ANNUAL REPORT
VTB BANK (EUROPE) SE

2017

CONTENT

FOREWORD BY THE MANAGEMENT BOARD

Arthur Iliyav,
Chairman of the Board

Alexander Frey,
Member of the Board

Oleg Osipenko,
Member of the Board

Oxana Kozliouk,
Member of the Board

EUROPE HAS CHOSEN

2017 was a year of many changes and political realignments: in Western Europe alone, parliamentary elections took place in the Netherlands, England, Austria, France and Germany, in addition to a disputed referendum in Catalonia that has not been officially recognised, in which 90% of those who took part voted for independence from Spain. But the first to make a change was America: Donald Trump became the 45th US President on 20 January and lost no time in implementing his first election promises, aiming to „make America great again“. As soon as he took office, he issued travel bans against citizens of predominantly Muslim countries, pulled out of the climate change agreement and threatened to take a harder and, if necessary, military international approach in order to implement what are primarily the financial interests of his „America First“ ideology, while in Washington a special investigator was appointed to look into the possible influence of Russia on the outcome of the US presidential election.

In Germany, Frank-Walter Steinmeier was elected as Federal president, while former SPD presidential candidate Martin Schulz as a chancellor candidate suffered the worst SPD election result in history in the Bundestag election in September 2017. Chancellor Angela Merkel was in a considerably weakened position when seeking a governmental majority, as the SPD announced on election night that it would no longer be available to form a government with her.

In England, Theresa May lost her absolute majority in the parliamentary elections in June. She had entered the election campaign with the aim of gaining a mandate for a „hard Brexit“ from voters, but the election results denied her this option.

Emmanuel Macron set „La République en Marche“ in France, winning the election with an absolute majority with his party only having been founded the year before; at 39, he became the youngest President in French history. The election result is a clear expression of the desire of French voters for a change in generation, personnel and politics in terms of their elected representatives. After decades dominated politically by coalitions of the Left or Right, France is now governed by a centrist majority for the first time.

Parliamentary elections in Austria were won by the ÖVP, who had campaigned on the basis of conservative issues, particularly the restriction of immigration. At 31, Sebastian Kurz became the youngest Chancellor ever elected in political history.

VTB IN EUROPE

A new course was also set for the future of VTB banks in continental Europe in 2017. At the beginning of the year, Group management gave the Management Board the task of fundamentally reconfiguring the three VTB units VTB Bank (Austria) AG, VTB Bank (France) SA and VTB Bank (Deutschland) AG. Instead of continuing to serve the central European market from Vienna, Paris and Frankfurt via three independent full-service banks, increasing cost effectiveness requirements set by the shareholder on one hand and rising regulatory requirements on the other hand made it urgently necessary to streamline the business model: the aim was to create a bank on the basis of a single full banking licence and modern IT infrastructure that could service the same market using European passporting options and represent the same business model, while also saving up to 50% on running costs. During an internal selection process, Frankfurt was chosen as the basis of the „new European hub“ for VTB, not least because of its winning combination of a central location with excellent transport connections, access to an international „talent pool“ and the recently modernised VTB core banking application; the location was redeveloped thoroughly and extended during 2017. As part of the project known internally as „Opera“, all preparations required to reach this target before the end of 2017 were made under five different work strands „Legal Reorganisation“, „Business Model“, „Operating Model“, „Corporate Governance“, „HR/Communication“ and „France“.

VTB BANK (EUROPE) SE

In effect, a cross-border „down-stream" merger brought VTB Bank (Austria) AG as the former parent institution together with VTB Bank (Deutschland) AG on 29 December 2017, with this merged company being established under the name „VTB Bank (Europe) SE"; VTB Bank (France) SA was also merged with VTB Bank (Europe) SE on the same day.

We chose the legal form of a „Societas Europaea" and the company name „VTB Bank (Europe) SE" in order to take into account the central driving thought behind the merger – that of a unified European institution.

VTB in France was prominently represented by its own workstream in project management, as a physical VTB presence in France was abandoned entirely and the French market will now be managed from Germany, while in Vienna VTB Bank (Deutschland) AG had already set up a branch before the merger, to which the business of VTB Bank (Austria) AG was transferred with effect as of 30 June 2017. This means that active business in Vienna, which has historically had a strong focus on the CEE region, could continue uninterrupted. Also after the merger, Vienna is still considered to be our „Center of Competence" for real-estate transactions and our ECA business. All administrative activities that are not part of the core area of entering into business risks were transferred to Frankfurt. As a former German branch of VTB Bank (Austria) AG, VTB Direktbank is now a branch of VTB Bank (Europe) SE.

The complete closure of the Paris location and major redundancies at the Vienna location means that the target number of staff at the new VTB Bank (Europe) SE will be approximately halved in comparison to the former European sub-holdings, while staff levels in Frankfurt increased by 70%. This increase is based, as expected, on risk and back-office functions that are intended to compensate for the centralisation of resultant additional workloads. The Management Board would like in particular to thank those members of staff in Paris and Vienna who have lost their jobs in the VTB Group as the result of our reorganisation, but enabled the successful merger due to their tireless commitment.

Another consequence of the return of two of the previous three banking licences in Europe was that VTB Bank (Europe) SE was classified as a „less significant institution" by the European Union, differing from the VTB Austria sub-holding, meaning that as of 1 February 2018 it is no longer subject to the direct supervision of the European Central Bank, but instead falls under the jurisdiction of the Federal Financial Supervisory Authority and Deutsche Bundesbank.

OUR BUSINESS ACTIVITIES IN 2017

Despite the aforementioned restructuring and continued sanctions in its major target markets, VTB Bank (Europe) SE has continued to chart a successful course and ended the 2017 financial year with satisfactory results – in spite of significant costs associated with the restructuring. Compared to the original plans for European business (VTBA-ESH target figures) that did not take into account the one-off expenses incurred by the „Opera project", VTB Bank (Europe) SE achieved the planned net financial result and return on assets; only the cost-to-income ratio ended up 10% higher as the result of „Opera". The results were driven not least by a risk provisions figure far below the planned figures with a net interest margin much higher than planned. Our focus in 2017 remained on our business with institutional customers from the European Union, the Russian Federation and CIS states in financing trade, export and working capital.

With a look to 2018, drawing on a significantly reinforced team, we plan an increased focus on our core competencies in customer acquisition and the granting of new loans, particularly in Germany and neighbouring countries. Our target for the annual results for 2018 is based on a conservative planning approach, taking account of all the rising regulatory requirements for capital resources, as well as the shareholder's wish to moderately expand business in Europe. The withdrawal of some market participants from Russian business, driven by corporate policy, means that we consider ourselves able to focus more than ever on customers based in Central Europe.

The Management Board of VTB Bank (Europe) SE would like to take this opportunity to thank its partners, customers, its sole shareholder, JSC VTB Bank, Moscow, the Supervisory Board and above all its employees for the sound working relationship and the confidence shown in us.

THE EFFICIENT STRUCTURES OF VTB (EUROPE) SE

VTB Bank (Austria) AG, VTB Bank (Deutschland) AG and the former VTB Bank (France) SA were merged in December 2017 to form the new VTB Bank (Europe) SE. With this complete reorganisation, we have set the course for optimising our infrastructure, internal processes and product and service sectors, thereby boosting efficiency. VTB Bank (Europe) SE now acts under one banking licence. The introduction of a cutting-edge uniform IT infrastructure should also significantly reduce IT costs in the future. The restructuring will deliver cost savings of around EUR 40 million. Further efficiencies should be achieved through the new framework conditions relating to liquidity management and capital resources.

VTB Bank (Europe) SE is part of the VTB Group – an international provider of financial services consisting of over 20 banks and financial companies active in key areas of the financial markets. The international network is unique in the Russian banking sector and enables the Group to maintain international partnerships and support the business activities of the Group's customers worldwide.

NEW HEADQUARTERS IN FRANKFURT/MAIN

For us, conversion into the SE legal form is not just a commitment to Europe in general, but also and in particular a commitment to Frankfurt/Main as a financial centre – the new headquarters of European business. With the relocation of our headquarters to Frankfurt, we are strengthening our commitment in one of our core regions outside Russia as part of our strategy. In Germany, we are concentrating on business with corporate clients and financial institutions, as well as offering convenient, easy and secure online banking to our private clients through VTB Direktbank. The Main metropolis provides an international environment for the bank in the heart of Europe. As an attractive employer, we benefit from excellent transport links thanks to our proximity to the airport, as well as a well-developed labour market and excellent access to expert professionals.

ON COURSE FOR GROWTH IN EUROPE

VTB Bank (Europe) SE is a universal bank that focuses on international customers. As the first Russian banking group and one of the first banks in Europe, we have integrated our organisational structure into a Societas Europaea. By taking this step, we are aiming to further develop the presence of the VTB Group in Europe.

The establishment of the SE has created excellent prerequisites for further growth for the bank in strategically significant regions. At present, we already have a presence in more than 20 countries in Europe, Asia and Africa. Outside of Russia, our core markets are Germany and Austria.

CORPORATE CLIENTS

In the corporate business sector, we concentrate on corporate clients and investment banking business, offering our clients a wide range of products. In the corporate finance, trade and export finance, real estate finance, financing of commercial transactions, cash management, treasury and fixed-income products sectors, our clients profit from the bank's comprehensive knowledge.

We focus on trade flows between east and west. Our home markets are in selected emerging economies as well as in Europe. We develop customised financing solutions and services for our clients featuring a variety of capital and product structures.

Employees with proven expertise ensure that transactions are processed efficiently and successfully. We draw on sound, in-depth industry specific and geographical expertise.

PRIVATE CLIENTS

In the private client sector, our branch VTB Direktbank is our presence on the German market and has successfully established us as a trusted direct bank for deposit products offering attractive conditions.

We currently serve more than 170,000 satisfied customers and have received multiple awards since our market entry in 2011. VTB Direktbank is a cost-efficient online bank that focuses on offering instant-access, fixed-term and savings accounts. This means that all accounts are managed online only and all orders are generally issued via online banking. VTB Direktbank's TÜV-certified online banking operations and mobile TAN process meet the German market's highest security standards.

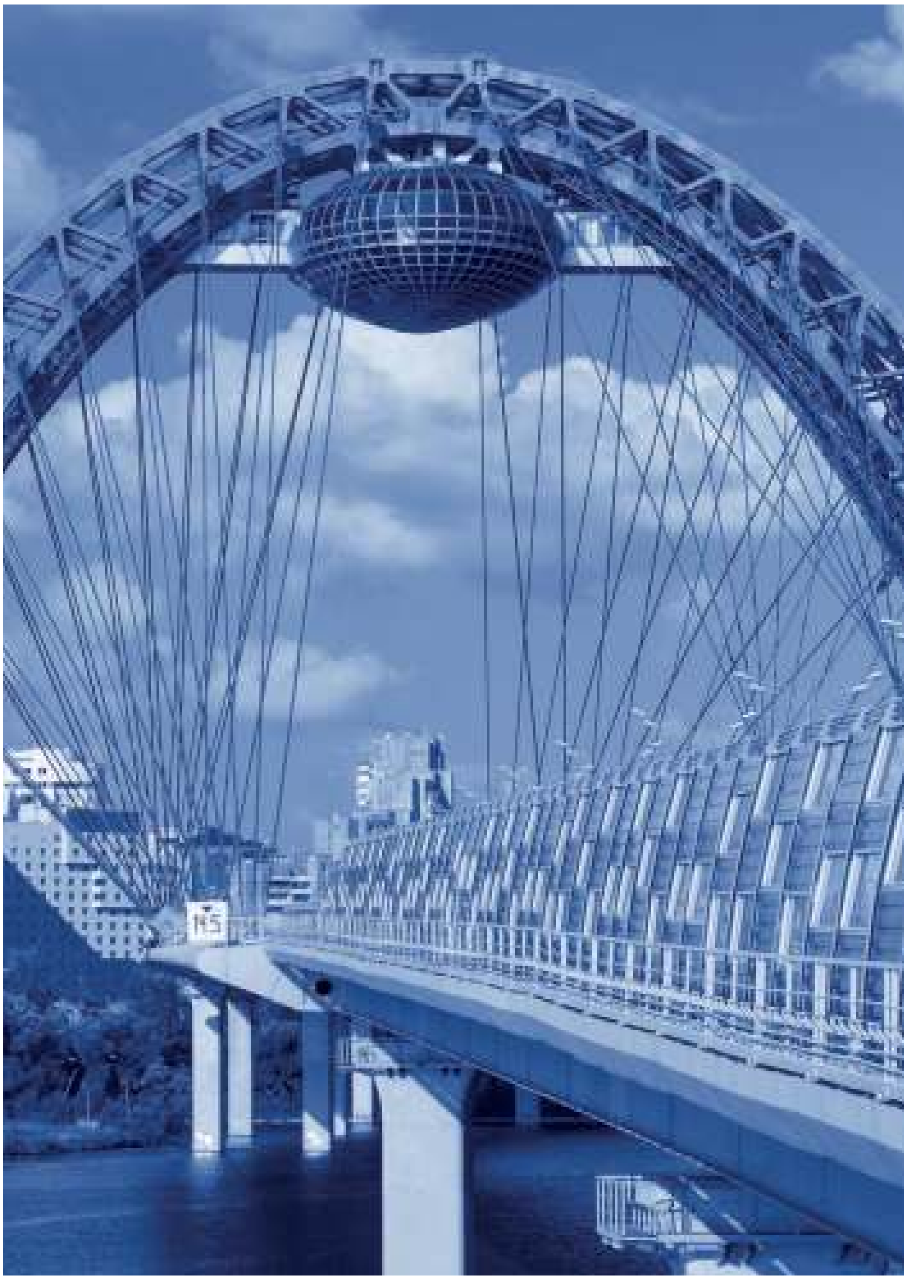
VTB Direktbank's deposits are protected by a statutory compensation scheme and voluntary deposit protection.

