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Market development

Euro area economy feeling effects of global headwind, interest rates still low

GDP growth in the euro area came in at 1.8 per cent for 2018, which was lower than in 2017, mainly due to weaker support from net exports. In contrast, the inflation rate rose significantly up until mid-2018 and for the most part slightly exceeded the European Central Bank's (ECB) target in the second half of the year. It was only towards the end of the year that inflation started to retreat below the 2 per cent level again. This up-and-down pattern was mainly due to the energy price trend, in turn driven by volatile oil prices.

The ECB left key rates unchanged in 2018 and incrementally scaled back its bond purchase program: Its net monthly purchases averaged € 30 billion from January to September 2018, with its net monthly volume reduced to € 15 billion from October to end-December 2018, at which time the program was completely halted. Money market rates remained largely flat across all maturities throughout the year. The yield on 10-year German government bonds, however, strongly fluctuated with rates of between 0.8 per cent in February to under 0.2 per cent in May being observed. Overall, it was a light downward trend (start of year: 0.4 per cent, end of year: 0.2 per cent).

Austria's economy put in a very robust performance once again in 2018, although it lost some growth momentum over the year. Thanks to the very strong 2017/2018 winter months, real GDP growth reached 2.7 per cent overall, following growth of 2.6 per cent in 2017. The overall positive development was broad based: exports withstood mounting global headwinds while private consumption continued to rise at a stable rate. Likewise, the strong equipment investment cycle continued in 2018 – albeit at a somewhat slower pace. Employment growth hit its peak in early 2018, posting its strongest growth rate in full-year 2018 since the beginning of the 90s. Mirroring this trend, the unemployment rate dropped below 5 per cent to come in at 4.9 per cent (2017: 5.5 per cent).

The US economy got off to a strong start in 2018 with quarter-on-quarter growth of 2.2 per cent (annualized) in the first quarter. It continued to expand at a significantly faster pace thereafter, averaging nearly 4 per cent per quarter (annualized) thanks to sizable tax cuts and a very large government spending package in the summer months. This positive development was thus primarily driven by consumer spending. In contrast, growth in investments weakened noticeably throughout the year. On balance, US economic output increased 2.9 per cent for full-year 2018.

In China, economic growth momentum slackened in 2018: Real GDP growth came to 6.6 per cent for the full year, around 0.3 percentage points below the previous year's rate. This was mainly attributable to the Chinese government's restructuring measures. Credit growth – notably on the part of shadow banks – slowed considerably while investment and production momentum temporarily dropped to the lowest level since 2015. In contrast, the simmering trade conflict with the US was initially reflected only in sentiment surveys while exports held up well for the time being thanks to pull-forward effects.

Solid economic growth in CE and SEE despite slowdown, growth in Russia benefits from one-off effects

Inflation in the CE region fluctuated around the 2 per cent level since the beginning of 2018, whereas in SEE it continuously climbed to a peak of just over 4 per cent before beginning to ease back slightly. Stronger inflation momentum in Southeastern Europe was largely driven by Romania, where it recently began to moderate again. Inflation rates in the CE region averaged 2.0 per cent and 3.4 per cent in the SEE region. The Czech central bank was the first in Europe to begin the interest rate normalization process, which commenced in August 2017 against the backdrop of a renewed pickup in inflation and a relatively weak Czech koruna / euro exchange rate. While Romania soon followed with liquidity tightening measures, subsequently hiking rates in early 2018, Hungary waited until the third quarter of 2018 to raise the prospect of a similar exit procedure, which it expects to implement in 2019. In contrast, Poland's monetary policy remained neutral given the country's muted pace of reflation.

GDP growth in the Central European (CE) region reached 4.5 per cent in 2018, and again exceeded the 4 per cent level (2017: 4.5 per cent) despite a modest slowdown. At country level, Poland was the top performer with 5.1 per cent GDP growth. Domestic demand was again the main driver of economic growth in the CE region in 2018. Investment spending remained dynamic while private consumption also started to record solid growth rates again in 2018. This was supported by the continued decline in unemployment rates, which even hit all-time lows in some of the region's countries. The resulting manpower shortage was reflected in appreciably higher wages.

In Southeastern Europe (SEE), GDP growth slowed again to 3.7 per cent during the period under review, following the strong 5.1 per cent increase in 2017. In the region's smaller markets, however, economic indicators exhibited a positive trend, resulting in stable growth overall. Serbia took the market by complete surprise with its 10-year high of 4.0 per cent, which was mainly driven by private investments with state co-financing and an increase in private consumption. In contrast, Romania, the region's largest economy, failed to match its exceptional performance from 2017 (7 per cent growth) as both gross fixed capital formation and private consumption expanded at a slower rate than in the previous year. However, it was precisely these components that drove growth in the remaining SEE countries.

Economic conditions in Eastern Europe (EE) continued to improve in 2018. Russia benefited from the recovery in oil prices, though private household demand continued to weaken. Moscow's cautious monetary and fiscal policy also had a stabilizing effect, albeit without delivering additional growth and investment impetus. GDP growth in Russia benefited from one-off effects, expanding 2.3 per cent and well above the previous year's level. At the same time, the inflation rate also rose following a record low in the previous year. In addition, the Russian ruble suffered setbacks due to new US sanctions in April and September. The rate cut cycle in Russia already came to a standstill in the first quarter of 2018, as US sanctions prompted Russia's central bank to exercise greater caution. The second half of the year saw a token rate hike of 0.5 percentage points to 7.75 per cent as a result of uncertainties surrounding possible further sanctions. The Ukrainian economy continued its recovery path, growing 3.3 per cent, somewhat stronger than the previous year's level. Moreover, financial risks for 2019 have been reduced thanks to renewed cooperation with the International Monetary Fund following a lengthy hiatus towards the end of 2018. The Belarus economy grew 3.0 per cent in 2018, influenced positively by its dominant trading partner Russia.

Annual real GDP growth in per cent compared to the previous year

Region/country	2017	2018	2019f	2020f
Czech Republic	4.5	3.0	2.7	2.5
Hungary	4.1	4.8	3.4	2.2
Poland	4.8	5.1	3.6	2.9
Slovakia	3.2	4.1	4.0	2.8
Slovenia	4.9	4.6	3.2	2.3
Central Europe	**4.5**	**4.5**	**3.4**	**2.7**
Albania	3.8	4.0	3.8	2.5
Bosnia and Herzegovina	3.2	2.8	2.7	2.5
Bulgaria	3.8	3.3	3.0	2.5
Croatia	2.9	2.6	2.5	2.0
Kosovo	4.2	4.2	4.0	3.0
Romania	7.0	4.1	2.5	2.5
Serbia	2.0	4.0	3.5	3.5
Southeastern Europe	**5.1**	**3.7**	**2.8**	**2.6**
Belarus	2.5	3.0	2.5	2.0
Russia	1.5	2.3	1.5	1.5
Ukraine	2.5	3.3	2.7	3.1
Eastern Europe	**1.6**	**2.4**	**1.6**	**1.6**
Austria	**2.6**	**2.7**	**1.3**	**1.2**
Germany	**2.5**	**1.5**	**1.3**	**1.0**
Euro area	**2.5**	**1.8**	**1.1**	**1.0**

Banking sector in Austria

In 2018 the Austrian banking sector continued its solid performance from the previous year, underpinned by the positive macroeconomic trend. The corporate customer business in particular put in a robust performance in 2018 – also for longer loan maturities. The sector likewise benefited from continued dynamic real estate lending although macro-prudential regulation has been tightened significantly in this area over the past two years. Supported by low loan loss provisioning in domestic and foreign business, the return on equity of the Austrian banks not only continued to maintain a robust level of nearly 11 per cent on a consolidated basis in 2018, but this was also well above the euro area average. This positive earnings performance was supported in large measure by favorable business developments in the CEE region, notably in the Czech Republic, Russia, Romania, Hungary, Croatia and Slovakia. Adjustments and efficiency enhancement programs of recent years are also having an impact. Given the positive overall market trend, the Austrian banking sector continued to improve its capitalization relative to other Western European banking sectors during the period under review, as also evidenced by the latest stress test results at the European level. However, capital requirements will continue to increase gradually as a result of the introduction both of the systemic risk buffer and of the buffer for Other Systemically Important Institutions, which the Financial Market Stability Board has recommended. The reduction in the bank tax implemented in 2017, should also have a positive impact on the profitability of Austria's (major) banks in the years ahead.

