommendation on intermediate objectives and instruments of macroprudential policy. While this is not enshrined in a legislative instrument, the framework is already applied in practice, with many of the prescribed instruments already adopted and legally binding.</td></tr>
<tr><td rowspan="3"></td><td rowspan="2">Section 18</td><td rowspan="2">Capital Buffers</td><td>Section Assessment</td></tr>
<tr><td>Equivalent</td></tr>
<tr><td>Rationale for section assessment</td><td colspan="2">Capital buffers

Four capital buffers are implemented in Serbia as the following:

- Capital conservation buffer, set at 2.5%;</td></tr>
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<td colspan="2">- Countercyclical capital buffer, currently set at 0%;
- Systemic risk buffer;
- Capital buffer for systemically important banks (O-SII).
No G-SII buffer is introduced, as there are no G-SII in Serbia, but the requirement and the methodology are present in the DCA and are the same as in the CRD/BCBS.

The systemic risk buffer was introduced to limit the risk of euroisation, which is one of the key structural non-cyclical systemic risks to the stability of the domestic financial system. All banks whose share of FX-lending to corporate and household sectors exceeds 10%, are obliged to maintain on an individual, consolidated or sub-consolidated basis the additional CET1 capital in the amount equal to 3% of total FX-indexed lending to corporates and households.

Since the systemic risk buffer only applies to domestic exposures, it is cumulative with the O-SII buffer, so that the combined buffer is defined as the sum of the buffers above.

The buffers consist only of CET1 capital and cannot be used to maintain other capital adequacy ratios.

Capital conservation measures-MDA

Where a bank fails to meet its combined buffer requirement on an individual, consolidated or sub-consolidated basis, it shall apply the capital conservation measures and present a capital conservation plan as prescribed, which are in line with respective requirements of the CRD.</td>
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<tr>
<td rowspan="2"></td>
<td>Section 19</td>
<td>Macroprudential Tools</td>
<td>Section Assessment
Equivalent</td>
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<td colspan="2">Macroprudential authority

The NBS has the mandate to determine and implement activities and measures to maintain and strengthen the stability of the financial system. Moreover, a financial Stability Committee was established by the Government, the NBS, the Deposit Insurance Agency and the Securities and Exchange Commission act as an advisory body to evaluate all issues and possible measures for maintaining the financial stability.

Macroprudential tools

In addition to the requirement of a systemic risk buffer, the Decision on Temporary Measures for Preserving Financial Stability in the Republic of Serbia prescribes measures aimed at reducing risks in the financial system arising from the high share of FX-denominated and -indexed dinar loans, via three measures:

- 80% LTV limit required for FX-denominated or -indexed housing loans;

- Approval of FX-indexed loans to natural persons is conditional on the euro being the currency of indexation;

- Down payment or placement of deposit of at least 30% of the loan amount as a requirement for the approval of FX-denominated and -indexed loans.

The Law on National Bank of Serbia does not prescribe a close list of macro-prudential policy instruments, to ensure enough flexibility and adaptation to future developments. Thus, the legislator empowered NBS to adopt macroprudential instruments on a case-by-case basis, selecting adequate and proportionate instruments with the aim of mitigating existing systemic risks.

Macroprudential framework:

In 2015 the NBS published a document (“Macroprudential Framework”) setting out macro prudential policy, objectives, instruments and decision making processes. In particular, macroprudential policy is implemented in four stages:

1) Identification, assessment and monitoring of systemic risk;
2) Selection and calibration of macroprudential instruments;</td>
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		3) Implementation of macroprudential instruments; 4) Evaluation of the impact of the applied instruments. The document is fully harmonised with the Recommendation of the ESRB on intermediate objectives and instruments of macroprudential policy (ESRB 2013/1). The NBS clarified that, while the document is not legislative in nature as it is not a regulation but a policy strategy document, its framework is already applied in practice with many of the prescribed instruments already adopted and legally binding.	
Topic VIII		**Other regulatory requirements**	Topic Assessment Equivalent
Rationale for overall topic assessment		The Serbian regulation on these three topics can be assessed as "equivalent". Both the framework for large exposures and for the leverage ratio are aligned with the provisions set out in the EU regulation, with small differences that are mainly related to the smaller size of the Serbian banking market or its lower complexity. There is a reporting obligation in place both for large exposures and the leverage ratio, although the latter is not a hard requirement yet, but only a reporting obligation. The NBS applies qualitative and quantitative disclosure elements, which are largely comparable to the EU requirements, while market discipline and transparency of banks' operations has been recently strengthened through the implementation of Basel III standards into the national legislation. The NBS also discloses a large amount of information on supervisory practices and requirements on its website.	
	Section 14	Large Exposures	Section Assessment Equivalent
	Rationale for section assessment	**Large exposure definition and limit** The Large exposure definition provided in the Serbian legislation is the same as in the EU, i.e. exposure exceeding 10% of the bank's capital, defined as the sum of T1 and T2, in the amount up to one third of T1 capital. The large exposure limit (for a client or group of connected clients) is 25% of bank capital. The NBS clarified that the limit is expressed only in percentage but not in absolute value, as the absolute limit set out in the CRR (150 mn EUR) is currently too high for the Serbian financial market. The sum of all large exposures of the bank shall not exceed 400% of the bank's capital. A bank shall inform without delay the NBS of each exposure in excess of the limit as well as the person or a group of related persons to which the exposure relates and the NBS may give a deadline to a bank to meet the limits, if it assesses that this is justified and on condition that it received the notification. The calculation of the exposure value is aligned with the provisions of the CRR. **Level of application** Large exposure limits are applied both at consolidated and solo level. **Connected clients** Large exposure limits apply to groups of connected clients. The definition of connected clients ("related persons") is aligned with the CRR. **Large exposures in the trading book** The provisions are very much in line with the EU framework: a bank may exceed the exposure limits for items in the trading book only if some specific conditions, aligned with Articles 395 and 397 of the CRR are fulfilled. **Exemptions** Exposures exempted are substantially the same as those envisaged in the CRR. Differences are negligible and, if anything, tilted in the direction of more conservative treatment (i.e. less exemptions are granted).	

		Reporting and monitoring Large exposures are constantly monitored through reporting and there are administrative and accounting procedures to identify and report them. The Decision on reporting requirements for banks establishes the obligation to submit a quarterly Report on large exposures of the bank and report on large exposure to a group of related persons. During the SREP process, supervisors assess the amount and composition of large exposures in relation to the banks' capital when assessing the level of the credit concentration risk.	
	Section 17	Leverage	Section Assessment Equivalent
	Rationale for section assessment	The leverage ratio has been introduced by the Decision on Reporting Requirements for Banks (DRR). The leverage ratio is defined as ratio of Tier 1 capital – sum of Common Equity Tier 1 capital and Additional Tier 1 capital in accordance with the DCA – to the bank's exposure measure and is expressed as a percentage. The total exposure amount is the sum of the following values: - on-balance sheet exposure, unless it is a deductible item; - derivative exposures; - add-on for counterparty credit risk exposure of repurchase and reverse repurchase transactions, margin lending transactions, securities or commodities lending or borrowing agreements and long settlement transactions; - exposures under off-balance sheet items. The calculation of on-balance sheet exposures follow the same methodology detailed in the Commission Delegated Regulation (EU) 2015/62 with regard to the leverage ratio, while the form and content of the leverage ratio reports are regulated – with small differences - in accordance with Commission Implementing Regulation (EU) 2016/200 of 15 February 2016. Although the leverage ratio itself is not a hard requirement at this moment, the reporting obligation, the form and content of the leverage ratio reports, as well as the exposures of banks included in the calculation of the leverage ratio by risk weights are already mandatory.	
	Section 21	Disclosure	Section Assessment Equivalent
	Rationale for section assessment	The Serbian Regulator applies qualitative and quantitative disclosure elements that are largely comparable to the EU requirements. Market discipline and transparency of banks' operation have been strengthened through the adoption of the Decision on Disclosure of Data and Information by Banks, which implements Basel III standards into the national legislation. With respect to disclosure at individual level, a more conservative approach has been taken given that the parent company of a banking group cannot be waived from the disclosure at solo level, thus making it easier to ensure transparency on internal transfer of Own Funds. Regarding supervisory disclosure, the NBS publishes the following information on its website: - Texts of laws in the field of prudential regulation as well as regulations, guidelines and methodologies. Additionally, the NBS updates information on applicable level of capital buffers on a regular basis; - General information on the criteria and methodologies applied in the SREP process; - Aggregate statistical data on supervisory examinations performed and measures taken, which are available in various NBS reports that are available to public. Also, in order to achieve a better understanding of the domestic regulatory framework as well as regulatory and supervisory expectations regarding certain provisions, the NBS publishes FAQs on laws and regulation in the field of prudential supervision on its website.	