FINANCIAL INSTITUTIONS

VTB Bank (Europe) SE also focuses on business with financial institutions. This is characterised by the constant development and optimisation of relationships with financial institutions in order to ensure secure and reliable payment transaction clearing, as well as current account management and the cross-selling of banking products.

As a clearing office, the bank plays a key role for over 200 correspondent banks in the Russian Federation and the Commonwealth of Independent States. We specialise in particular in clearing in EUR for correspondents as well as the processing of cross-border payment orders. All transactions are processed using the SWIFT network or the bank's own electronic banking system.

As a member of SWIFT and the European clearing platform TARGET2, we are fully equipped to meet the growing expectations of companies and financial institutions in this sector.



MANAGEMENT REPORT

BASICS

BUSINESS STRUCTURE

The corporate structure of VTB Bank (Europe) SE – hereinafter referred to as „VTBE" – has changed significantly over the last financial year. A cross-border „down-stream" merger on 29 December 2017 brought together VTB Bank (Austria) AG as the former parent company and VTB Bank (Deutschland) AG with effect as of 01 July 2017, with the resultant company being renamed „VTB Bank (Europe) SE". As the result of the merger with VTB Bank (Austria) AG, which had held 100% of the shares in VTB Bank (Deutschland) AG, PJSC VTB Bank, St. Petersburg, became the direct main shareholder of the merged institution. Following conversion to the legal form of a „Societas Europaea" (SE) and renaming as VTB Bank (Europe), VTB Bank (France) SA also merged with VTBE on 29 December 2017 with effect as of the date of entry in the commercial register.

The former minority shareholder of VTB Bank (France) SA, VO Novoexport, Moscow, therefore became a shareholder in VTBE with a share of 0.61% as the result of the merger with VTB Bank (France) SA, meaning that PJSC VTB Bank's participation was reduced to a total of 99.39%. VTBE is therefore a company dependent on PJSC VTB Bank, St. Petersburg (sec. 17 para. 2 Stock Corporation Act [AktG]). In terms of regulatory and corporate law, VTBE is based on the former VTB Bank (Deutschland) AG and, like this former version, it is a member of the Federal Association of German Banks [Bundesverband Deutscher Banken]. The banking licences of the former VTB Bank (Austria) AG and VTB Bank (France) SA were rendered void by the merger and were revoked. As a result of the revocation of these banking licences, the merged institution was reclassified as a „less significant institution" and subjected to the supervision of the Federal Financial Supervisory Authority (BaFin) and the Bundesbank. In regulatory terms, the merger was closely monitored by the Joint Supervisory Team (JST) of the European Central Bank (ECB) responsible for the VTB Group from the start of 2017, including members of the supervisory authorities from Austria, France and Germany. The bank reported to the JST at regular intervals about the current project planning status and any progress made, in order to clarify any issues requiring a statement to be made in the required ownership control procedures for Bafin and the French ACPR before the corresponding applications were submitted.

In order to ensure continuity in customer and all other legal relationships involving VTB Bank (Deutschland) AG, a branch was set up in Vienna before the merger, which was transferred to the business operations of VTB Bank (Austria) AG with retroactive effect as of 01 July 2017.
The business operations of VTB Bank (France) SA were transferred as part of the universal succession to VTBE and are being continued by the latter, unless individual commitments were transferred to a third party as the result of restructuring activities. Strategic customers from the French market will be managed in future via European passporting from Frankfurt without a local representative. As a former German branch of VTB Bank (Austria) AG, VTB Direktbank is now a branch of VTBE.

BUSINESS MODEL AND CONTROL OF THE BUSINESS

As part of the VTB Group, VTBE provides consultation and other services to its customers specifically in the area of European-Russian trade relations and has been offering all necessary products in this field for over 47 years. With the experience gained from our successful business activities, we handle banking and finance transactions expertly and reliably, particularly in the area of trade finance and payment transactions between our markets in Europe, Russia and selected CIS countries. Although Russia has been faced with sanctions and counter-sanctions, the value of its exports in 2017 to Germany alone amounted to EUR 31.4 billion and the value of German exports to Russia amounted to EUR 25.9 billion, thereby rising for the first time in five years (exports +20.2%, imports +18.7% compared to 2016). We also provide our customers active in these goods and payment flows with access to the entire product range of the VTB Group, Russia's second-largest bank, and regard ourselves as the first choice among banks in our segment. We basically offer our customers all the services that were previously provided by the three banks in the former European sub-holdings. The services that VTBE offers its customers comprise Global Transaction Banking, Finance, Documentary Services and Treasury. Private clients can also continue to hold instant access accounts and time deposits via Direktbank.

The business activities of VTBE are managed by the Management Board on the basis of specific criteria: in addition to regulatory indicators such as overall capital ratios according to the European Capital Requirement Regulation (CRR) or liquidity ratios such as the Liquidity Coverage Ratio (LCR), new business is managed based on balance-sheet indicators such as Return on Equity, Return on Risk Adjusted Capital and Net Profit according to International Financial Reporting Standards (IFRS). As a result of the imbalance between existing EUR funding and lending predominantly in USD, the bank is monitoring the ratio of lending in EUR to USD and is endeavouring to balance this ratio. The bank is also controlling its lending in terms of geographical risk diversification.

Risks with regard to individual business segments, types of business or risk concentration are controlled as before by limiting cash amounts either in absolute terms or relative to other values such as the equity consumption of one portion of the portfolio compared with the entire loan portfolio. In addition, at the individual transaction level, risks are limited by the requirement for collateral or offset by the use of relevant financial products, as far as possible.

Internal reporting thresholds more stringent than regulatory indicators are used to limit risks to ensure that, even in case of unforeseen events, there is a sufficient buffer before the minimum regulatory requirements are reached and appropriate management measures can be initiated.

STAFF

VTBE employed 147 members of staff as of the end of 2017 at the Frankfurt site, including Direktbank (previous year: 106). After the successful merger of VTB Bank (France) SA with VTB Bank (Deutschland) AG, no members of staff were active in the operational business in Paris as of 29 December 2017. A branch was set up in Vienna before the merger, with the operational business of VTB Bank (Austria) AG being transferred to this branch. As of 31 December 2017, this branch still employed 115 members of staff, with the majority of these being involved in tasks relating to the merger. A total of 52 members of staff were active in the operational business in Vienna as of January 2018.

In addition to the internal transfer of many members of staff within the Group from Vienna to Frankfurt in 2017, personnel recruitment in Frankfurt was stepped up from the second quarter onwards in order to expand the teams both in the front office and – more importantly – the various back office departments. Qualified employees had already been appointed to areas viewed as critical by the bank, such as risk controlling, compliance and audit, and management functions by the end of 2017.

Overall, the restructuring measures during the reporting year and the resultant additional expenses in all areas placed extremely high demands on the performance of our employees, who met these requirements thanks to their extraordinary commitment. Further personnel expansion is planned for 2018, focusing on Finance, Credit Risk and IT.

ECONOMIC REPORT

GLOBAL ECONOMY

According to preliminary calculations by the International Monetary Fund („IMF“), the global economy expanded by 3.8% in 2017 – more than in the previous year (3.2%), and had been experiencing highly dynamic growth since the end of 2016. This worldwide upturn also had an impact in Russia, the home market of the VTB Group. Gross domestic product („GDP“) in Russia returned to positive figures after its previous downturn. Growth forecasts for 2018 and 2019 for global economic growth rose by 0.2 percentage points to 3.9%. This increase is attributable to rising global growth dynamics and changes in US fiscal policy.

The IMF considers Europe and Asia as the main drivers of the current upturn. According to forecasts, developing and emerging countries will make an above-average contribution to global growth. As in the previous year, IMF economists believe that macroeconomic uncertainties will be caused by the economic consequences of the United Kingdom's decision to leave the EU („Brexit“).

The pronounced weakness of global trade recorded between 2012 and 2016 ended during the past year. According to calculations by the Netherlands Bureau for Economic Policy Analysis (CPB), the international exchange of goods was up by 4.5% in 2017, far more than in the previous 5 years where the average rise was only around 2%. The decisive factors for global trade expansion were the significant revival in Chinese foreign trade and a pick-up in worldwide investments.

USA

The economic development of the USA is highly significant not only for the global economic climate and world trade, indicated not least by discussions on imminent punitive tariffs between the EU and the USA, but also for VTBE as a bank committed to the international transfer of money and goods. The US dollar rate, which is vitally important for the entire banking sector, is also dependent on the state of the US economy. Economic activity in the United States accelerated strongly during the past year. Having only risen by 1.6% in 2016, gross domestic product experienced an even stronger increase in 2017, rising by 2.3%. The growth forecast for the US was revised on the grounds of stronger than anticipated activity in 2017, higher projected foreign demand and the expected macroeconomic impact of tax reform, particularly the lowering of corporation tax rates and temporary consideration of full capital expenditure. The expectation is that the decline in tax income will not be offset in the short term by expenditure cuts.

The tax reform should therefore boost short-term activity in the USA. Stronger domestic demand should increase imports and the current account deficit as a side-effect. Overall, political changes will increase growth until 2020, meaning that real GDP in the USA is likely to be 1.2% higher by 2010 than originally forecast, as this original forecast did not take tax policy changes into consideration. The growth forecast for the USA was raised from 2.3% to 2.7% for 2018 and from 1.9% to 2.7% for 2019. Given the rise in budget deficit, it is expected that growth as of 2022 will be lower than in earlier forecasts.

EUROZONE

The economic upturn in the eurozone, which is so vital to VTBE, continued in 2017 and economic expansion strengthened and spread significantly. The eurozone should also maintain its solid growth rate over the next two years, after a 2.4% increase over the past year. Germany is around 0.5 points above the previous IMF forecast, with an expected increase of 2–2.5%. The European national economies are recording robust wage and salary growth in the medium term. Among other things, the IMF attributes the excellent economic situation in Europe to the relaxed monetary policy of the European Central Bank („ECB"), which triggered a turnaround for its unconventional bond purchases, as well as stronger global support for economic activity through fiscal policy. Exports were a major driver for European economic activity, gathering momentum significantly during 2017. The underlying trend for investments maintained its tangible upward movement, while gains in private consumption slowed down slightly during the course of the year. An economic upturn at European level is likely to have a positive impact on the entire banking sector, particularly as the number of company insolvencies due to cyclical reasons is as low as the resultant need for write-downs in the banks' loan portfolios. These positive effects were a boost for our business, particularly in terms of cooperation with European export credit agencies.