Development of the banking sector in CEE

Multiple factors in 2018 underpinned the significant recovery of the CEE banking sector relative to the partly still subdued development of the previous years. New lending and asset growth both continued to accelerate in some CE and SEE countries (e.g. in the Czech Republic, Slovakia and Romania). Moreover, a greater number of banking markets (e.g. Hungary, Serbia and Croatia, as well as Bosnia and Herzegovina) participated in the overall positive trend, with significant asset growth recorded virtually across the board. In Russia, foreign banks with a sustainable business model benefited from the generally improving general market environment despite a further market shakeout driven by the central bank. In particular, the necessary nationalization of two of the larger banks in Russia in the fall of 2017 had no impact either on the overall market or on Western foreign banks operating as niche players, which even increased their market share slightly in Russia in 2018. Virtually all CEE banking markets now show a comfortable loan/deposit ratio (well below 100 per cent for the most part), which constitutes a solid foundation for future growth. In addition, significant progress was made in terms of reducing non-performing loans (NPLs). In CE and SEE in particular, the NPL ratio dropped to just under 5 per cent in 2018, its lowest level since 2008. Against the backdrop of the positive overall market development, return on equity in the CEE banking sector solidified at double-digit levels in 2018. In particular, banking markets in Southeastern Europe made a significant recovery. As a result, major Western European banks operating in the CEE region also posted a double-digit return on equity in 2018.

Regulatory environment

Changes in the regulatory environment

In the year under review, RBI continued to focus intensively on current and forthcoming regulatory developments.

Changes to prudential requirements (CRD IV/CRR) and the recovery and resolution framework (BRRD, SRMR)

The European Commission's proposals to revise the Capital Requirements Directive IV/Capital Requirements Regulation and the Bank Recovery and Resolution Directive (BRRD) have been finalized by the European legislature. The regulations are expected to take effect in 2021 and 2022, respectively. As far as RBI is concerned, the deduction exemption for software is particularly important in creating a level playing field with the US. The legislation also harmonizes reporting requirements for credit institutions. Other key changes include parameters for reducing risk-weighted assets for SMEs and infrastructure projects.

Basel IV

At the end of 2017, the Basel Committee on Banking Supervision finalized the new international rules for calculating capital requirements under Pillar 1 (Basel IV). The primary objective of the new rules is to make banks' risk calculations more comparable. To accomplish this, not only were large parts of the standard models changed, but the scope of application of internal models was also restricted and the requirements for these models were revised. In addition, an output floor will be phased in by 2027, which sets a floor for capital requirements calculated using internal models at 72.5 per cent of the values calculated using the standard models.

The Basel Committee is aiming for an implementation date of 1 January 2022. However, there is still no full legal implementation of the standards for the EU, which also means there are no detailed guidelines with respect to the expected implementation date.

BCBS 239

In January 2013, the Basel Committee on Banking Supervision issued 14 generally formulated principles for risk data aggregation and risk reporting of credit institutions (BCBS 239). They reflect the Basel Committee's conclusions that data quality and governance play a fundamental role in bank management and efficiency of banking operations.

Due to its classification as a systemically important institution, RBI is required to comply with these principles. It has developed a comprehensive Group-wide action and implementation plan that ensures compliance with the BCBS 239 principles which is currently being implemented in consultation with the relevant supervisory authorities.

Bank recovery and bank resolution

The BRRD was transposed into Austrian law by the Bank Recovery and Resolution Act (BaSAG). The review of the original BRRD was negotiated up until the end of 2018 as part of the trilogue process. It must be implemented within two years of its publication – which is expected in Q2 2019 – by an amendment to the BaSAG.

RBI has a Group recovery plan as required by law. It sets out measures for restoring financial stability in the event that this becomes necessary. The BaSAG also requires the resolution authority, in close collaboration with RBI, to draw up resolution plans based on the preferred resolution strategy, including analyzing which liabilities are eligible as MREL (minimum requirement for own funds and eligible liabilities). RBI has adopted a multiple point of entry (MPE) approach as the preferred resolution strategy. The resolution authorities define resolution groups, and for each resolution group an individual resolution plan has to be developed. The resolution plan has to describe the resolution strategy and its implementation, by the use of the resolution tools. The resolution authority decides which resolution tools (sale of business, bridge institution, asset separation and bail-in) should be used. Official MREL quotas are being set for each resolution group and are expected for the second half of 2019.

Payment Services Directive 2

The new Payment Services Directive (PSD 2), which came into force on 13 January 2018, is designed to better protect consumers by promoting service security and the use of new technologies as part of an open banking system. The directive opens up the payment services market to new participants – known as third-party providers (TPPs) – such as fintech companies. It also regulates TPPs' relationships with traditional banks, which are required to give the TPPs access to the accounts of customers who have given their consent. These rules governing TPP access to payment service user data will take effect on 14 September 2019. They were further elaborated on in the course of last year while work on their implementation had already begun.

General Data Protection Regulation (GDPR)

The EU General Data Protection Regulation (GDPR) has been in effect since 25 May 2018. It applies to personal data (e.g. that of customers or employees) and strengthens the rights of control that individuals have with respect to their data. The GDPR affects all departments at RBI that handle individuals' personal data. RBI has adopted the new requirements as part of a wide-ranging project. Various processes were implemented, including those for complying with the data subjects' rights (e.g. right of access, right of erasure) and identifying personal data protection breaches; the required IT framework was created; relevant contracts were thoroughly reviewed and examined; and the requisite organizational structure was established. In addition to the project at head office, other projects were conducted at the network units and the Austrian companies in which equity participations are held, with coordination and support provided by head office.

Capital markets and sustainable financing

The implementation of MiFID II began in 2018, which had a large-scale effect on RBI's market and customer divisions and required an extensive implementation project. PRIIPs (Packaged Retail and Insurance-based Investment Products) under which a 3-page standard customer information sheet is required for packaged (securities) products also came into effect in 2018. One new issue on European level is the regulation of covered bonds, which has not yet been implemented in Austria. The changeover of benchmark indices and related uncertainty – primarily Eonia and Euribor, scheduled for early 2020 – was postponed for two years in response to market participants' objections and concerns (implementation beginning in early 2022). Other important new developments for all financial market participants include the Commission's action plan and regulatory proposals on sustainable financing and investments, which aim to reorient capital flows towards green and sustainable economic activities from 2022 onwards. The objective is to transition financial sector products, services and activities – including transparency measures and corporate governance – to a framework based on uniform definitions and standards.

Regulatory compliance (§ 39 (6) of the Austrian Banking Act (BWG))

The EBA's Guidelines on Internal Governance were transposed into Austrian law in 2018. The process added new provisions to the Banking Act (§ 39 (6) BWG) which came into effect on 1 January 2019. There are now stronger regulatory compliance requirements for monitoring and ensuring RBI's adherence to applicable Austrian law. The implementation of these activities at RBI builds on existing methods and tools.

Banking supervision

In 2018, the ECB's banking supervision activities focused on four areas: risks related to the business model, profitability, credit risk with emphasis on non-performing loans, and risk management in general. In relation to this fourth area, i.e. activities with multiple risk dimensions, RBI participated in the European Banking Authority's EU-wide stress test in 2018. The stress test results essentially depend on three factors: the capital ratio at the beginning of the stress test, losses caused by the simulated stress scenario, and the resulting capital ratio at the end of the stress test horizon. RBI's performance with respect to these factors was significantly better than in the previous stress test conducted in 2016 (participating institution: RLB Holding), although the 2018 test was more stringent. In an adverse scenario, RBI's hypothetical remaining common equity tier 1 ratio (CET1) was projected to stand at 9.7 per cent in 2020. The stress scenario simulated a sharp slump in economic growth and house prices as well as pessimistic assumptions about economic developments in most Central, Eastern and Southeastern European countries. RBI's better result reflects in particular the strengthening of its capital ratio following the merger of RZB and RBI and improved portfolio quality.

In 2018, the focus of the Joint Supervisory Team included interest rate risk in RBI's banking book and a review of the internal credit risk models.

Significant events in the reporting period

Adoption of IFRS 9

On 1 January 2018, the new accounting standard for financial instruments (IFRS 9) took effect. This replaces the previous accounting standard, IAS 39 (Financial Instruments: Recognition and Measurement). The regulations set out in the new standard are primarily reflected in the impairment on financial instruments valued at amortized cost or at fair value recognized directly in equity. Under IFRS 9, the impairment requirements also apply to credit commitments and financial guarantees off the statement of financial position. The model used to determine impairment loss changes from a historically oriented model under IAS 39 (incurred losses) to a future oriented model under IFRS 9 (expected losses). The impact of the new regulations on the market valuation of loans, by contrast, is of lesser significance. In total, € 301 million of loans must be accounted for at market value, representing 0.3 per cent of the volume of financial instruments.

The adoption resulted in an adjustment of minus € 169 million to equity on 1 January 2018, taking deferred taxes into account; the effect on the CET1 ratio (fully loaded) amounted to around 19 basis points. Impairment losses increased € 285 million. As a result of the new classification of financial instruments, there was a positive impact of € 70 million, which was essentially due to the reallocation of liabilities recognized at fair value.