GERMANY

The economic situation in Germany in 2017 was characterised by steady economic growth, leading to an increase of 2.5% in GDP. According to the Federal Statistical Office (Statistisches Bundesamt), this is the strongest level of growth since 2011. An entire 1.2% of GDP came from the federal, state and welfare fund surplus, which recorded more income than expenditure in 2017 for the fourth time in a row. Minor fluctuations were observed in the first quarter, according to the calculations of the Federal Statistical Office. With growth rates of 0.9% and 0.6% respectively in the first and second quarters and 0.7% and 0.6% respectively in the third and fourth quarters, economic growth in 2017 maintained its gains. Positive growth momentum came primarily from within Germany during 2017, mainly as the result of the rise in private and state consumption expenditure. Almost every economic sector contributed to the positive overall economic development in Germany in 2017. VTBE also profited from the positive development of the German market, particularly in business sectors involving foreign trade.

ENGLAND

In comparison to development in the rest of the European Union, output in the United Kingdom rose only slightly by 1.8% over the past year. The negative impact of Brexit in March 2019 may well be the fundamental reason behind this relatively weak expansion. The pound fell significantly in value as a result, which increased inflation and put the brakes on any rise in consumption as the result of the diminished purchasing power of private households, which had previously been the major driving force behind expansion. With the exception of the GBP exchange rate, the bank was not affected financially by developments in the United Kingdom.

CHINA

The Russian economy – and therefore ultimately our parent company – is heavily dependent on demand from China, particularly with regard to the export of raw materials. China's economy profited from increased global trade in 2017, recording even more dynamic growth than at the start of the year, with GDP of 6.9%. The Chinese yuan (Renminbi) increased its purchasing power by 7% over the past financial year (previous year: 3%). However, the Chinese economy lost momentum overall during 2017. Although the quarterly growth rates for GDP compared to the previous year do not reflect this conclusion, official statistics seem to confirm economic fluctuations according to the Kiel Institute for the World Economy.

RUSSIA

The worldwide upturn also had an impact in Russia. GDP rose by 1.5% in 2017. After a significant gain in value by the Russian rouble against the euro in 2016, the European currency regained some of its purchasing power during 2017 (8% increase). Against this backdrop, the Russian Central Bank dropped its base rate further. A further loosening of monetary policy is expected in the next few months. Output across the entire economy continued to rise during the second half of 2017. The corresponding index for the services sector increased further, with records coming close to historic highs.

Exports to Russia were also up in 2017 for the first time in five years. They rose by more than 21% in the first eleven months, reaching EUR 24.1 billion. This meant that in those eleven months they had already significantly exceeded the EUR 21.5 billion figure recorded for the whole of 2016, as underlined by the calculations of the Federal Statistical Office.

German imports from Russia also increased at the same time, and reached EUR 28.6 billion in the first eleven months of 2017. By way of comparison: the figure for the whole of 2016 was only EUR 26.5 billion. In particular, there was a remarkable increase in demand for Russian crude oil and natural gas. Overall, economic operators are hoping for an end to the conflict in Eastern Ukraine and the associated surmounting of reciprocal sanctions.

FINANCIAL STATUS

As already mentioned at the outset, the former parent company VTB Bank (Austria) AG, Vienna, with retroactive effect as of 01 July 2017, was merged with the former affiliate VTB Bank (France) SA, Paris, with effect as of 29 December 2017, creating VTBE. Given this restructuring and the associated transfer of assets and liabilities to VTBE, a comparison with the values of previous years is not possible at all or only on a limited basis.

LENDING BUSINESS

In addition to payment transactions, lending remains the bank's core business segment. With 62.6% (previous year: 50.0%) of the business volume, receivables from banks and customers continue to make up the bank's main assets. The increase in this indicator is primarily a result of the increase in the volume of receivables in the past financial year.

The rise in total assets from EUR 3,248.9 million to EUR 7,855.3 million compared with the previous year's reporting date is primarily the result of the merger of the three predecessor banks to form VTBE: liabilities to customers have therefore risen by EUR 3,133.4 million in comparison to the former VTB Bank (Deutschland) AG, reaching EUR 4,195.4 million. This is mainly attributable to the retail customer deposits held by VTB Direktbank, which were taken over by VTBE in the amount of EUR 2,875.9 million as part of the merger. Irrespective of this, liabilities to banks fell in the financial year from EUR 1,766.0 million to EUR 1,510.9 million. The key reason for this was a decline in liabilities due on demand to banks in other foreign countries. This decline in liabilities to banks was mainly due to the negative interest rates introduced on euro correspondent accounts to compensate for the negative rate of interest on balances held with Deutsche Bundesbank. As in the previous year, we mainly place liabilities due on demand on the interbank market with first-class banks on a term-congruent basis, or as a cash reserve with Deutsche Bundesbank. Liabilities to banks with an agreed term also fell, primarily as the result of the repayment of an ECB tender totalling EUR 100.0 million.

On the other hand, our lending business with customers grew in 2017 as a result of the merger. As of the reporting date, we registered a rise in this segment of EUR 3,292.6 million to EUR 4,567.1 million. The bank addresses acute risks from lending with specific loan loss provisions. In addition to direct provisions (EUR 111.4 million), general allowances (EUR 68.2 million) and provisions for off-balance sheet transactions (EUR 3.8 million) are also in place to cover latent risks. The bank has a procedure in place to establish suitable provisions for country risks. On the closing date, no country risk provisions were necessary.

SECURITIES

The securities portfolio increased to EUR 836.5 million (previous year: EUR 559.4 million). The key factors in this increase were the takeover of securities from VTB Bank (Austria) AG at a nominal value of EUR 362.7 million and from VTB Bank (France) SA at a nominal value of EUR 70.0 million as part of the merger. In addition to securities acceptable as collateral of EUR 639.4 million, the securities portfolio mainly consists of bonds from Russian companies and banks.

DEFERRED TAXES

Deferred taxes rose from EUR 7.0 million to EUR 21.2 million. The increase was primarily the result of general allowances that were not recognised for tax purposes at their actual amount.

OTHER ASSETS

Participations mainly consisted of our participation in Evrofinance Mosnarbank JSC, Moscow, with a carrying amount of EUR 14.8 million. This participation was taken over from VTB Bank (France) SA as part of the merger.

Shares in affiliated companies include mainly our 100% interest in Ost-West Vermögensanlagen GmbH. The sole purpose of this company is the purchase and management of real estate purchased in the past for the bank's purposes.

Fixed assets include the bank's operating and business equipment. Intangible assets consist solely of software subject to capitalisation. The increase is primarily the result of the merger.

Other assets mainly comprise positive replacement values for swaps totalling EUR 68.4 million.

DEPOSIT OPERATIONS

Deposits from banks and customers rose compared with the previous year's reporting date, from a total of EUR 2,878.3 million to EUR 5,706.3 million. This was attributable, as indicated, to the takeover of retail customer deposits in VTB Direktbank as the result of the merger.

OTHER LIABILITIES

Other liabilities of EUR 76.1 million mainly comprise margin accounts totalling EUR 47.5 million (previous year: EUR 0.7 million).

PROVISIONS

Provisions amounted to EUR 157.6 million (previous year: EUR 36.8 million). The increase is primarily attributable to the merger and associated takeover of provisions from VTB Bank (Austria) AG, Vienna (EUR 79.6 million) and VTB Bank (France) SA (EUR 16.0 million). The items consist of provisions for pensions, tax provisions and other provisions.

Pension provisions were valued on the basis of actuarial assessments. The effects of the initial application of the BilMoG provisions in 2010 are being distributed over a period of up to 15 years. Due to a change in the review period for calculation of the average interest rate from 7 to 10 years, the average market interest rate was increased and the associated pension provisions reduced. The rise in pension provisions by EUR 3.6 million to EUR 30.0 million is the result of the VTB Bank (Austria) AG merger to form VTBE.

Tax provisions of EUR 47.0 million mainly consist of obligations resulting from corporation and trade tax. The rise in tax provisions by EUR 45.1 million to EUR 47.0 million is also the result of the VTB Bank (Austria) AG merger to form VTBE.

Other provisions of EUR 80.6 million mainly consist of expenses for staff, flat-rate allowances for credit risks and imminent losses from pending transactions, the archiving of business documents, account maintenance fees, the annual financial statements and costs relating to the merger.

EQUITY

The equity capital of EUR 894.2 million (not including unappropriated profit) increased by EUR 612.2 million in comparison with the previous year. This is the result of the equity capital components taken over from VTB Bank (Austria) AG and VTB Bank (France) AG during the merger and allocated to capital reserves. It is recommended to the Shareholders' Meeting to distribute the profit of EUR 53.2 million to the shareholders.

In previous years the bank has built up risk provisions amounting to EUR 55.2 million to cover specific risks from the banking business. The increase in these risk provisions is the result of the merger with VTB Bank (France) SA.

On the closing date, eligible own funds stood at EUR 1,257.8 million (previous year: EUR 314.5 million) and core capital at EUR 934.4 million (previous year: EUR 314.5 million). The core capital ratio under CRR stands at 14.53% (previous year: 17.04%). The overall capital ratio stood at 19.56% (previous year: 17.04%).

The main financial IFRS performance indicators include Return on Equity (ROE), Return on Assets (ROA) and the Cost-Income Ratio (CIR). The Return on Equity is the ratio of net profit to average equity. On the closing date, this stands at 2.9% (previous year: 6.3%). The reduction in ROE is mainly due to the lower net profit in 2017. ROA amounted to 0.4% for the 2017 financial year (previous year: 0.4). Return on Assets is the ratio of the net profit to average total assets. The decline in the return on assets is mainly due to lower net profit in the financial year. The CIR is the ratio of operating costs to operating income. At the end of the financial year, the CIR stands at 34.5% (previous year: 34.2%).

Non-financial performance indicators are only monitored, not measured, on account of the bank's manageable size, and are therefore not used for internal management.

ROA pursuant to sec. 26a para. 1 sentence 4 KWG (German Banking Act) amounted to 0.3% for the financial year 2017 (previous year: 0.5 %). Return on Assets is the ratio of the net profit to total assets. The reduction in ROA is due to the increase in total assets arising from the merger with VTB Bank (Austria) AG and VTB Bank (France) SA.

FINANCIAL POSITION

VTBE's refinancing is mainly based on interbank deposits that are due daily and medium- to longer-term customer deposits in euro and US dollars. The average rate of interest charged on liabilities to banks stood at 1.7% and to customers at 1.3%. The refinancing structure was therefore unchanged compared with the previous year. In this context, please refer to the paragraph on deposit operations in this section and the statements on liquidity risks in the risk report in this Annual Report for more details. The bank remained solvent at all times throughout the past financial year. Compliance with regulatory indices for liquidity was maintained at all times. The liquidity ratio stood at between 2.00 and 3.69 (average 2.82). As of 31 December 2016 it was 2.00. The liquidity maturity statement in our liquidity report to the regulator, which also looks at a period up to one year, shows a cash surplus in all maturity bands. Consequently, we regard the bank's liquidity position as secure. There were no particular call risks.

As at the end of the financial year, irrevocable credit lines amounted to EUR 221.6 million (previous year: EUR 57.2 million), for which a provision of EUR 1.8 million (previous year: EUR 0.2 million) was formed. The credit lines normally lead to an outflow of funds in the short term. The benefits of these credit lines lie in their generation of future interest income. Contingent liabilities amounted to EUR 145.8 million (previous year: EUR 17.2 million).

There was no knowledge of any significant changes or deterioration in the bank's liquidity position at the time the 2017 annual financial statements were prepared.

EARNINGS POSITION

The bank's profit for the year rose by 23.4% compared with the previous year. This was caused mainly by the interest earnings of the Vienna branch.

The interest surplus increased to EUR 117.7 million, following EUR 56.0 million in the previous year. This corresponds to an increase of 110.2%. Interest income from lending and money market transactions increased by EUR 97.7 million to EUR 166.6 million and interest income from securities by EUR 4.5 million or 42.1% to EUR 15.2 million. This was mainly due to interest income for the Vienna branch in the second half of the year, amounting to EUR 89.2 million. Interest expenses increased by 170.5% to EUR 64.1 million. This is mainly attributable to the retail customer deposits in VTB Direktbank taken over from VTB Bank (Austria) AG.

Net commission income was up by 95.6% from EUR 6.8 million in the 2016 financial year to EUR 13.3 million during the past year. This was driven by commission income of EUR 3.8 million from the Vienna branch, primarily arising from lending.

General administrative expenses increased by EUR 44.2 million compared with the previous year, amounting to EUR 66.9 million (previous year: EUR 22.7 million). The main factors here were the staff and material costs for the Vienna branch.

Negative valuation results from receivables and certain securities, as well as from allocations to provisions relating to the lending business, amounted to EUR -29.7 million and related mainly to net allocations to specific loan loss provisions amounting to EUR 28.2 million and general loan loss provisions amounting to EUR 18.7 million. These were offset by proceeds from securities amounting to EUR 30.9 million and write-downs on securities amounting to EUR 11.9 million.

Other operating earnings of EUR -10.0 million consisted of other operating income of EUR 11.7 million and other operating expenses of EUR 21.7 million. Both items were mainly shaped by derivative transactions.

Overall, the profit and loss account closes with a profit for the year of EUR 20.6 million (previous year: EUR 16.7 million). EUR 32.6 million was withdrawn from capital reserves, resulting in a profit of EUR 53.2 million. It is recommended to the Shareholders' Meeting to distribute the profit of EUR 53.2 million in its entirety to the shareholders.

SUBSIDIARIES

VTBE has a foreign branch in Vienna. According to sec. 44 (4) of the Austrian Banking Act (BWG), the branch's eligible assets amount to EUR 3.339.4 million. Interest income is EUR 89.2 million and commission income is EUR 6.9 million. In 2017, the average number of employees working for the branch was 120 (not including employees on leave).

GENERAL STATEMENT ON THE COMPANY'S FINANCIAL POSITION

The development of the bank's business activities in the 2017 financial year was shaped by the merger of the continental European VTB companies in Austria, Germany and France to form VTBE. Changes to all balance sheet items and the profit and loss account are fundamentally due to the merger. The increase in interest and commission income is also mainly due to the merger with VTB Bank (Austria) AG, as is the increase in staff and material costs.

Business development continues to be shaped by sanctions and a difficult situation on the financial markets. As a result, VTBE had to increase its risk provisions, leading to a reduction in net profit compared to the previous year.

RELATIONS WITH RELATED PARTIES

Pursuant to sec. 312 AktG, the Management Board is required to prepare a dependency report with regard to these corporate relationships. This report contains the following declaration: „We hereby declare that VTB Bank (Europe) SE, according to the circumstances that were known to the Management Board at the time at which the aforementioned legal transactions were undertaken, received adequate remuneration for each transaction. The company was not put at a disadvantage by any measures undertaken or omitted."

REPORT ON OPPORTUNITIES, RISKS AND OUTLOOK

2017 is the tenth year after the banking crisis. In 2007 the collapse of IKB was averted. The world stood on the threshold of a real estate crisis. In addition to these problems, in common with all banks in the world, further developments have hit the industry and still have to be overcome.

Since then, regulators have taken measures to make the banking sector safer. New regulations were developed, on the one hand to maximise industry resilience and on the other hand to improve its transparency. The result was a partial realignment of banks' business activities, as well as a standardisation of products. However, the tighter regulatory requirements for banks and insurance companies have not led to an improvement in the overall situation in the financial sector; in fact, they merely caused the markets to slow down. Other factors have dominated in the last few years, among them crises in the eurozone, such as the Greek crisis or the crisis in the PIGS/PIIGS countries, the effects of which continue to be felt. New concerns about the Italian economy are also an issue and are likely to continue to preoccupy the EU in the next few years. Brexit – which the EU had considered unlikely – has become a new challenge after the referendum in Great Britain. Uncertainty about the terms of the exit and the UK's future relationship with the EU has had negative effects on the UK's economy – import prices have risen and the pound is weak; moreover, in Scotland, there is an ongoing open discussion about a second referendum to withdraw from the UK in order to remain in the EU. While investments have been postponed and banks are considering the possibility of retaining access to the EU market by leaving the UK, the British government is looking for a way to implement its various election pledges.

For a bank in Frankfurt, all of this is a challenge. The first major international banks have already at least announced the development of Frankfurt/Main as an alternative location, even if they have not yet left London completely. From VTBE's point of view, these changes will change the face of the banking sector in mainland Europe over the next few years. There will be a vital adjustment process on both sides – among the banks that are already on site and among those that might come later. This will have effects on the labour market – on both sides of the English Channel. Rents and purchase prices for freehold flats are already rising in the Rhine-Main region.

Alongside a run on high potentials, it is becoming obvious that salaries will have to rise considerably to ensure that those with low or medium incomes have a chance to acquire acceptable living space.

The banking sector also faces other challenges. The ECB continues to carry out „quantitative easing", making further purchases in the bond market to provide liquidity to the banks. This monetary mechanism is being accompanied by a negative interest rate policy that encourages banks to grant loans according to the ECB. However, banks are reluctant to trust the risks on offer and continue to hold money at no risk with the Bundesbank even if this comes at a cost. The Bundesbank therefore charges negative interest rates that in fact play the role of a charge on deposits. A slight rising trend of inflation, which the ECB has been trying to achieve in order to raise interest rates, is now coming at a time of rising oil prices. At the same time, yields on German government bonds are beginning to rise, while the federal budget is producing a long-awaited surplus. For a long time Germany was the target of cash inflows from other EU countries, either because it offered better investment opportunities or because it was considered more stable politically and economically. However, despite rising inflation in Germany, the ECB will probably not raise interest rates. Italy is supporting its banks via financial donations to prevent their collapse.

Along with the monetary and economic situation, politics also plays an important role for banks in the eurozone and the EU. Since 2014, sectoral sanctions have been applied to banks, the future effects of which will continue to be manageable. However, since the sanctions apply to the direct parent company itself, VTBE faces challenges here, too. It has adapted its business and is consistently following its chosen method of reducing risks by entering transactions only when the risk content, in its view, is acceptable given the overall situation of the bank. It acts like this consistently, even at the expense of losing short-term yields if this would mean that such transactions carry the need to make higher risk provisions in the future.

Apart from this restriction on VTBE, caused by the crisis in Crimea, and the questions posed by Brexit, other uncertainties in the world economy are making planning much more difficult. The crisis in the Crimea was a big topic, with sanctions still in place, but the crises around IS, Syria and Iran are also a topic affecting the whole world. Since the imposition of sanctions, Russia and Turkey have had a closer relationship; the domestic situation in Turkey as a long-term EU candidate country has led to distancing from the EU, although it remains an important economic partner both for the EU and Russia. Foreign trade activities form a particularly excellent basis for mutual interests.

The US election has pushed the country in a very different political direction. The President will re-evaluate all the focuses of Barack Obama's policy. The results of negotiations by the Obama government are being reversed, the President plans to build a wall between Mexico and the US, the Iran nuclear deal is to be reversed and the geopolitical deck of cards is being reshuffled in general. Japan, rather than China, is now the US's largest creditor; relations with Taiwan are being improved, which could worsen relations with China. American foreign policy is therefore setting new and different priorities. Economic alliances may have to be renegotiated, if they are not dissolved, even with long-term partners such as the EU. Current debate about increased US tariffs on metal and other products from the eurozone also plays a part here.

The US has become an element of uncertainty, also in terms of foreign policy and sanctions. New sanctions legislation also indirectly threatens companies not based in the US with sanctions if they violate US sanctions against other countries or companies. This leads to further distortions and uncertainty on the market.

The German government has laid out new requirements for banks with regard to data quality through the IT Security Act and its ambitions for BCBS 239. Apart from their existing adjustment processes, banks have to make efforts to improve their own internal business situation. Cyber-attacks leading to a failure of payment systems are to be reported to the regulator.

Given that the banks' revenue situation is already not looking encouraging due to the poor market situation and negative euro interest rates, increased spending on technology or staff places an additional burden on banks. The banking sector could eventually be in a stronger position if the situation improves with regard to technology and costs and the economic climate as a whole picks up. Until then, the adjustment process that the banking sector is going through will likely make painful cuts unavoidable. However, it is difficult to assess when an improvement might come.
The zero interest rate policy of the Japanese Central Bank has been in deadlock since the 1990s; rising interest rates or even an actual recovery in the US will not ease the situation of banks in continental Europe. If the ECB were to loosen interest rate policy, the question arises as to what extent adjustment processes and bank sector clean-ups have taken place in the economies weakened by the real estate crisis of the 2000s. With regard to Italy, we can expect that the clearing of bank balance sheets is far from complete, but an expensive refinancing of the banks could be detrimental to overall stability. The economic situation as well as the overall situation could deteriorate considerably, trust in the resilience of banks and countries themselves, as well as in the ECB, which has assumed responsibility for the supervision of key banks, could evaporate. The potential consequences for the banking sector could be inconceivable, not to say unpredictable. The last remnants of trust – in this case in a powerful and highly informed Central Bank drawing the wrong conclusions and taking inappropriate measures – would be gone.

MiFID II 2014/65/EU replaced MiFID Directive 2004/39/EC on markets in financial instruments on 3 January 2018. The aim of MiFID is to harmonise the financial markets in the European Single Market. The aims of the MiFID II directive are to further reinforce investor protection and also to restructure the securities and derivatives markets. This includes the regulation of trade infrastructures, commodity futures markets or high-frequency trading, as well as investor protection. The powers of intervention and sanction available to regulatory authorities are also expanded through MiFID 2 entering into force. VTBE has set up a project to implement MiFID II requirements and has also introduced measures to ensure compliance with regulatory requirements. The bank was given professional support by an external consultant.

OPPORTUNITIES REPORT

OPPORTUNITIES ARISING FROM IMPROVED INFRASTRUCTURE

The situation in the banking sector is challenging. In order to offset deficits in their interest-earning business, the banks are trying to improve their cost situation. The bank cannot escape this challenge. One of the reasons behind the merging of all VTB Group activities was the implementation of further cost reduction and cost optimisation measures. In Frankfurt, VTBE had already updated its banking software in 2016 from an earlier version, skipping an entire software generation. This made it possible to implement the merging of the balance sheets of what were previously three independent banks on one IT platform during ongoing operations. The bank therefore considers itself well prepared to better meet regulatory requirements and to focus on the future.

OPPORTUNITIES ARISING FROM THE MERGER AND COST OPTIMISATION

The ECB has placed significant banks under its direct supervision since 2014. The European VTB Group, consisting of VTB Bank (Austria) AG, Vienna, VTB Bank (Deutschland) AG and VTB Bank (France) S.A., belonged to this group until the end of the year. For VTB, this meant particularly increased reporting expenditure, along with the associated staff and IT costs. Based on these issues, the European activities of the VTB Group were bundled together in 2017 in the „OPERA project“ to form the new structure of VTB Bank (Europe) SE with headquarters in Frankfurt/Main. The merging of the three financial institutions released the bank from direct ECB supervision and instead placed it under the supervision of the Bundesbank and BaFin. VTB Russia is now the direct majority shareholder in the new bank. These changes will lead to cost optimisation and shorter decision-making paths within the bank.

OPPORTUNITIES ARISING FROM THE EXPANDED CUSTOMER BASE AND PRODUCT RANGE

The merging of the three banks has not only created a better and far leaner organisational structure for VTBE, but also expanded its product range and customer base. The bank has changed from being a specialist bank to a universal bank that continues to focus on low-risk trade finance. The classic short-term trade and export business was expanded in 2017 to incorporate long-term finance through the arrangement of cover by export credit agencies („ECA“). The bank considers this to be a logical extension of its low-risk foreign trade business.

VTBE also considers itself to be well-equipped for the commodity trading finance business, which is very closely associated with and complementary to classic foreign trade finance. There will be further opportunities to expand business activities here.

Customer geography was expanded through the incorporation of the former VTB (Austria) and VTB (France). This has resulted in further business opportunities with new customers, mainly from the CEE region. Existing market-specific know-how with a focus on business in Eastern and Southern Europe was bundled at the Vienna branch.