In addition to the adoption of IFRS 9, RBI also changed the presentation of its balance sheet, which is now aligned with the financial reporting standards (FINREP) issued by the European Banking Authority (EBA). With the adoption of the standards, it was also necessary to adjust the figures comparable period and comparable reporting date. The changes are described in more detail in the notes, in the chapter on principles underlying the consolidated financial statements, under changes in the presentation of financial statements.

Sale of RBI's Polish subsidiary's core banking operations to BGZ BNP

In April 2018, RBI signed a contract to sell the core banking operations of Raiffeisen Bank Polska S.A. by way of demerger to Bank BGZ BNP Paribas S.A., a subsidiary of BNP Paribas S.A. (BNP). Following receipt of the regulatory approvals in particular, and eventual demerger, the transaction closed on 31 October 2018.

The sales price was PLN 3,250 million (€ 749 million), equating to a price/tangible book value multiple of 0.94 times. This is based on core banking operations equity of approximately € 869 million at the time of the demerger. The sale resulted in a positive impact of 85 basis points on RBI Group's CET1 ratio (fully loaded). Under the terms of the agreement with the buyer, total assets of approximately € 9.5 billion and total risk-weighted assets of approximately € 4.9 billion have been allocated to the core banking operations.

The direct impact of the sale on RBI Group's consolidated profit amounted to minus € 120 million, already recognized in the income statement in the second quarter of 2018. Additional equity neutral effects from the disposal after closing amounted to minus € 64 million and was primarily due to already realized currency effects.

RBI transferred the remaining Raiffeisen Bank Polska S.A. operations following the demerger, mainly comprising the foreign currency retail mortgage loan portfolio, to a newly established Polish branch of RBI AG. The branch has total assets of approximately € 3.2 billion at its disposal as at the reporting date.

Placement of additional tier 1 capital (AT1)

RBI placed a perpetual AT1 capital issue in an amount of € 500 million and with a value date of 24 January 2018. The issue has a discretionary coupon of 4.5 per cent p.a. until mid-June 2025, after which it will be reset. The AT1 is classified as equity under IAS 32 due to the terms and conditions of the issue. As a result of this issue, together with the € 650 million AT1 capital placed in July 2017, RBI has now completed its planned AT1 issuance program.

Green bond issuance

On 28 June, RBI issued the first benchmark-sized green bond from an Austrian bank. The bond has a notional amount of € 500 million, a maturity of three years, and carries a coupon of mid-swap plus 40 basis points. The offering was significantly oversubscribed, with an order book of € 1.3 billion. The issuance forms part of RBI's ongoing strategy - which it has been putting into effect for many years - to pursue sustainable business activities. The proceeds from the green bond will be used to finance sustainable projects across the entire RBI network. The allocation of funds follows a clearly defined selection and evaluation process. Ongoing reporting also ensures that the criteria are fulfilled after the investment is made and assesses the contribution to improved sustainability.

Earnings and financial performance

In the 2018 financial year, RBI continued to utilize the positive economic developments in Central and Eastern Europe, as well as in Austria, to generate further growth. The operating result improved 8 per cent, or € 162 million, to € 2,250 million, compared to the previous year, mainly due to higher interest income as well as higher fee and commission income. Lending volumes were up 4 per cent year-on-year, despite the deconsolidation of the Polish core banking operations. The continued positive economic environment facilitated a further reduction of non-performing loans in 2018, and many loans were sold at a profit as a result of active risk management on the part of RBI. At € 166 million, impairment losses on financial assets were € 146 million below the previous year, though new impairment losses of € 159 million were recognized in the fourth quarter for the fine-tuning of IFRS 9 models, as well as for expected credit risks arising from specific events which were not fully captured by the risk models.

The loss of € 120 million reported in the other result from the sale of the Polish core banking operations constituted a significant one-off effect. There was also an effect of minus € 64 million from the recycling of accumulated foreign currency differences previously recognized in equity as other comprehensive income.

Consolidated profit for the reporting period amounted to € 1,270 million, an improvement of 14 per cent, or € 154 million, compared to the prior year.

The Management Board has resolved to propose a dividend payment of € 0.93 per share for the 2018 financial year to the Annual General Meeting. This would correspond to a maximum dividend payout of € 306 million and a payout ratio of 24 per cent.

Comparison of results with the previous year

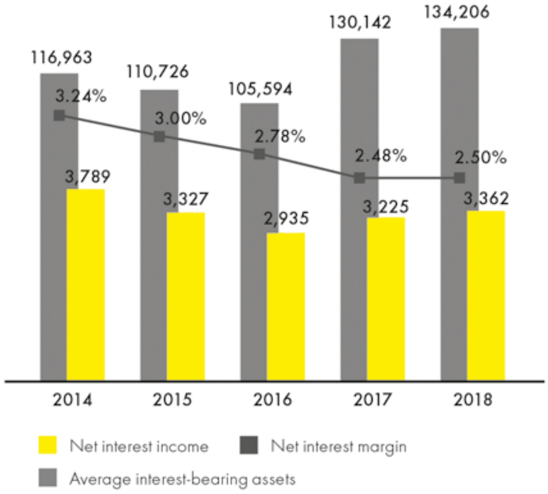
in € million	2018	2017	Change	
Net interest income	3,362	3,225	137	4.2%
Dividend income	51	35	16	46.1%
Net fee and commission income	1,791	1,719	72	4.2%
Net trading income and fair value result	17	35	(19)	(52.4)%
Net gains/losses from hedge accounting	(11)	(16)	4	(28.0)%
Other net operating income	88	100	(12)	(12.0)%
Operating income	**5,298**	**5,098**	**199**	**3.9%**
Staff expenses	(1,580)	(1,554)	(26)	1.7%
Other administrative expenses	(1,178)	(1,157)	(21)	1.8%
Depreciation	(290)	(300)	10	(3.2)%
General administrative expenses	**(3,048)**	**(3,011)**	**(37)**	**1.2%**
Operating result	**2,250**	**2,087**	**162**	**7.8%**
Other result	(161)	0	(161)	–
Levies and special governmental measures	(170)	(163)	(7)	4.0%
Impairment losses on financial assets	(166)	(312)	146	(46.9)%
Profit/loss before tax	**1,753**	**1,612**	**141**	**8.8%**
Income taxes	(355)	(366)	11	(2.9)%
Profit/loss after tax	**1,398**	**1,246**	**152**	**12.2%**
Profit attributable to non-controlling interests	(128)	(130)	2	(1.4)%
Consolidated profit/loss	**1,270**	**1,116**	**154**	**13.8%**

Operating income

Operating income was up 4 per cent year-on-year, or € 199 million, to € 5,298 million. Net interest income rose 4 per cent to € 3,362 million driven by lending growth, with Group average interest-bearing assets up 3 per cent. There was loan growth in almost all markets, with the main contributions coming from head office, the Czech Republic, Romania, and Slovakia. The net interest margin rose 3 basis points to 2.50 per cent, primarily driven by higher interest rates in Romania, the Czech Republic, and Ukraine. Net fee and commission income was up € 72 million year-on-year to € 1,791 million despite significant depreciation of Eastern European currencies (depreciation of the Russian ruble of 11 per cent and of the Belarusian ruble of 9 per cent). Increases were mainly posted at Raiffeisen Bausparkasse, head office, and in Romania.

Development of the net interest margin

in € million



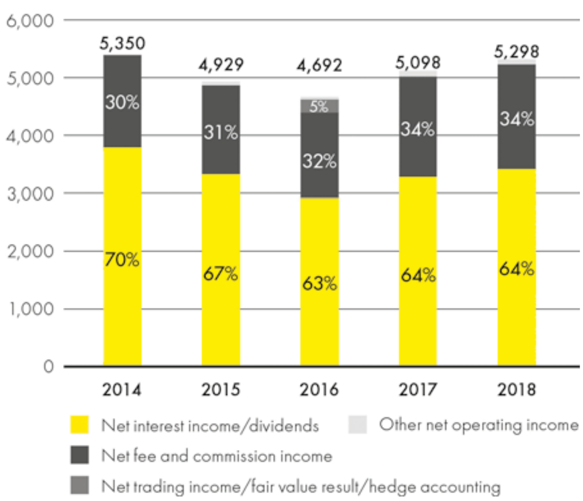
General administrative expenses

General administrative expenses increased € 37 million year-on-year to € 3,048 million. Currency developments caused a € 65 million reduction. The average number of staff decreased, by 394 full-time equivalents year-on-year to 49,745, due to the disposal of the Polish core banking operations. Excluding this effect, full-time equivalents would have increased by 759. Staff expenses rose € 26 million to € 1,580 million, mainly due to a higher level of salary increases in many markets, as well as higher bonus payments. Other administrative expenses rose € 21 million year-on-year, primarily due to higher deposit insurance fees in Russia, Romania, and Poland, as well as for IT services purchased for innovation projects at head office. The number of business outlets declined 250 year-on-year to 2,159, mainly reflecting the sale of the Polish core banking operations. Adjusting for the one-off effect of the sale, the reduction came to 13.