OPPORTUNITIES ARISING FROM CHANGED MARKET CONDITIONS

Previous market regulations and conditions have changed significantly in recent years. Customer relations will be put to the test as a result of the unpredictable and seemingly arbitrary sanctions policy of the US and the extremely complex and extensive EU policy in this sector. Although they have not been on the receiving end of sanctions, Russian customers have nevertheless experienced difficulties with bank accounts, whether this involves clearing or other banking services such as borrowing. Even first-class Russian borrowers have been rejected by Western banks. The bank considers opportunities to assist here, even though it will also need to carefully balance up the risks in an assessment and, as a European bank, ensure strict compliance with all the standards relating to EU sanctions.

OPPORTUNITIES ARISING FROM ECONOMIC DEVELOPMENTS

The home market of the Group, Russia, is heavily dependent on oil prices. Low oil prices, as well as sanctions by the EU and the US, have forced the Russian economy to undergo an adjustment process, which will make it stronger. Oil prices have stabilised, contrary to expectations, and even increased as the result of current uncertainties on the global markets relating to Iran and Middle East policy. Increased oil revenue has led to some relief for the Russian national budget. Rising oil prices could lead to a moderate economic stimulus that could result in increase in productivity and reduce risks in the bank’s portfolio. Rising productivity in Russia and a pick-up in economic activity in the EU could lead to business expansion, particularly in the sector of trade finance – a core activity of VTBE and one it would be keen to continue to expand. As part of diversification, the bank considers the processing of foreign trade business, not only between the EU and Russia, but also with third countries, to be a further opportunity. VTBE applies a „follow your customer“ approach here, i.e. it provides existing customers with corresponding instruments, even in transactions with third countries.

Since VTBE, as in previous decades, carries out clearing operations, particularly for Russian and CIS banks, a pick-up in economic activity and increased trading volumes could provide further opportunities.

OPPORTUNITIES ARISING FROM QUALIFIED STAFF

VTBE relies on its employees, who have supported the bank in making adjustments over the past few years. It is not just the bank itself that has matured throughout this process: by participating in specific projects or measures, our employees have been able to acquire additional know-how that they can fruitfully apply for the benefit of the entire company. Given its organisational structure, both in terms of its age structure and origins, the bank sends out a clear message encouraging diversity. The majority of its employees are specialists with years of experience in various countries and with various banks. The bank organises language courses, as well as internal and external courses to improve the qualifications of its employees and managers. At a time of global change and ongoing regulatory adjustment, practical know-how is an important asset for any enterprise. To this end, VTBE makes a point of carrying out specialised continuing education and training, as well as improving its managers' social skills, which is important in an international environment. The bank has a flat hierarchy and direct communication channels that ensure it deals efficiently and rapidly with any challenges it may face, especially in times of crisis.

OPPORTUNITIES ARISING FROM HIGHER VISIBILITY

VTBE is represented in Frankfurt, the central banking location in continental Europe. Subsequent to Brexit, this offers a locational advantage compared with London. The new, fundamentally larger and more significant VTBE can now draw on the expertise of three banks that have more than 47 years of experience in the European market.

Even at a time of sanctions and an economically weak market environment, VTBE will be perceived as a reliable partner in the banking market. Maintaining and enhancing this reputation depends on the bank operating in a professional manner on the market. A uniform assessment shows that the bank is well able to stand comparison with other banks. It regarded the creation of transparency as a chance to assert itself in its markets.

VTB Direktbank, which became part of the new VTBE during the merger, is being more and more positively received in the market as a German company, thereby making a positive contribution to VTBE's image.

OPPORTUNITIES FOR THE FUTURE

All the signs for VTBE point very clearly to a moderate expansion in business opportunities, in particular in the pan-European market. With its technology and employees considered to be a valuable asset, VTBE plans to make further progress along these lines. The bank views the adjustments that major banks have made to their business models when moving away from the Russian or East-European market as the sign of a business opportunity, as long as risk profiles match VTBE's desired profile according to its risk assessments. Since the bank will remain risk-conscious in future, it will also avail itself of opportunities without incurring non-controllable risks. Instead, apart from FX swap transactions entered into earlier, it has also concluded interest rate swaps that allow it to better manage the book. Thanks to new infrastructure and an extension of its product range, VTBE is keeping all future options open. It currently acts as a non-trading book institution, but it already has the opportunity to convert its status – both in terms of IT infrastructure and in terms of regulatory reporting – to a trading book institution.

VTBE has created all the necessary conditions for a successful future, without generating overcapacity. It is a modern bank and a member of a banking sector that will see future regulatory change but also opportunities to successfully apply its business model and to undergo further development.

VTBE continued to invest in IT infrastructure in 2017. This included investment in the Vienna branch in order to standardise the VTBE system landscape, as well as investment in a new trading platform in order to standardise structures within the VTB Group. The bank invested a total of EUR 8.3 million.

INDIVIDUAL RISKS

VTBE has identified the most important risks in its risk inventory. These risks stem from the bank's business profile, its target markets and its penetration rate VTBE's risk profile has not changed in comparison to the former ESH Group, which means that no new risk types have been identified for VTBE.

Risks offer the bank opportunities to make profits and expand its business, since the risks taken by other market players are not necessarily of the same type as for VTBE. For example, competitors have reduced their Russian business significantly, whereas the bank still takes risks in Russia or in CIS countries onto its books and will continue to do so in the future. The bank's business orientation and risk profile are for historical reasons different from those of other banks. VTBE runs a niche business with a clear focus on foreign trade financing and clearing.

The focus of VTBE determines its risk position, based on which particular counterparty risk is relevant. Due to its corporate background and business areas, it is also exposed to country risks. Further potential for risk arises from funding and interest rate risks, to which the bank is exposed through the assumption of maturity mismatches. Further relevant risks are assessed for their significance within the risk inventory and are accounted for in a model that assesses risk coverage funds. In general the bank is orientated towards the prevention of risk, however it may readily take on risks within its business policy framework if it can control and deal with them. Other risks, such as operational risks, arise in particular from standard banking transactions that the bank carries out as a commercial company.

MACROECONOMIC RISKS

VTBE further optimised its portfolio in 2017 by continuing to pursue a conservative risk policy – only entering into risks that are acceptable and controllable according to the risk strategy.

This development will be visible in the bank's external rating. Despite sanctions and other VTBE market uncertainties, the rating still has a stable outlook. In spite of adverse market circumstances, ECB regulations and sanctions, the bank was also able to maintain its business model.

VTBE has consistently offset risks on its balance sheet with reserves and exited certain positions.

Due to this focus on the core business, credit volumes declined in Germany during the year, but rose in general as the result of the VTBE merger. This resulted in a change in regulatory and economic indicators, which were appropriate during the past year.

The set of early warning indicators remained unchanged in 2017. Developments in exchange rates, oil prices and credit default swaps are monitored to form an overall picture, along with the bank's own market assessment that takes into account potential risks. One indicator for the development of target markets is the base rate, along with the rouble exchange rate, which can affect the earnings position of the Russian enterprise. Although VTBE has continued to be highly restrictive in handling its portfolio of US dollar credits, Russian enterprises continue to seek and request financing operations in US dollars.

REGULATORY RISKS

Regulators have in the past introduced a number of quantitative restrictions. These involved the implementation of Basel III and IV, as well as the implementation of measures intended to improve the banking sector and introduce a uniform model of global monitoring. In addition, German regulators are setting new qualitative standards and putting further regulations such as BCBS 239 and BCBS 248 in place, which have also been partially incorporated into the amendment of MaRisk (minimum requirements for risk management). These set out additional requirements for reporting and risk management in particular and compliance with them requires a corresponding effort in terms of data acquisition and data quality. Since these requirements apply to all banks, only those banks that in recent years have consistently ensured transparency and correctness in their data management have had a competitive and time advantage. The bank recognised this early on and implemented measures to comply consistently with these requirements, restructuring and standardising its data management after the turn of the millennium – an approach that it continued to pursue later in implementing new systems. The standardisation of the data structure as the result of the merger also led to further synergies. The bank has therefore already been able to respond appropriately in crisis situations in the past. The regulatory requirement to apply this approach to all data, in order to be able to correctly answer data queries and ensure transparency in times of crisis, has not caught the bank unprepared; it also makes its own assessment of possible future data requirements. The additional requirements of the new MaRisk were reviewed as part of the merger project and processed in additional project measures where necessary.

Bank supervisors have started to study the sustainability of banks' business models. Banks not only have to make profits in the short term, but also act as sustainable partners to the real economy, especially in difficult times. The approach chosen by certain banks to transform their fixed costs via outsourcing them to a variable cost basis has appeared in the past to be the correct one. In future, banks will have to monitor and control all permitted outsourcing more closely.

ORGANISATION OF RISK MANAGEMENT

After the merging of the companies to form VTBE, the bank established additional committees. The front and back office remain separated up to board level. The Credit Committee (CC) meets weekly and is responsible for decisions on the granting of limits and loans, as well as on commitments to borrowers, counterparties or statutory bodies. However, the Risk Committee (RC) is the bank's supreme body ensuring risk management and the Asset Liability Committee (ALC) is responsible for liquidity management. Initiatives relating to new products or markets are coordinated in the New Business Forum (NBF). The function of the Risk Committee was carried out jointly in the ALC in 2017 under the supervision of the risk management department and Treasury.

VTBE has implemented MaRisk requirements, whereby in addition to the risk management department, which handles risk control, the Compliance and Internal Audit departments are in charge of monitoring and control of the bank's risks. In carrying out their duties, employees are not bound by any internal directives and have direct information channels to the Board and the Supervisory Board.

REGULATIONS AND RESTRICTIONS

VTBE continues to define itself as a non-trading book institution under CRR and thereby dispenses with the generation of short-term and especially speculative profits. With this restriction, it continues to avoid the more stringent supervision requirements and the associated costs, but on the other hand it loses the potential revenue that could be generated in this way.

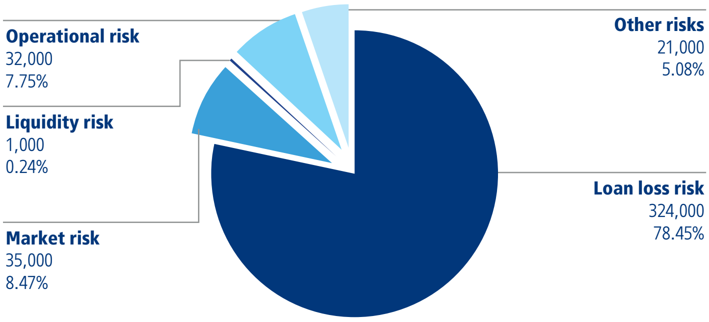
Within the framework of its strategy process, VTBE develops a business and risk strategy based on the available inventory, in which it describes its activities based on its capabilities – whether on a personnel, capital or technical basis. In choosing its business direction, the bank has to account for regulatory requirements. As an internal control measure it has developed the concept of risk-bearing capacity, which quantifies the main risks of the bank as a ‚going concern'. For the relevant risks it assesses possible impairments and offsets these with risk coverage funds. The bank adjusted limits on individual risks over the course of the year and carried out adjustments to its models where they proved to be necessary due to the specific characteristics of the market or the portfolio. Over the course of the reporting year, a secondary control was developed using the approach of the former parent company, which calculates the risks in a model based on the ‚gone concern' approach.

AS ALREADY MENTIONED ABOVE, THE TABLE BELOW SHOWS THE RISK COVERAGE FUNDS FOR THE ‚GOING CONCERN' APPROACH (CALCULATED AS OF 31 MAY 2018 FOR THE 2017 YEAR-END). RISK COVERAGE POTENTIAL IS BASICALLY CALCULATED IN LINE WITH CURRENT REGULATORY REQUIREMENTS AND INCLUDED IN THE SAME FORM IN THE NOTIFICATION PURSUANT TO THE FINANCIAL AND RISK-BEARING CAPACITY INFORMATION DIRECTIVE (FINARISIKOV).

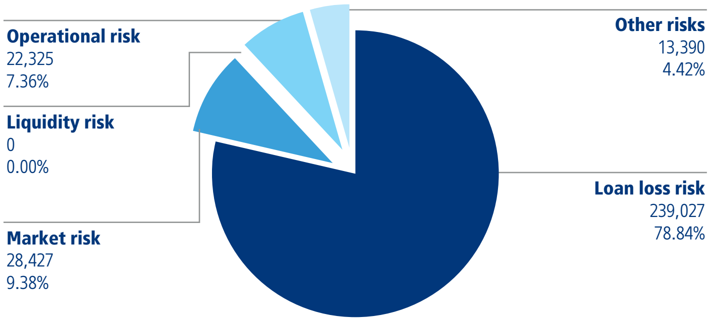
	Value taken into consideration in RCP
1.1 Risk coverage potential from equity	
Balance sheet equity	933,256.921.33
1.3 Further items	
Fund for general bank risks	55,158,441.49
Subordinate liabilities without running loss absorption	127,979,734.10
Projected results (+/-) after valuation/before tax	66,700,000.00
Minimum profit/planned distribution (-)	-57,232,174.73
Accumulated gains and losses as of the reporting date (+/-)	57,232,174.73
Hidden reserves	5,420,840.67
- of which in securities	5,420,840.67
Other intangible assets (-)	-15,550,695.84
Equity required in order to comply with requirements pursuant to Article 92 para. 1 letter c) CRR	-511,918,936.30
Equity required in order to comply with requirements pursuant to sec. 10 para. 3 and para. 4 KWG (-)	-207,967,067.90
1.4 Sub-total	**453,079,237.55**
1.5 Additional adjustments	
Cushion not explicitly taken into consideration to cover risks (-)	-40,079,237.55
1.6 Total	**413,000,000.00**

IN THE FOLLOWING SECTION, WE GRAPHICALLY PRESENT THE BANK'S RISK-BEARING CAPACITY COMPARED WITH THE PREVIOUS YEAR WITH RESPECT TO TOTAL RISK COVERAGE FUNDS, THEIR UTILISATION, PRINCIPAL RISKS AS WELL AS INDIVIDUAL LEVELS OF UTILISATION:

Limits (EUR thousand) as at 31/12/2017
(Total limits: EUR 413,000 thousand;
%-figures: ratio of limit to risk coverage funds))

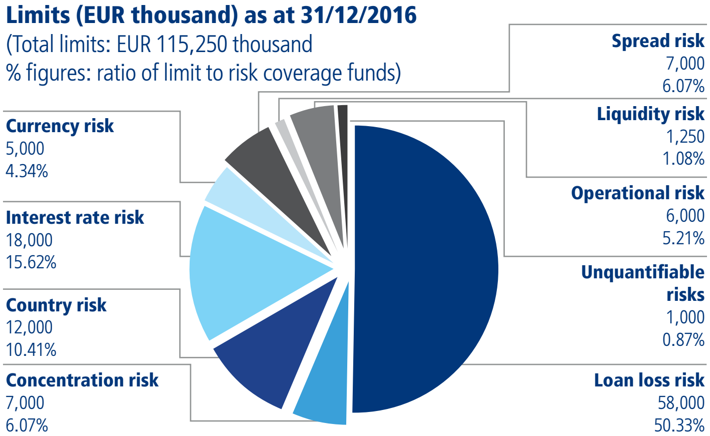


Utilisation (EUR thousand) as at 31/12/2017
(Total utilization: EUR 303,169 thousand;
%-figures: ratio of risk capital to total risk capital)

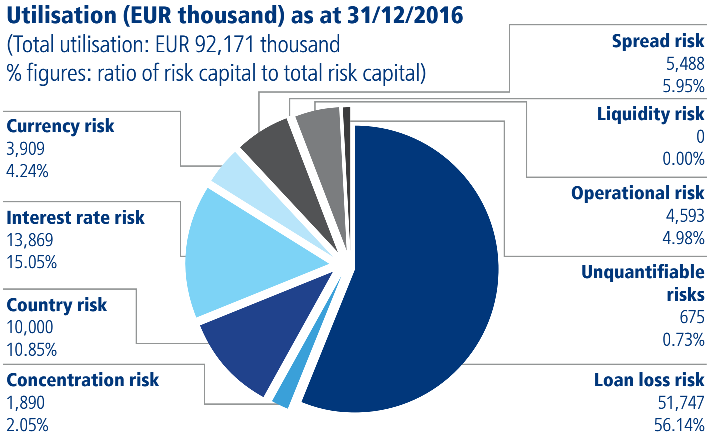


RISK TYPE LIMITS ARE NO LONGER DIVIDED INTO RISK SUB-TYPES.

Limits (EUR thousand) as at 31/12/2016
(Total limits: EUR 115,250 thousand
% figures: ratio of limit to risk coverage funds)



Utilisation (EUR thousand) as at 31/12/2016
(Total utilisation: EUR 92,171 thousand
% figures: ratio of risk capital to total risk capital)



REPORTING

Both internal and external reporting (supervision, disclosures, rating companies etc.) are important to VTBE. For example, it is already possible to present liquidity positions on an hourly basis in data management. The bank can prepare current regulatory indicators and details of their composition on a daily basis. The key indicators that the bank uses for daily management are increasingly being generated automatically. Reporting is therefore flexible enough even in crisis situations to ensure that actions appropriate to the situation are taken on the basis of reliable data. The bank uses additional tools such as daily and weekly reports, with decision-makers also being provided with reports on a monthly or quarterly basis. These can be calibrated and are flexible enough that they can be generated more frequently.

MANAGEMENT

VTB Bank also examines its opportunities and risks in the course of its annual risk inventory. In this context, all working guidelines and regulations for handling these risks and opportunities are examined and adjusted where necessary.

To quantify the level of utilisation of the economic capital provided, risk coverage funds in a risk-bearing capacity are compared with the significant risks. In the process, the absolute values of each significant risk are described and quantified. The bank describes the stress test as the calculation of individual risk potential in the case of extraordinary but theoretically plausible events. This evaluation must therefore always be adjusted to fit the changing situation. Reporting at the bank is flexible enough to enable it to analyse data quickly and react appropriately.

VTBE took the following risk types into consideration for its risk-bearing capacity strategy and with regard to its internal risk limitation system in 2017:

- Counterparty risk (default, migration and concentration risks)
  - Classic credit risk
  - Issuer risk
  - Replacement risk
  - Country risk
- Market price risk
  - Interest rate risk
  - Currency risk
  - Spread risks from the securities portfolio
- Liquidity risk
- Operational risk
- Business risks

Counterparty default risk plays the most important role for VTBE. As it operates in a volatile market, credit defaults can occur. The bank focuses on a certain choice of counterparties, which is reflected also in concentration risk. On the one hand, the bank imposes restrictions on itself in order to take on only risks that match its portfolio, but on the other hand, in so doing, it runs the risk of concentration risk, where external factors could at the same time affect a series of borrowers. As it is traditionally represented in Russia and the CIS countries, the bank is exposed to particular risks here, which are minimised due to the fact that the bank commands specialist knowledge through its attachment to the Group as well as through its own expertise. Beside these risks, other risks play a secondary role, with the exception of risks from maturity transformation. The bank does not recognise these primarily under liquidity risks, but rather as interest rate risks. To manage this risk more efficiently, the bank has included interest rate swaps (IRS) for its own control purposes in its product range.

The weekly report from the risk management department lists overviews of the most important risk-specific indicators, as well as current limit utilisation factors for all approved countries, which are circulated to the bank's policymakers. Both internal limits and regulatory thresholds are monitored in the process. For example, internal reporting contains information on:

- Counterparty risks: Equity capital, overall capital ratio under CRR, amount of single and general loan loss provisions
- Concentration risk: number of large exposures, utilisation factor of large exposure limit, ratio of equity consumption of Russian assets to total equity, proportion of Russian trade finance measured against equity consumption of Russian assets, level of loans secured through property
- Interest rate risk: an interest rate shock analysis with respect to the non-trading portfolio by means of a parallel shift of the yield curve by +/- 200 basis points; the hedging effect of IRS; an NII method is used in ICAAP for interest risks in the going concern approach
- Currency risks: open currency positions, EUR/USD and RUB/USD exchange rates

- Liquidity risk: progress of liquidity ratios (Liquidity Regulation, LCR, NSFR), surplus of cash for the liquidity ratio measured in accordance with the Liquidity Regulation, sum of amounts to be counted in accordance with deposit security and investor compensation legislation, sum of amounts for the private deposit security fund

- Operational risks: current absolute amount determined in accordance with the internal OpRisk model;

- Early warning indicators: As well as exchange rates, the euro and US dollar yield curves are monitored, as is the oil price; an internal assessment is made of funding opportunities in US dollars; and a watch is kept on CDS spreads for important target countries, as well as key indicators with regard to operational risks (OpRisk reports and staff turnover)

Numerous analyses by the bank have shown no indication of threats to the bank's continued existence, either before or after the merger. In this section, we address various aspects of individual risks.

COUNTERPARTY RISKS

VTB defines counterparty risk as the loss of a business partner due to default or a deterioration in their creditworthiness. It also includes concentration risk and specific country risk, as well as classic credit risk. The workflow management system reflects the two-vote process required for lending and covers everything up to the final rating and the lending decision. It also encompasses the evaluation and monitoring of collateral. The bank handles problem loans, intensive-support loans and restructurings in separate lending processes.

The bank's risk strategy specifies the rules for its commitments. VTBE makes lending decisions on the basis of its own analyses and evaluations as part of an extensive analysis of creditworthiness, which includes qualitative and quantitative company data. The analysis follows a regular schedule and takes into consideration the relevant accounting regulations as well as the industrial sector of the borrower. Russian banks are subject to particularly close monitoring; their data can be analysed on a monthly basis.

VTBE also controls the credit risk by classifying each loan granted in one of 14 ratings categories reflecting various levels of creditworthiness. Due to strict qualitative and quantitative criteria as well as acceptance of collateral, VTBE does not expect total defaults on the funds lent on the part of its borrowers or borrowing entities. Due to the Ukrainian/Russian crisis, the bank already began subjecting the loan commitments to be entered into to closer inspection during the course of 2014. In the reporting year, the bank also proceeded in a defensive manner regarding new commitments in the crisis regions.

By limiting loans to any one borrowing entity, the bank follows regulatory procedures governing maximum limits. For risk-related reasons, it has lowered the maximum limits in correlation with the borrower's rating.

The probability of default on the part of specific borrowers, defined in order to set an adequate price for the risk premium to be collected, was based in the reporting year on an internal, fourteen-stage rating system that has been calibrated against external ratings from Standard & Poor's. The relevant probability of default is therefore based on realistic, current figures that originate from a professional, external service provider. Due to a lack of sufficient historical data, VTBE would have only limited capability to make its own assumptions in this regard. In order to calculate the expected default on a loan, the bank assumes a credit volume amounting to the net exposure, also taking into account loan collateral. The so-called „expected loss" (EL) is calculated by multiplying the „probability of default" (PD) of the rating level of the relevant borrower by the probable level of exposure („EAD") and a loss-given default (LGD) of 45%. The bank uses this EL value in its risk-bearing capacity analysis, based on a confidence level of 95% (going concern) using the F-IRB formula. Reporting also includes a gone concern calculation carried out at the same time with a confidence level of 99%.

Suitable risk provisions are created for non-performing loans in accordance with the procedures for loan loss provision. VTBE basically follows the CRR definition of default. An internal master scale is used here among other things. Specific loan loss provisions are built up as the difference between the carrying amount of the receivable and the present value of the expected payments, including collateral proceeds, where the carrying amount of the receivable is greater than its present value.

As far as latent risks in the portfolio are concerned, general loan loss provisions are also formed for borrowers' risk of default. The general loan loss provisions are basically calculated by multiplying the credit volume of all loan commitments not included in specific loan loss provisions, minus the collateral relating to KWG, by the loss-given default („LGD"), the probability of default („PD") and the time interval between when the default occurs and when it is identified (so-called „LIP factor").