Depreciation of tangible and intangible fixed assets was down 3 per cent, or € 10 million, with Russia and Croatia reporting the largest reductions.

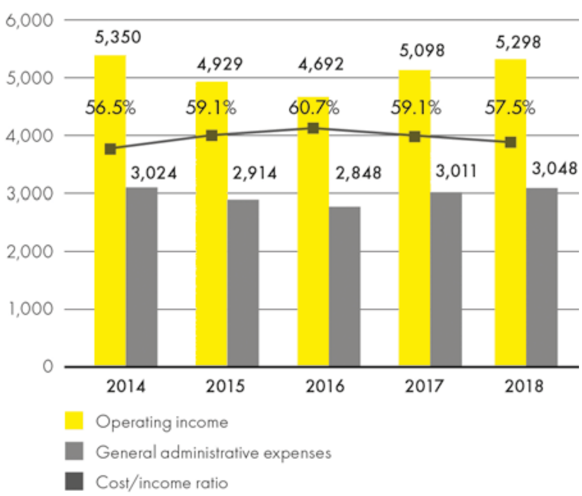
Development of operating income

in € million



Cost/income ratio performance

in € million



Other result

The other result amounted to minus € 161 million, compared to a flat result in the previous year. The main driver was the € 120 million loss from the sale of the Polish core banking operations. There was also an effect of minus € 64 million from recycling accumulated foreign currency differences previously recognized under other comprehensive income. This was offset by a higher results contribution from subsidiaries and associates (positive effect of € 21million), mainly due to lower impairment losses on associates.

Levies and special governmental measures

The expense for levies and special governmental measures rose € 7 million year-on-year to € 170 million. This change mainly resulted from a release of provisions totaling € 21 million in the previous year in connection with the Walkaway Law in Romania. In contrast, contributions to the resolution fund, which (as with the majority of the bank levies) have to be recognized in full at the start of the year, fell € 11 million primarily due to lower contributions in Romania and Austria. The expense for bank levies declined € 5 million to € 116 million, reflecting the disposal of the Polish core banking operations.

Impairment losses on financial assets

Impairment losses on financial assets amounted to € 166 million in the reporting period, compared to € 312 million in the prior year. Non-performing loans decreased, reflecting the good macroeconomic environment. Drivers of this positive trend also included inflows and recoveries in an amount of € 587 million, generating a positive effect of € 116 million. The most significant changes to risk costs occurred in the Group Corporates & Markets segment (down € 199 million), in Romania (down € 35 million) and in Croatia (down € 29 million). Impairment losses in the fourth quarter, however, were up € 159 million due to fine-tuning of the IFRS 9 models (for performing loans) and provisions for expected credit losses, due to specific events which were not fully captured by the risk models. The improvement in the NPL ratio continued in 2018: it declined 1.9 percentage points since the start of the year and stood at 3.8 per cent at the end of December. The NPL coverage ratio rose a further 10.6 percentage points to 77.6 per cent, primarily due to sales of highly collateralized loans and the first-time application of IFRS 9.

Income taxes

The tax expense declined € 11 million to € 355 million. The effective tax rate declined 2 percentage points to 20 per cent. This mainly reflected the improved earnings contribution from RBI AG.

Consolidated profit/loss

Profit attributable to non-controlling interests changed only slightly year-on-year, from € 130 million to € 128 million. Consolidated profit improved € 154 million to € 1,270 million.

Comparison of results with the previous quarter

Quarterly results

in € million	Q4/2017	Q1/2018	Q2/2018	Q3/2018	Q4/2018
Net interest income	818	829	834	856	843
Dividend income	5	9	48	3	(9)
Net fee and commission income	447	410	460	455	467
Net trading income and fair value result	9	(1)	18	4	(3)
Net gains/losses from hedge accounting	(23)	(1)	(1)	1	(11)
Other net operating income	21	45	20	14	8
Operating income	**1,277**	**1,291**	**1,379**	**1,334**	**1,294**
Staff expenses	(409)	(384)	(396)	(383)	(416)
Other administrative expenses	(315)	(286)	(287)	(280)	(325)
Depreciation	(75)	(70)	(71)	(71)	(79)
General administrative expenses	**(798)**	**(740)**	**(754)**	**(734)**	**(819)**
Operating result	**479**	**551**	**625**	**600**	**475**
Other result	(31)	27	(121)	7	(74)
Levies and special governmental measures	(17)	(132)	(8)	(16)	(13)
Impairment losses on financial assets	(121)	83	0	(28)	(222)
Profit/loss before tax	**311**	**529**	**496**	**563**	**166**
Income taxes	(77)	(98)	(106)	(111)	(40)
Profit/loss after tax	**234**	**430**	**389**	**452**	**127**
Profit attributable to non-controlling interests	(28)	(31)	(33)	(35)	(29)
Consolidated profit/loss	**206**	**399**	**357**	**417**	**97**

Development of fourth quarter 2018 compared to third quarter 2018

Operating income

Net interest income was down 2 percent, or € 13 million, to € 843 million, reflecting a € 35 million decline in Poland due to the sale of the Polish core banking operations, partly offset by higher interest income in a large number of other countries on the back of higher volumes. The Czech Republic reported the strongest growth of € 7 million following increased customer loans. In Russia, higher interest income, generated primarily from growth in investments in public sector bonds in the third quarter as well as higher customer loan volumes, led to a € 2 million increase. RBI's net interest margin increased 1 basis point to 2.52 percent.

Compared to the third quarter of 2018, net fee and commission income improved 3 per cent, or € 12 million, to € 467 million. The increase mainly resulted from higher fee and commission income from loan and guarantee business at head office and at Raiffeisen Bausparkasse, as well as higher revenue from clearing, settlement and payment services in Russia. This was offset by lower fee and commission income in Poland due to the sale of the Polish core banking operations.

Net trading income was down € 7 million quarter-on-quarter to minus € 3 million, predominantly due to losses on assets held for trading as well as negative currency differences. This was offset by lower valuation losses on loans in the mandatorily fair value through profit/loss category.

Net gains/losses from hedge accounting declined € 13 million, due to the recalibration of fair value hedges at head office.

Other net operating income fell quarter-on-quarter from € 14 million to € 8 million. This mainly reflected the recognition of other provisions (increase of € 5 million) in Russia and Romania for litigation in the fourth quarter. Net income from derecognition of financial assets and liabilities fell € 4 million to € 2 million, primarily in the Czech Republic and Russia. Offsetting this, net income from non-banking business improved € 5 million to € 15 million, due to developments in Slovenia, Belarus, and at Raiffeisen Leasing Austria.

General administrative expenses

At € 819 million, general administrative expenses in the fourth quarter were up 12 per cent, or € 85 million, from € 734 million in the previous quarter.

Staff expenses rose € 32 million quarter-on-quarter to € 416 million, primarily due to increases in provisions for retirement benefits, bonus payments and severance payments, mainly at head office and in Russia, as well as the release of provisions for overdue vacations in the third quarter. Growth in the number of staff in the fourth quarter occurred mostly in Russia and at head office.

Other administrative expenses were up € 45 million to € 325 million, driven by a seasonal increase in advertising expenses, mainly in Russia, and due to legal, advisory and consulting expenses incurred at head office for the disposal of the Polish core banking operations.

Depreciation of tangible and intangible fixed assets rose € 8 million to € 79 million in the fourth quarter. This was mainly due to an adjustment in relation to the useful life of a building in Hungary, as well as the capitalization of internally produced software in Romania and at head office.

Other result

In the fourth quarter of 2018, the other result was minus € 74 million, compared to a positive result of € 7 million in the third quarter. This was due to two main factors: In the fourth quarter, the recycling of cumulative foreign currency differences previously recognized under other comprehensive income in connection with the sale of the Polish core banking operations generated a negative effect of € 64 million, and impairment losses of € 19 million were recognized in relation to investments in associates.

Levies and special governmental measures

Levies and expenses from special governmental measures declined € 4 million compared to the third quarter to € 13 million, with the sale of the Polish core banking operations resulting in a € 4 million reduction in bank levies.

Impairment losses on financial assets

In the fourth quarter of 2018, impairment losses on financial assets amounted to € 222 million, compared with € 28 million in the previous quarter. The sharp rise in impairment losses derived mainly from provisions of € 105 million due to fine-tuning of the IFRS 9 models, and provisions of € 54 million for expected credit risks not fully captured by the model due to specific events (primarily potential sanctions relating to Russia).

The largest changes in this respect were in the Eastern Europe segment, with an increase of € 58 million. In Russia alone, impairment losses were € 52 million higher. The increase in Central Europe amounted to € 54 million, of which € 20 million derived from Slovakia, and € 16 million from both the Czech Republic and Poland. In Southeastern Europe, the quarter-on-quarter increase amounted to € 49 million, of which € 25 million was attributable to Romania, € 11 million to Croatia, and € 6 million to Bulgaria. The Group Corporates & Markets segment posted an increase of € 27 million.