VTBE controls country risks by monitoring the risks using its own risk assessments, Group assessments and external ratings. It divides investment countries into three categories. The ALC limits investments by volume on the basis of the specifications of the risk strategy and risk-bearing capacity. The country risk is already taken into account in the rating. To ensure sufficient consideration of the transfer risk, the bank has also implemented a so-called Harte Country Ceiling as part of the risk-bearing capacity calculation. No separate report is made here.

Assets are essentially split across three fields of activity and target regions: Germany, Russia (with other CIS countries), and customers and counterparties in Europe. In trade finance the bank pursues a „follow-your-client" approach, enabling it to focus on new countries. Within this approach, it consistently operates only low-risk business with no general, long-term commitment to these countries; it assumes only some addition to the portfolio, without a redirection of the bank's focus.

Since the middle of 2014, VTBE has been conducting two warranted stress tests per month. One scenario covers a possible economic downturn in Russia, and the other simulates an EU trade embargo with Russia. In 2016, an additional scenario was developed based on macroeconomic stress for the whole business and thus affecting the whole lending portfolio. In these scenarios, the bank has so far been able to demonstrate that even in crisis situations, the ratios never fell below the minimum thresholds demanded by the regulator (overall capital ratio under CRR).

VTBE manages its lending risk in the sense of risk limitation or risk avoidance. Risk avoidance is effected by not accepting certain levels of credit rating in the lending portfolio. Monitoring performed by the risk management department follows a regular pattern, and the Management Board is kept informed on a weekly basis.

Within counterparty risk, VTBE has also identified concentration risks in its commitments in Russia and with regard to specific sectors. Sector concentrations are measured and assessed in a risk-bearing capacity analysis. The bank responds to any lack of diversification with corresponding limits.

Among other methods, VTBE measures its risks daily by country and country groups in accordance with the CRR, based on the capital consumed by the transactions. It has defined a quota limit that it uses to limit the proportion of Russian risk. The proportion of risk relating to the real estate sector is also limited.

MARKET PRICE RISKS

Market price risks mean the risk that lost earnings might arise due to a change in market prices and possible write-downs in the bank's portfolio. For VTB Bank (Europe) SE, interest rate risks, foreign exchange risks and spread risks are the most relevant in this context.

As far as currency risk is concerned, VTBE basically pursues a fully currency-congruent funding strategy. To this end it undertakes FX swaps which are only entered into for the sake of currency procurement and not for speculation purposes. In most cases FX swaps do not concern anticipatory hedges, since purchases of US dollars are always accompanied by parts of the loan portfolio that cannot be covered through other liquidity sources in US dollars.

Currency risks are limited by way of position and stop loss limits that are monitored daily with tight schedules. From the bank's perspective, foreign currency risks result from exchange rate fluctuations when there is a currency mismatch between sources of funding and lending. These risks can affect the business in the form of lower interest and capital repayments on the part of customers or by making foreign currency liabilities more expensive. Market price fluctuations with currency swaps can also lead to risks and replacement risks can occur through default on the part of currency swap counterparties.

As part of the risk-bearing capacity strategy, VTBE assesses foreign currency risk by measuring the market price fluctuation of existing currency swaps as well as interest and capital cash flows. To determine the foreign currency risk, the bank relies on a combination of historical simulation and the assumption of a normal distribution of exchange rates. For both normal and stress scenarios, the bank assumes a holding period of one year and applies a confidence level of 95% (going concern) or 99.9% (gone concern). This gives the Value at Risk („VaR"). The VaR with a holding period of one year describes the maximum level of loss that could occur within a year based on the relevant confidence level. For both VaRs calculated, we look at a scenario stress for the bank that is within the limit set for market price risks as part of the risk-bearing capacity strategy.

The bank's own securities portfolio is always divided into the asset portfolio and the liquidity portfolio. VTBE intends to hold items in the asset portfolio until the due date.

Interest rate risks for VTBE can result from the fact that it tends to fund its borrowing through short-term arrangements, whereas on the lending side, funds are invested on a longer-term basis. The risk is lessened by the fact that loans are restricted with regard to their maturity in accordance with the risk strategy. This affects results on the lending side, results on the borrowing side (both market entities) and transformation results; the latter are the responsibility of Treasury.

In order to calculate interest rate risks for the non-trading portfolio, VTBE uses the net interest income (NII) method in the risk-bearing capacity analysis for a going concern and the economic value of equity (EVE) method in the risk-bearing capacity analysis for a gone concern. The NII method is orientated towards profit and loss, not present value, and measures the effects of interest rate changes on profit and loss. Here, the bank measures the influence of eight IRRBB interest rate scenarios for the major currencies. The definition of the interest rate stress test scenarios corresponds to the requirements of BCBS 238.

The EVE method is orientated towards present value and VTBE uses interest shock scenarios in line with regulatory specifications. An interest rate shock scenario of +/- 200 basis points is used for the current yield curve to simulate the present value loss (or profit) due to extreme changes in the interest rate structure.

Credit spread risk is defined as the change in market prices on the basis of changes in credit spread. VTBE uses the so-called Z-spread to quantify the credit spread components. The Z-Spread is the spread in basis points that is balanced against the implied spot yield curve so that the discounted cash flow of a bond (respective interest instrument) matches its current market price. The bank uses a historic Z-spread distribution to calculate risk capital requirements.

LIQUIDITY RISKS

VTBE defines the liquidity risk or funding risk as the risk of not being able to procure the funds it needs or only at a higher cost. The bank's liquidity risk is seen as significant and is discussed on an ongoing basis in ALC and Risk Committee meetings.

To reduce liquidity risk, the bank finances parts of its lending with matching maturities if possible. As previous years have shown, funds can be borrowed in the form of customer deposits due to membership in the private deposit security fund. This funding option has proven itself even in times when there has been a financial market crisis. Refinancing in the US dollar area can also be secured via sufficient lines for currency swaps with other banks.

Due to its business structure, VTBE distinguishes between short-term liquidity risk, which is managed and monitored daily by Treasury, and long-term liquidity risk. The bank sees itself as exposed to this risk when loans or credits are not funded with matching maturities.

In addition, the bank uses various ways of measuring and monitoring liquidity risks. Besides the management of payment streams, automatic bulletins on the liquidity position are sent out at hourly intervals. This means, above all, that liquidity in loro accounts can be measured constantly, giving the bank the chance to react quickly to unscheduled outflows.

VTBE controls liquidity through a system of regulatory indicators and self-imposed limits to reduce maturity transformation risks. With respect to the internal limit on term transformations on short-term liquidity, the bank prefers to secure its supply of liquidity rather than to invest surplus funds in order to generate income. With regard to maturity transformations, the bank relies on contractually agreed payment streams. It makes no differentiation between euro and US dollar payments as it assumes that both its main currencies can be freely converted at any time.

In the reporting year, VTBE had sufficient short-term liquidity on an ongoing basis to service its short-term liabilities at all times.

VTBE calculates scenarios that offer a preview of the near future on the basis of realistic assumptions. For example, it forecasts on the basis of contractual agreements to what extent an ad hoc outflow of liquidity could affect the bank's solvency. In the process, it assumes outflows of 40% or 50% of the funds with an immediate effect on liquidity. For example, these include the bank's Nostro balances, overnight or call money, the withdrawal of deposits as well as the utilisation of lines of undrawn and irrevocable loan commitments.

On the opposite side of the equation, corresponding funds from the bank's own bank balances, receivables from money market transactions, collateral held with the Deutsche Bundesbank and mandatory funding credit for a potential liquidity bottleneck must at least cover any shortfall as part of a stress-test scenario. These stress calculations are put into concrete form as the survival period indicator. For longer-term liquidity planning, the bank uses a standard group model for monitoring and managing liquidity. In this context, the bank allocates assets and liabilities to corresponding maturity bands, with the result that Treasury can use a liquidity maturity statement to intervene early with measures to affect liquidity. Here too, a corresponding scenario is examined whereby calculations are made applying significant haircuts to securities in the liquidity reserve to cover potential liquidity shortfalls. The results in the reporting year did not indicate that limits had been exceeded.

The bank's own emergency plan describes the course of action in the case of liquidity bottlenecks. Authorisation and representation provisions ensure that the bank can react to specific risks in an appropriate manner.

A „Liquidity Coverage Ratio" (LCR) has had to be maintained by banks since 01/10/2015. The lower threshold for the LCR in the reporting year was set at 80% by the regulator and internally at 90%. In the period from 1 January 2017 to 31 December 2017, the LCR was between 99.8% and 203.4% (average 121.8%)[1]. This incorporates the LCR figures for VTB Bank (Deutschland) AG until 30/11/2017 and the LCR figures for VTBE as of 31/12/2017.

The bank was also able at all times to meet maturity transformation limits. Here, VTBE prefers to secure its supply of liquidity rather than to invest surplus liquidity in order to generate income.

INTERACTION OF RISKS

When risks arise, they may spread to other risks and exacerbate the problems already caused. On the other hand, risks can wholly or partially cancel each other out when considered together. For its risk-bearing capacity analysis, VTBE assumes that risks do not eliminate each other (correlation of around 1). On the one hand, the bank thus avoids the challenging task of determining correlations between risks that would be sufficiently robust from a regulatory point of view. On the other hand, adding up the totality of all significant risks (correlation of around 0) usually leads in any case to an overestimation of the risk from the bank's perspective. Consequently, the bank takes on the position of a risk-averse decision-maker in accordance with the principles of prudence.

OPERATIONAL RISKS

Based on the definitions of CRR, VTBE understands operational risk to be the danger of losses that occur as a result of the unsuitability or failure of internal procedures, people or systems or external events. The definition includes legal risks, but does not include strategic risks, business risks or risks to reputation.

VTBE sees operational risks mainly in the areas of processing (Documentary and Settlement), payment transactions (International Payments), Human Resources (staff turnover/staffing) and across the whole bank in the event of the limited availability of IT systems[2].

Incidents are filed by the OpRisk officer of the department and sent to the risk management department, where they are collated and assessed. In addition, a bank-wide self-assessment is carried out every year to regularly identify potential risks in the area of operational risk.

Finally, within the framework of the risk-bearing capacity analysis, the bank assesses normal and stress scenarios with regard to operational risk.

In the case of incidents of risk occurring, regular reports are sent to the ALC and the Supervisory Board. Ad-hoc reports are provided in the case of serious events.

RISKS ARISING FROM THE MERGER

The merging of three different platforms to form one standardised platform was successful. However, there were delays in external notifications and publications in 2018. The merger also led to financial impairments in 2017 and 2018, but these will be more than offset by cost savings in the future. The merger also involved an increase in the risk of loss of employees important to the implementation of the merger when normal banking business was continued, to an extent beyond that of normal turnover. This risk was taken into consideration in specific measures. No further risks, such as those that could involve subsequent liability on the part of VTBE, could be identified either during preparatory work for the merger or following the merger, nor are such risks expected, particularly given the similarity of the business models, comprehensive knowledge of all the commitments assumed and the standardised governance that has been in place for years.

OUTLOOK

After the legal merger completed at the turn of the year 2017/2018, the unified bank now considers itself to be better positioned than ever when it comes to overcoming future challenges and remaining successful in its chosen field of financing for German-Russian trade and economic relations.

Continued sanctions by the EU and the US against Russia have already resulted in Western or West-orientated banks withdrawing gradually from Russian business over the past few years – a trend that we expect to continue for the entirety of 2018. Given the tone and language used in the escalating political conflict between East and West, there is no expectation that the economic sanctions imposed by either side will expire or be lifted in 2018, which would have been a prerequisite for the re-entry of Western banks onto the market in Russia or broader acceptance

[1] Provision through notification to Deutsche Bundesbank in the currently valid calculation form.
[2] In common parlance at the bank, this includes ITC systems, i.e. telecommunication systems.

of Russian risks in Europe. In fact, it is becoming clear that the reason for the sanctions and counter-sanctions, originating from the annexation of Crimea and destabilisation of the situation in the Ukraine, has receded into the background and the reciprocal sanctions are actually being used as instruments of power to support the individual positions of each side on different political topics and will be maintained or even intensified. At any rate, the lifting of the existing sanctions regime on both sides is not expected any time soon and numerous old and new players are getting in on the action.