Income taxes

Income taxes decreased € 71 million to € 40 million, mainly due to the level of profit. However, the effective tax rate increased 4 percentage points to 24 per cent.

Consolidated profit/loss

Consolidated profit reduced markedly by € 319 million to € 97 million. This mainly reflected a € 194 million increase in impairment losses on financial assets and a € 124 million reduction in the operating result, driven primarily by the sale of the Polish core banking operations and seasonal effects relating to general administrative expenses.

Statement of financial position

In 2018, RBI's total assets rose by 4 per cent, or € 4,969 million, to € 140,115 million, despite the sale of the Polish core banking operations (€ 9,506 million). Currency movements resulted in a € 661 million reduction; notably the depreciation of the Russian ruble against the euro by 13 per cent, of the Belarusian ruble by 5 per cent, and of the Hungarian forint and the Polish zloty each by 3 per cent, partly offset by the appreciation of the Ukrainian hryvnia by 6 per cent and of the US dollar by 5 per cent.

Assets

in € million	31/12/2018	31/12/2017	Change	
Loans to banks	9,998	10,741	(743)	(6.9)%
Loans to customers	80,866	77,745	3,121	4.0%
Securities	19,778	21,967	(2,189)	(10.0)%
Cash and other assets	29,473	24,694	4,780	19.4%
Total	**140,115**	**135,146**	**4,969**	**3.7%**

The 7 per cent, or € 743 million, decline in loans to banks to € 9,998 million, mainly resulted from a decrease in loans to the Czech and Hungarian central banks.

Despite the sale of the Polish core banking operations, loans to customers rose 4 per cent, or € 3,121 million, to € 80,866 million. Without the sale, they would have increased by 10 per cent, or € 7,754 million. A significant rise was recorded at head office (up € 3,596 million), due to short-term (utilization of loan commitments) and long-term loans. In addition, loans to households (mortgage loans) and non-financial corporations (investment financing) in particular increased; in the Czech Republic (up € 991 million or 10 per cent), in Romania (up € 898 million, or 19 per cent, in all product groups mainly to non-financial corporations and to a lesser extent households), in Slovakia (up € 717 million, or 8 per cent, mainly mortgage loans to households) and in Russia (up € 568 million, or 7 per cent, despite the strong currency devaluation, mainly to non-financial corporations and households). In Central, Southeastern and Eastern Europe, loans to households increased by € 2,371 million and loans to non-financial corporations by € 1,921 million.

The decline in securities was largely due to the sale of the Polish core banking operations (down € 3,311 million). This contrasted with a € 990 million increase in Russian government bonds.

Since the beginning of the year, cash balances increased € 5,652 million to € 22,557 million, primarily at head office as a result of deposits at the Austrian National Bank. Other assets fell € 872 million to € 6,916 million, mainly due to the decline in tangible fixed assets, financial derivatives and tax receivables.

Equity and liabilities

in € million	31/12/2018	31/12/2017	Change	
Deposits from banks	23,980	22,378	1,602	7.2%
Deposits from customers	87,038	84,974	2,064	2.4%
Debt securities issued and other liabilities	16,684	16,553	130	0.8%
Equity	12,413	11,241	1,172	10.4%
Total	**140,115**	**135,146**	**4,969**	**3.7%**

The Group's funding from banks, which mainly relates to short-term funding at head office, increased 7 per cent, or € 1,602 million, to € 23,980 million.

Deposits from customers rose € 2,064 million to € 87,038 million, despite the sale of the Polish core banking operations (€ 8,237 million). Without the sale, they would have increased by 12 per cent or € 10,301 million. The largest increases were posted at head office (up € 5,007 million, or 34 per cent, primarily due to short-term deposits), in Russia (up € 1,680 million, or 18 per cent, primarily due to short-term deposits from non-financial corporations and households), Slovakia (up € 891 million or 9 per cent), the Czech Republic (up € 738 million or 6 per cent), Romania (up € 679 million or 11 per cent), Hungary (up € 621 million or 12 per cent), and Croatia (up € 346 million or 10 per cent).

For information relating to funding, please refer to note (53) Liquidity management, in the risk report section of the consolidated financial statements.

Equity on the statement of financial position

After taking into account the reduction of € 169 million resulting from the application of IFRS 9, equity including capital attributable to non-controlling interests increased € 1,341 million to € 12,413 million. Of this, € 496 million was attributable to capital transactions and € 1,217 million to the total comprehensive income for the financial year, while dividend payments had a negative effect of € 343 million.

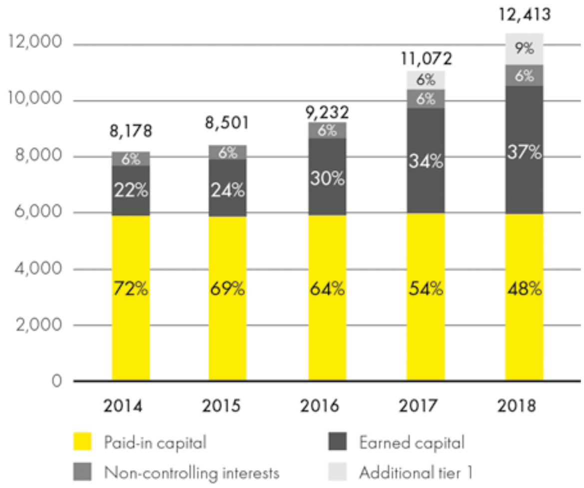
At the start of 2018, RBI placed € 500 million of perpetual additional tier 1 capital (AT1). Taking into account the issuance costs and the discount, this increased capital by € 496 million. According to IAS 32, the AT1 is classified as equity due to the terms and conditions of the issue.

After RBI had not paid dividends to shareholders for the 2014 to 2016 financial years in order to strengthen the capital base, the June 2018 Annual General Meeting approved a dividend of € 0.62 per share for 2017. This resulted in a total payment of € 204 million. A further € 79 million was paid to non-controlling shareholders of Group companies and dividend payments of € 60 million were attributable to the AT1 capital.

Total comprehensive income of € 1,217 million comprises profit after tax of € 1,398 million and other comprehensive income of minus € 181 million. Other comprehensive income was mainly affected by the Russian ruble exchange rate and the sale of the Polish core banking operations. The depreciation of the Russian ruble resulted in a negative contribution of € 223 million from currency translation within the Group, which was partly offset by net income from the hedging of the net investment in Russia (€ 42 million). The sale of the Polish core banking operations resulted in a recycling of the accumulated currency translation differences of € 64 million from equity to the income statement.

Breakdown of equity

in € million



Total capital pursuant to the CRR/Austrian Banking Act (BWG)

As at 31 December 2018, RBI's common equity tier 1 (CET 1) after deductions amounted to € 9,702 million, representing an increase of € 436 million compared to the end of 2017. The improvement was attributable to the recognition of profit generated in the regulatory capital. CET1 was reduced by the switch to the new IFRS 9 accounting standard on 1 January 2018, FX effects and other deductions. Tier 1 capital after deductions increased by € 1,089 million to € 10,928 million, notably due to the issue of € 500 million of perpetual additional tier 1 capital in January 2018 and to the changes in CET1. In contrast, tier 2 capital declined € 690 million to € 2,363 million due to early repayments and maturing of capital instruments. RBI's total capital amounted to € 13,291 million, representing an increase of € 399 million compared to the end of 2017.

Risk-weighted assets (total RWA) increased € 770 million to € 72,672 million as at 31 December 2018. The increase was primarily due to new business and to business developments in Group Corporates & Markets, Russia, Romania, the Czech Republic (due inter alia to the termination of a securitization transaction) and Slovakia. This was offset by the sale of the Polish core banking operations which reduced RWA by € 4,941 million.

The CET 1 ratio (fully loaded) improved 0.6 percentage points to 13.4 per cent, with the sale of the Polish core banking operations accounting for 0.9 percentage points. The tier 1 ratio (fully loaded) improved by 1.3 percentage points to 14.9 per cent, and the total capital ratio (fully loaded) by 0.3 percentage points to 18.2 per cent.

Research and development

As a universal bank, RBI's activities also include research and development.

Product development

In financial engineering, customized solutions in connection with investments, financing and hedging are developed for customers. Financial engineering encompasses not only structured investment products, but also structured financing in particular, i.e. financing concepts that go beyond the use of standard instruments and are employed in areas such as acquisition or project financing. RBI also develops individual solutions for its customers to hedge a broad spectrum of risks, from interest rate risk and currency risk through to commodity price risk. Besides financial engineering, RBI is also actively working on the further development of integrated product solutions for international clearing, settlement and payment services in the area of cash management.

Digitalization

RBI is continuously focused on the prospects and opportunities that the ongoing process of digitalization in the financial sector offers the Group. In view of the significance of this trend, RBI merged the former Group Strategy and Group Digital Banking & Innovation divisions in 2018. The new Group Strategy & Innovation area reports to the CEO and combines the Strategy department with the Fintech Partnerships and Innovation Management departments and the Group Transformation department. These changes were made not only to develop and implement innovations and partnerships, but also to shift the focus onto the strategic aspect of RBI's digital transformation. As part of its innovation strategy, the bank also established its own Innovation Board in April 2018 to coordinate and manage all of the Group's innovation activities.

RBI successfully concluded the first round of Elevator Lab, the fintech partnership program, at the start of 2018. Five selected fintechs presented the results of their pilot projects which they had developed over the previous four months. In May 2018, a cooperation agreement was also entered into with one of the participants, kompany, an Austrian enterprise. Working jointly with kompany, RBI has now developed and implemented an innovative know-your-customer (KYC) solution which is optimally aligned to RBI's regulatory needs. RBI continues to hold in-depth talks with two other participating companies and is in the process of developing joint projects.

In May 2018, RBI launched Elevator Ventures, its new corporate venture capital company. With investment capital of € 25 million, the company focuses on strategic direct investments in selected fintechs, co-investments and investments in other venture capital funds. Elevator Ventures thus represents a logical extension of Elevator Lab, as participants can now be offered the prospect of follow-up investments. Growth capital is therefore also available for young enterprises. Investment targets are fintechs that have gained some market experience and need capital to scale up their business models. Furthermore, RBI's expertise and extensive network in CEE is of particular interest to international fintechs.

The second round of Elevator Lab started in October 2018. From more than 400 applications – a 20 per cent increase from 2017 – eight fintechs were selected to work on pilot projects jointly with RBI. For the first time, eight RBI network banks took part in the selection of the fintechs in regional Elevator Lab Challenges.

In 2018, RBI not only expanded its collaboration with fintechs, but also increased the focus on strengthening the innovative capabilities of its own employees. In June 2018, for example, RBI launched a group-wide intrapreneurship program. More than 3,600 employees registered for the program and 765 ideas were submitted. From August to December, eight interdisciplinary teams worked on developing pilot projects. The employees also developed their knowledge of modern working practices and technologies during the process.

In 2018, RBI also worked extensively on blockchain technology. The focus was on specific applications in trade finance, capital markets business and in clearing, settlement and payment services. Moreover, the first feasibility studies for the necessary identification processes were successfully concluded. To further develop blockchain solutions, RBI entered into a cooperation agreement with the Institute for Cryptoeconomics at the Vienna University of Economics and Business. It has been a member of the international blockchain consortium R3 since the end of 2017.

The work that began in the previous year on advanced analytics – the advanced analysis and evaluation of data that can be used to better understand and also manage business processes – was continued in the reporting period. A concept developed in the prior year has now been made operational.

In 2018, RBI became the first bank in Austria to offer video identification (video ID) to its corporate customers. This allows customers to carry out the statutory identification by video in just a few minutes, eliminating the need for a time-consuming appointment with a bank employee or notary. RBI has set up the Identification & Verification Competence Center in Vienna to implement this service.

The network banks in CEE also regularly initiate innovative projects. RBI's subsidiary bank in Russia, for example, is a pioneer in the implementation of blockchain technology. In September 2018, in cooperation with the Russian central bank and leading state institutions and banks, it initiated the first mortgage certificate transaction on the state masterchain platform.

In 2018, Tatra banka was the first bank in Slovakia to introduce facial recognition in mobile banking to add to its list of biometric innovations. With its extensive offering of digital and mobile banking products, Tatra banka is one of the leading banks in CEE and regularly brings innovative solutions into the Group. In September 2018, Tatra banka, in collaboration with the HubHub coworking center in Bratislava, opened its own Elevator Lab. The aim is to offer a platform for startups from various sectors to enable them to develop and scale their business ideas jointly with the bank's experts and IT and data specialists.

The experience gained in head office and the network banks from the various digitalization projects is regularly evaluated and enhanced. The stated goal of RBI's digitalization strategy is to refine these insights and implement them at other Group network banks.

Internal control and risk management system in relation to the Group accounting process

Balanced and comprehensive financial reporting is a priority for RBI and its governing bodies. Compliance with all relevant statutory requirements is of course a basic prerequisite. The Management Board is responsible for establishing and defining a suitable internal control and risk management system that encompasses the entire accounting process while adhering to company requirements. This is embedded in the company-wide framework for the internal control system (ICS).

The ICS is intended to provide the Management Board with the information needed to ensure effective and continuously improving internal controls for accounting. The control system is designed to comply with all relevant guidelines and regulations and to optimize the conditions for specific control measures.

The consolidated financial statements are prepared in accordance with the relevant Austrian laws, predominantly the Austrian Banking Act (BWG) and Austrian Commercial Code (UGB), which govern the preparation of consolidated annual financial statements. The accounting standards, used to prepare the consolidated financial statements, are the International Financial Reporting Standards (IFRS) as adopted by the EU.

Control environment

An internal control system has been in place for many years at the Group, which includes directives and instructions on key strategic issues. It incorporates:

- The hierarchical decision-making process for approving Group and company directives, as well as departmental and divisional instructions.
- Process descriptions for the preparation, quality control, approval, publication, implementation, and monitoring of directives and instructions.
- Regulations for the revision and repeal of directives and instructions.

The senior management of each Group unit is responsible for implementing the Group-wide instructions. Compliance with Group rules is monitored by Group Accounting & Reporting and in the course of the audits performed by internal Group and local auditors.

The consolidated financial statements are prepared by Group Accounting & Reporting, which reports to the Chief Financial Officer. The associated responsibilities are defined for the Group within the framework of a dedicated Group function.

Risk assessment

Significant risks relating to the Group accounting process are evaluated and monitored by the Management Board. Complex accounting standards can increase the risk of errors, as can the use of differing valuation standards, particularly in relation to the Group's principal financial instruments. A difficult business environment can also increase the risk of significant financial reporting errors. For the purpose of preparing the consolidated financial statements, estimates have to be made for asset and liability items for which no market value can be reliably determined. This is particularly relevant for credit business, equity participations and goodwill. Social capital and the valuation of securities are also based on estimates.

Control measures

The preparation of financial information on an individual Group unit level is decentralized and carried out by each Group unit in accordance with the RBI guidelines, with the calculation of parts of the impairment charges under IFRS 9 carried out centrally. The Group unit employees and managers responsible for accounting are required to provide a full presentation and accurate valuation of all transactions. Differences in local accounting standards can result in inconsistencies between local individual financial statements and the financial information submitted to RBI. The local management is responsible for ensuring implementation of mandatory internal control measures, such as the separation of functions and the principle of dual control. The reconciliation and validation controls are imbedded in the aggregation, calculation and accounting valuation activities for all financial reporting processes. Particular focus is placed on the controls for the core processes that play a fundamental role in the preparation of the financial statements. This primarily relates to processes which are relevant for valuations, the results of which have a significant impact on the financial statements (such as credit risk provisions, derivatives, equity participations, provisions for personnel expenses and market risk).

Group consolidation

The financial statement data, which are examined by an external auditor or undergo an audit review, are mostly automatically transferred to the IBM Cognos Controller consolidation system by the end of January of the subsequent year. The IT system is kept secure by limiting access rights.

The plausibility of each Group unit's financial statements is initially checked by the responsible key account manager within Group Accounting & Reporting. Group-level control activities comprise the analysis and, where necessary, modification of the financial statements submitted by Group units. In this process, the results of meetings with representatives of the individual companies, in which the financial statements are discussed, and comments from the audit of the financial statements are taken into account. The discussions cover the plausibility of the individual financial statements as well as critical matters pertaining to the Group unit.

The subsequent consolidation steps are then performed using the consolidation system, including capital consolidation, expense and income consolidation, and debt consolidation. Finally, intra-Group gains are eliminated where applicable. At the end of the consolidation process, the notes to the financial statements are prepared in accordance with IFRS and the BWG/UGB.

In addition to the Management Board, the general control system also encompasses middle management. All control measures constitute part of the day-to-day business processes and are used to prevent, detect and correct any potential errors or inconsistencies in the financial reporting. Control measures range from managerial reviews of the results for the period, as well as the specific reconciliation of accounts, through to analyzing ongoing accounting processes.

The consolidated financial statements and management report are reviewed by the Audit Committee of the Supervisory Board and are also presented to the full Supervisory Board for information. The consolidated financial statements are published as part of the Annual Report on the company's website and in the Wiener Zeitung's official journal and are then filed in the commercial register.

Information and communication

The consolidated financial statements are prepared using Group-wide standardized forms. The accounting and valuation standards are defined and explained in the RBI Group Accounts Manual and must be applied when preparing the financial statements. Detailed instructions for the Group units on measuring credit risk and similar issues are provided in the Group directives. The relevant units are kept abreast of any changes to the instructions and standards through regular training courses.

Each year the Annual Report shows the consolidated results in the form of a complete set of consolidated financial statements. These consolidated financial statements are examined by an external auditor. In addition, the Group management report contains comments on the consolidated results in accordance with the statutory requirements.

Throughout the year, consolidated monthly reports are produced for the Group's senior management. The statutory interim reports conform to the provisions of IAS 34 and are published quarterly in accordance with the Austrian Stock Exchange Act. Before publication, the consolidated financial statements are presented to senior managers and the Chief Financial Officer for final approval and then submitted to the Supervisory Board's Audit Committee. Analyses pertaining to the consolidated financial statements are also provided for management, as are forecast Group figures at regular intervals. The financial and capital planning process, undertaken by Group Planning & Finance, includes a three-year Group budget.

Monitoring

Financial reporting is a main focus of the ICS framework, whereby financial reporting processes are subject to monitoring and control reviews, the results of which are regularly reported to the Management Board and the Supervisory Board for evaluation. Additionally, the Audit Committee is required to monitor the financial reporting process. The Management Board is responsible for ongoing company-wide monitoring. The internal control system is based on three lines of defense:

The first line of defense is formed by individual departments, where department heads are responsible for monitoring their business areas. The departments conduct control activities and plausibility checks on a regular basis, in accordance with the documented processes.

The second line of defense is provided by specialist areas focused on specific issues. These include, for example, Compliance, Data Quality Governance, Operational Risk Controlling, and Security & Business Continuity Management. Their primary aim is to support the individual departments when carrying out control steps, to validate the actual controls and to introduce state-of-the-art practices within the organization.

Internal audits are the third line of defense in the monitoring process. Responsibility for auditing lies with Group Internal Audit and also the respective internal audit departments of the Group units. All internal auditing activities are subject to the Group Audit Standards, which are based on the Austrian Financial Market Authority's minimum internal auditing requirements and international best practices. Group Internal Audit's internal rules also apply (notably the Audit Charter). Group Audit regularly and independently verifies compliance with the internal rules within the RBI Group units. The head of Group Internal Audit reports directly to the Management Boards, with additional reporting obligations to the Chairman of the Supervisory Board and members of the Audit Committee of the Supervisory Board.

Capital, share, voting, and control rights

The following disclosures satisfy the provisions of § 243a (1) of the Austrian Commercial Code (UGB):

(1) As at 31 December 2018, the company's share capital amounted to € 1,003,265,844.05 and was divided into 328,939,621 voting common bearer shares. As at 31 December 2018, 322,204 of those were own shares, and consequently 328,617,417 shares were outstanding at the reporting date. In comparison with 31 December 2017 (394,942 shares), this was a reduction of 72,738 own shares and was due to the transferring of shares within the framework of the share-based remuneration program. Please see note (30) for further disclosures.

(2) The Articles of Association contain no restrictions concerning voting rights or the transfer of shares. The principle of one share one vote applies and there is only one class of shares. Shares with multiple voting rights are not permissible under § 12 (3) of the Austrian Stock Corporation Act (AktG). The regional Raiffeisen banks and direct and indirect subsidiaries of the regional Raiffeisen banks are parties to a syndicate contract (syndicate agreement) regarding RBI AG. The terms of this syndicate agreement include not only a block voting agreement and preemption rights, but also a prohibition on sales of the RBI shares held by the regional Raiffeisen banks (with few exceptions) for a period of three years (lock-up period) from the effective date of the merger between RZB AG and RBI AG, i.e. from 18 March 2017, if the sale would reduce the regional Raiffeisen banks' aggregate shareholding in RBI AG (direct and/or indirect) to less than 50 per cent of the share capital plus one share. After the lock-up period expires, the shareholding threshold falls to 40 per cent of the share capital of RBI AG.

(3) RLB NÖ-Wien Sektorbeteiligungs GmbH holds around 22.24 per cent of the share capital of the company according to the most recent notification of voting rights published on 7 September 2018. By virtue of the syndicate agreement regarding RBI AG, the directly or indirectly held voting rights attached to a total of 193,449,778 shares, corresponding to a voting interest of around 58.81 per cent, are mutually attributable to the regional Raiffeisen banks and their direct and indirect subsidiaries pursuant to §§ 130 and 133 7 of the Austrian Stock Exchange Act (BörseG) as parties acting in concert as defined in § 1 6 of the Austrian Takeover Act (ÜbG) (see the notification of voting rights published on 7 September 2018). The remaining shares of RBI AG are held in free float, with no other direct or indirect shareholdings amounting to 10 per cent or more known to the Management Board.

(4) The Articles of Association do not contain any special rights of control associated with holding shares. According to the syndicate agreement for RBI AG, the regional Raiffeisen banks can nominate nine members of the RBI AG Supervisory Board. In addition to the members nominated by the regional Raiffeisen banks, the RBI AG Supervisory Board should also include three independent representatives of free-float shareholders who are not attributable to the Austrian Raiffeisen Banking Group.

(5) There is no control of voting rights arising from interests held by employees in the share capital.

(6) Pursuant to the Articles of Association, a person who is 68 years or older may not be appointed as a member of the Management Board or be reappointed for another term in office. The rule for the Supervisory Board is that a person who is aged 75 years or older may not be elected as a member of the Supervisory Board or be re-elected for another term in office. Moreover, no person who already holds eight supervisory board mandates in publicly traded companies may be a member of the Supervisory Board. Holding a position as chairman of the supervisory board of a publicly traded company would count twice for this purpose. The Annual General Meeting may choose to waive this restriction through a simple majority of votes if permitted by law. Any candidate who has more mandates for, or chairman positions on, supervisory boards in publicly traded companies must disclose this to the Annual General Meeting. There are no further regulations regarding the appointment or dismissal of members of the Management Board and the Supervisory Board beyond the provisions of the relevant laws. The Articles of Association stipulate that the resolutions of the Annual General Meeting are, provided that there are no mandatory statutory provisions to the contrary, adopted by a simple majority of the votes cast. Where the law requires a capital majority in addition to the voting majority, resolutions are adopted by a simple majority of the share capital represented in the votes. As a result of this provision, members of the Supervisory Board may be dismissed prematurely by a simple majority. The Supervisory Board is authorized to adopt amendments to the Articles of Association that only affect the respective wording. This right may be delegated to committees. Furthermore, there are no regulations regarding amendments to the company Articles of Association beyond the provisions of the relevant laws.

(7) Pursuant to § 169 of the Austrian Stock Corporation Act (AktG), the Management Board has been authorized since the Annual General Meeting of 4 June 2014 to increase the share capital with the approval of the Supervisory Board – in one or more tranches – by up to € 446,793,032.95 through issuing up to 146,489,519 new voting common bearer shares in exchange for contributions in cash and/or in kind (including by way of the right of indirect subscription by a bank pursuant to § 153 (6) of the AktG) by 25 August 2019 at the latest and to fix the offering price and terms of the issue with the approval of the Supervisory

Board. The Management Board is further authorized to exclude shareholders' subscription rights with the approval of the Supervisory Board (i) if the capital increase is carried out in exchange for contributions in kind, or (ii) if the capital increase is carried out in exchange for contributions in cash and the shares issued under the exclusion of subscription rights do not exceed 10 per cent of the company's share capital (exclusion of subscription rights).

The Annual General Meeting held on 21 June 2018 authorized the Management Board pursuant to § 65 (1) 8, § 65 (1a) and § 65 (1b) of the AktG to purchase own shares and to retire them if appropriate without requiring any further prior resolutions to be passed by the Annual General Meeting. Own shares, whether already purchased or to be purchased, may not collectively exceed 10 per cent of the company's share capital. The authorization to purchase own shares expires 30 months after the date of the Annual General Meeting resolution, i.e. until 20 December 2020. The acquisition price for repurchasing the shares may be no lower than € 1 per share and no higher than 10 per cent above the average unweighted closing price over the 10 trading days prior to exercising this authorization. The authorization may be exercised in full or in part or also in several partial amounts, for one or more purposes – with the exception of securities trading – by the company, by a subsidiary (§ 189a 7 of the UGB) or by third parties for the account of the company or a subsidiary.

The Management Board was further authorized, pursuant to § 65 (1b) of the AktG, to decide, with the approval of the Supervisory Board, on the sale of own shares by means other than the stock exchange or a public tender, to the full or partial exclusion of shareholders' subscription rights, and to stipulate the terms of sale. Shareholders' subscription rights may only be excluded if the own shares are used to pay for a contribution in kind, to acquire enterprises, businesses, operations or stakes in one or several companies in Austria or abroad. This authorization may be exercised in whole, in part or in several partial amounts for one or more purposes by the company, a subsidiary (§ 189a 7 UGB) or by third parties for the account of the company or a subsidiary and remains in force for five years from the date of this resolution, i.e. until 20 June 2023.

This authorization replaces the authorization approved by the 16 June 2016 Annual General Meeting to purchase and retire own shares pursuant to § 65 (1) 8 of the AktG. No own shares have subsequently been purchased either on the basis of the now expired June 2016 authorization or the authorization from June 2018 which is now in effect.

The Annual General Meeting of 21 June 2018 also authorized the Management Board, under the provisions of § 65 (1) 7 of the AktG, to purchase own shares for the purpose of securities trading, which may also be conducted off-market, during a period of 30 months from the date of the resolution (i.e. until 20 December 2020), provided that the trading portfolio of shares purchased for this purpose does not at the end of any given day exceed 5 per cent of the company's respective share capital. The consideration for each share to be acquired must not be less than half the closing price at the Vienna Stock Exchange on the last day of trading preceding the acquisition and must not exceed twice the closing price at the Vienna Stock Exchange on the last day of trading preceding the acquisition. This authorization may be exercised in full or in part or also in several partial amounts by the company, by a subsidiary (§ 189a 7 UGB) or by third parties acting for the account of the company or a subsidiary.

(8) The following material agreements exist, to which the company is a party and which take effect, change or come to an end upon a change of control in the company as a result of a takeover bid:

- RBI is insured under a Group-wide D&O policy. Insurance cover would remain in place following a merger with another legal entity belonging to the RBI Group. In the event of a merger with a legal entity outside the RBI Group, the insurance policy would automatically cease at the end of the insurance period in which the merger took effect. In such cases, insurance cover only exists for claims for damages arising from breaches of obligations that occurred before the merger, which are reported to the insurer prior to any termination of RBI's Group-wide D&O insurance cover, and thereafter, within the agreed notification period of five years.
- RBI AG is a member of the Professional Association of Raiffeisen Banks. Upon a change in control of RBI AG which results in the attainment of control by shareholders outside of the Raiffeisen Banking Group Austria, membership of the Professional Association of Raiffeisen Banks and of the Raiffeisen Customer Guarantee Scheme Austria may be terminated. RBI AG continues to serve as the central institution of the Raiffeisen Banking Group at a national level. Upon a change in control of RBI AG, related contracts (membership of the liquidity group pursuant to § 27a of the BWG; membership of the federal IPS pursuant to Art. 113 (7) of the CRR) may end or change.
- The company's refinancing agreements and agreements concerning third-party financing for subsidiaries, which are guaranteed by the company, stipulate that the lenders can demand early repayment of the financing in the event of a change in control.

(9) There are no indemnification agreements between the company and its Management Board and Supervisory Board members or employees that would take effect in the event of a public takeover bid.

Risk management

For information on risk management, please refer to the risk report in the consolidated financial statements.

Corporate Governance

The Corporate Governance Report can be found on the RBI website (www.rbinternational.com → Investors → Corporate Governance), as well as in the Corporate Governance Report chapter of the Annual Report.

Consolidated non-financial report

Pursuant to the Sustainability and Diversity Improvement Act (NaDiVeG), the consolidated non-financial statement, which has to be prepared in accordance with § 267a of the Austrian Commercial Code (UGB), is issued as an independent non-financial report (Sustainability Report). The report containing detailed information on sustainability management developments, will be published online – at www.rbinternational.com → About us → Sustainability Management – and also contains the disclosure for the parent company in accordance with § 243b of the UGB.

Outlook

Economic outlook

Central Europe

Economic conditions in Central Europe (CE) should remain favorable overall in 2019, despite global headwinds and that GDP growth is expected to slow somewhat: A growth rate of 3.4 per cent is anticipated for 2019 – down from 4.5 per cent in 2018. Thanks to a continuing decline in unemployment and solid real wage increases, private consumption should remain a stable pillar of economic growth. Despite the prospect of lower GDP growth rates, investment is also likely to be a key source of support for the economy in 2019. At country level, Slovakia and Poland are expected to post the strongest increases (at 4.0 per cent and 3.6 per cent, respectively).

Southeastern Europe

In Southeastern Europe (SEE), economic growth is expected to again slow to a low level. As in 2018, this is being driven by economic developments in Romania, where the GDP makes up the largest contribution to the region. GDP growth of 2.5 per cent is expected in Romania (following 4.1 per cent in 2018). In the remaining SEE countries, economic activity is expected to remain relatively stable or slightly decline; with a slowdown to 2.8 per cent from 3.7 per cent in 2018. Economic activity is expected to be driven primarily by domestic demand. An increase in wages should have a positive impact on spending on the part of private households. Similarly, investment activity is expected to remain at high levels, albeit heavily dependent on progress made in the utilization of EU funds and implementation of major infrastructure projects. All in all, the expected economic slowdown in the EU is also likely to curb the region's economic growth in 2019 and 2020.

Eastern Europe

Following a somewhat stronger 2018, the Russian economy is expected to grow at a low rate of 1.5 per cent in 2019, and therefore continue on its moderate growth trajectory. Oil prices should support the economy, while no significant impetus is expected from the continued comparatively restrictive monetary and fiscal policy. Risks of sanctions continue to persist, which could negatively affect the currency and economic development. In Ukraine, parliamentary and presidential elections are scheduled for 2019, but the renewed cooperation with the International Monetary Fund should have a stabilizing effect. Economic growth in Ukraine should reach a moderate 2.7 per cent in 2019.

Austria

Even though the economic peak in Austria has already passed, economic momentum should continue to remain over the average euro area rate, despite slowing down and increased external risks. Following 2.7 per cent in 2018, GDP growth is expected to expand at the low rate of from to 1.3 per cent in 2019. Domestic demand is anticipated to be the main driver while foreign trade should increasingly feel the effects of global headwinds. Thanks to the continuation of good labor market conditions, private consumption also looks set to achieve solid growth rates in 2019. Although investment activity should weaken, it is expected to also support economic growth in 2019.

Banking sector in Austria

The positive trend in new business in the Austrian banking market should continue in 2019. Depending on the market segment, credit growth rates are expected to range between 3 per cent and 5 per cent. A pick-up in the corporate customer business, despite the economic slowdown, continued to support positive momentum in the sector. Moreover, the continuing positive wage trends should support the granting of loans. Nonetheless, a moderate downturn in the granting of mortgage loans is expected following stricter communication by the regulator. All in all, the return on equity of Austrian banks should be in the high single-digit percentage range in 2019, with stable or only slightly increasing risk costs.

CEE banking sector

For the CEE banking markets, credit growth rates are expected to range between 5 per cent and 9 per cent over the next 12-18 months. Accordingly, solid economic growth in the CE and SEE regions should have an overall positive impact on CEE banks' earnings in 2019, despite moderately weaker momentum. Given new unemployment rate lows in CE and SEE, growth in wages should also be in the high single-digit percentage range in 2019, while some regional central banks in CE and SEE are expected to cautiously normalize monetary policy. It is anticipated that tightened macroprudential regulations will curb mortgage and consumer loan growth, notably in the Czech Republic, Slovakia and Romania, but conversely also maintain the sustainable return potential of these markets. Thanks to the adjustments carried out in recent years – e.g. reducing foreign currency loans and NPL portfolios – there should be no significant negative impact on returns from this side. Likewise, given the still positive overall economic growth and currently stable corporate insolvency situation, a significant increase in risk costs is not anticipated. Also, in Russia, Ukraine and Belarus, the general conditions for the banking sector should develop favorably in 2019 in view of high local interest rate levels and solid macroeconomic parameters. All in all, the return on equity of the CEE banking sector in 2019 should almost reach its 2018 level, even though there is the possibility of a slight rise in risk costs in some regions (starting from low levels). In Romania, a newly introduced bank tax is expected to have a negative impact on new loan business and the profitability of the Romanian banking sector.

Outlook for RBI AG

We will pursue loan growth with an average yearly percentage increase in the mid-single digit area.

The provisioning ratio for FY 2019 is expected to be around 45 basis points.

We anticipate that the NPL ratio will further reduce.

We aim to achieve a cost/income ratio of around 55 per cent in 2021.

In the coming years we target a consolidated return on equity of approximately 11 per cent.

We seek to maintain a CET1 ratio of around 13 per cent in the medium term

Based on this target, we intend to distribute between 20 and 50 per cent of the consolidated profit.

Events after the reporting date

Romanian bank tax

At the end of 2018, the Romanian Government decided to introduce a new bank tax. As there is discussion surrounding the potential negative impact on the Romanian economy, there is still a need for consultation at government level. It therefore cannot be ruled out, that the draft which was presented at the end of 2018, could still be revised and mitigate the burden on the banking sector. The impact on RBI cannot be quantified at this point in time.