On the other hand, it is expected that increasingly strict US sanctions legislation that affects not just American companies but all companies or at least those that have business relations with the US will have some kind of reflex effect, meaning that many Western companies that are highly dependent on US business may revise their presence in Russia. This is a major issue, particularly for an economy as heavily dependent on exports as Germany, and will have a huge impact on world trade. The Association of German Chambers of Commerce and Industry (DIHK) dropped its forecast for growth in exports in 2018 from 6% to 5%, not just as a result of this issue, but also given the expected introduction of punitive US tariffs and the expected counter-reactions that are likely to have a dampening effect on world trade. Nevertheless, the EU Commission continues to expect robust growth rates for Germany. Stronger private consumption and continued high demand from abroad meant a 2.2% rise in GDP in 2017, according to the EU Commission. Brussels is forecasting growth of 2.3% for 2018 and 2.1% for 2019. The outlook is positive for European macroeconomic framework data, particularly Germany, which is a natural focus for our business activities along with Russia.

FORECAST FOR RUSSIA

The International Monetary Fund (IMF) left its growth forecast for the Russian economy unchanged from 2017 to 2018 in the latest „World Economic Outlook" (http://www.imf.org/en/publications/weo), setting it at only 1.7% and falling to 1.5% for 2019.

While the IMF predicts a rise in raw material exports and a loosening of monetary policy as the reasons behind this growth, it still believes as before that the structural problems in the Russian economy and the effects of the sanctions will act as brakes on growth. Although the IMF can see positive momentum in the Russian economy, based on an annual average rise of 18% in oil prices, it assumes that the price of crude oil will fall slightly in 2019. It must be said that the IMF continues to assume a very high correlation between the performance of the Russian economy and oil prices.

„The Economist" has reported that analysts from leading Western banks are somewhat more optimistic in their forecasts for the Russian economy than the IMF, although these are still below the forecasts of the government, which predict growth of 2.1% in 2018 and 2.2% in 2019.

The IMF expects the greatest growth momentum to come from private consumption in Russia and an increase in capital investments, while the rising foreign trade deficit will have a tangible negative impact. The expected devaluation of the rouble against the US dollar will make imports more expensive and, in the end, lead to a rise in consumer prices.

The economies of Western countries that are reliant on oil imports are now once again considering oil price developments to be a risk to economic growth. In the eurozone, the high oil price is yet another negative factor for the European economy, alongside the appreciation of the euro and the trade dispute with the US; these have an inversely positive impact for oil-producing and oil-exporting countries such as Russia. Further political developments involving Iran remain far from predictable – its entry onto the oil market would have an impact on oil prices that would not apply if this entry were to be prohibited.

The weaknesses of the Russian economy in 2018 will continue to be insufficient diversification, the high share of the public sector in the economy, the continued need to upgrade a large part of the infrastructure, as well as insufficient progress in such areas as reducing bureaucracy and combating corruption. We are not assuming that the FIFA World Cup that takes place in Russia in Summer 2018 will have a major effect on the economic development of the country. Our forecasts for the Russian market for 2018 are positive, as we assume that the economic situation will stabilise, even if the rate of inflation remains above the rate of GDP growth.

DEVELOPMENT IN THE EUROZONE

The forecast for Europe is more difficult, particularly in terms of interest development in the eurozone. The ECB extended its major bond purchase programme for government and corporate bonds by nine months to run until at least the end of September 2018, although it halved the monthly volume to EUR 30 billion from January onwards. The transactions will continue and a volume of EUR 2.55 trillion will be reached by the end of September. Many financial experts believe that the ECB has already done whatever it takes in order to achieve its inflation target of just under 2.00% and that anything above and beyond that is not expedient, as ongoing low or even falling prices could make companies and consumers postpone investments. However, as before, Mario Draghi states that the ECB will act „reactively" to market developments and did not exclude further purchases.

ECB economists are predicting a 2.4% rise in GDP in 2018. The forecast for 2019 remains unchanged at 1.9% and 1.7% is predicted for 2020. This is a reasonably secure forecast to a certain extent as Draghi's term of office as President of the ECB will end on 31 October 2019 and his successor is likely to pursue his/her own interest rate and monetary policy. Growing dissatisfaction with the extent and duration of the ECB's „quantitative easing" programme and the clear failure to hit inflation targets may lead to a monetary policy hardliner taking up the position. However, the financial crisis in Europe seems to have been overcome: the EU Commission has once again increased its growth forecast significantly for the eurozone and the EU as a whole. The economy is set to grow more strongly in 2018 and 2019 than originally predicted. Nevertheless, there is uncertainty surrounding the geopolitical tension between East and West, the proxy conflict in Syria, developments relating to North Korea and the exact configuration of Brexit once the United Kingdom leaves the EU at the end of March 2019 (provisional date). The EU Commission is now predicting 2.3% growth in GDP in the 19 countries that use the euro as their currency. Growth in 2019 is predicted to be 2.0% in the eurozone and 2.1% in the 27 EU states, not including Great Britain.

BREXIT

The EU Commission expects growth of 1.4% for the UK in 2018, slowing down to 1.1% in 2019. However, this is based on the assumption that trade relations between the remaining 27 EU states and the UK remain unchanged. This is questionable, for the financial sector at the very least. Even if no inherently dramatic departure from the City of London is expected in March 2019, the expected relocation of activities to continental Europe will mean significant increases for those locations, given their relative size. The medium- to long-term impact of this on existing economic relations will be more serious for the UK economy than the short-term relocations. In many ways, it is likely that the English point of view will swing round closer to the American point of view, not least in order to compensate for the lack of proximity to Europe in economic terms. After all, the roots of the British „Leave" campaign lay in the protection of the country's own interests ahead of European interests and self-determined policy over common policy, similar to the current US President's „America First" campaign.

Developments in the UK are only significant in terms of the VTBE business model to the extent that business involving Russia may be relocated to continental Europe against the backdrop of growing uncertainty about the future development of the Anglo-Russian relationship. VTBE itself is therefore not dependent on the further development of Brexit.

TARGET FIGURES FOR VTB BANK (EUROPE) SE

Within these overall economic parameters in Russia and Europe, in particular in view of economic expectations for Germany, we continue to assume a favourable market environment for our business segment overall, as we will be faced with a falling number of competitors. We are planning our business development for 2018 with an essentially unchanged capital base from 2017 and are assuming that we will achieve a total capital ratio of >15% by the end of 2018. We are expecting an increase of around 3% in risk-weighted assets by the end of 2018 in comparison to the previous year. Based on a net interest margin of 3.4%, 1.0% lower than in 2017, we are planning to achieve a return on equity of approx. 4.2% by the end of 2018. The main source of income here will remain our interest-bearing business. Our plans include significant allowances for provisions that will enable us to react to any crises that arise and any tightening of sanctions, even though we are not currently aware of any individual cases in our portfolio in which additional precautions are necessary. The loss of certain competitors means that we consider ourselves to be in a position to acquire business at prices commensurate with the level of risk, without having to leave our niche. The aforementioned merger of the three former ESH banks to form VTBE has helped us permanently reduce the ongoing costs of our business model significantly without abandoning our previous products and distribution channels, meaning that we are planning on a cost-income ratio of 33.2% for 2018. For the coming financial year, we expect our profit after tax to be significantly below the results for 2017, as payments of approx. EUR 45 million will now be due for our restructuring measures. The predicted developments and target figures for 2017, which were adjusted during the year as the result of the Opera project, were largely realised, despite the considerable expenses and efforts that accompanied the legal, organisational and technical implementation of the merger. A direct comparison of target/actual figures for the year with the previous period (previous year's plan by VTBD for 2017) is of little value, given that the previous year's plan was based on the assumed continuation of VTB Bank (Deutschland) AG in cooperation with the European sub-holding of VTB Bank (Austria) AG. Business development has been more satisfactory than predicted in the plan revision generated during the year as part of the „Opera" project, as this revised plan assumed a reduction in earnings and sharply rising costs as the result of resource bottlenecks during the restructuring phase. However, net profit before tax was actually far above these expectations and the use of loss allowances was far below them. We expect our liquidity position to remain adequate at all times during 2018 and predict an LCR of 140% as of the end of 2018.

In our „International Payments" business segment, we enjoyed significant growth in 2016 and 2017 and expect this positive trend to continue in 2018, based on further positive development of our business relations with corporate clients involved in German-Russian economic trading. Our ambition is to offer our customers products that are well able to cope with current and future challenges. Having achieved our aim of merging the three banks to form VTBE, with the merger being formally recorded in the Frankfurt/Main commercial register on 29 December 2017, we will carry out further investments in our infrastructure in 2018 in order to be able to offer our customers products from this new bank of the same quality that they expect from us. Our overall aim is to reduce our dependency on interest-bearing business by expanding our commission income.

Plans had already been made during the restructuring project to convert the merged bank from a non-trading book institution to a trading book institution. This step should be implemented by the end of 2018 once the project planning phase is complete. Beginning in 2018, VTBE is also planning on carrying out investment services to the extent necessary to qualify as an investment services institution.

Given the one-off expenses that have been incurred, such as costs arising from the severance schemes set up in Austria and France as part of the merger, and the fact that the centralisation of back-office functions in Frankfurt meant that a large number of jobs in Vienna were lost and the Paris location was closed entirely, a meaningful comparison with the previous year (including staff figures – number of members of staff, staff expenses etc.) will only be possible in the coming year. We will make additional adjustments wherever it is necessary in order to adapt the staffing levels planned for the period after the merger to the actual workload. We currently assume that the average number of staff we employ in 2018 (Germany and Austria) will be around 180 people.

INDIVIDUAL FINANCIAL STATEMENTS

BALANCE SHEET AS AT 31 DECEMBER 2017
OF VTB BANK (EUROPE) SE

Assets				
	EUR	EUR	EUR	Prev. year, EUR thousand
1. Cash reserve				
a) Cash balances		4,236.25		1
b) Balances with central banks		1,695,582,866.08		973,606
of which: held with Deutsche Bundesbank EUR 1,694,244,134.20 (Prev. year, EUR 973,606 thousand)			1,695,587,102.33	
2. Receivables from banks				
a) due on demand		252,011,004.47		165,952
b) other receivables		343,044,754.56	595,055,759.03	221,109
3. Receivables from customers			**4,567,051,084.39**	**1,274,546**
4. Debt securities and other fixed-interest securities				
a) Bonds and debt securities				
aa) from public issuers	477,190,436.42			331,803
of which: eligible as collateral at Deutsche Bundesbank EUR 477,190,436.42 (Prev. year, EUR 331,803 thousand)				
ab) von anderen Emittenten	359,353,341.18	836,543,777.60	836,543,777.60	227,613
darunter: beleihbar bei der Deutschen Bundesbank EUR 163.758.883,32 (Vj. TEUR 74.878)				
5. Participations			**15,338,425.61**	**92**
of which: in banks EUR 15,208,392.60 (Prev. year,EUR 0 thousand)				
of which: in financial service institutions EUR 23,491.93 (Prev. year, EUR 0 thousand)				
6. Shares in affiliated companies			**422,344.39**	**424**
7. Intangible assets:				
a) Acquired concessions, industrial property and similar rights and assets as well as licences for such rights and assets		15,069,081.84	15,069,081.84	8,198
8. Fixed assets			**3,394,435.69**	**2,266**
9. Other assets			**102,989,234.43**	**35,277**
10. Accruals and deferrals			**2,626,848.08**	**974**
11. Deferred tax assets			**21,208,954.38**	**6,995**
Total assets			**7,855,287,047.77**	**3,248,856**

Liabilities	EUR	EUR	EUR	Prev. year, EUR thousand
1. Liabilities to banks				
a) due on demand		1,076,218,776.35		1,190,282
b) with agreed term or notice period		434,730,781.83	1,510,949,558.18	575,679
2. Liabilities to customers				
a) Savings				
aa) with an agreed notice period of three months	16,770,332.16			0
ab) with an agreed notice period of more than three months	324,551,614.66	341,321,946.82		0
b) other liabilities				
ba) due on demand	1,483,699,318.75			285,776
bb) with agreed term or notice period	2,370,336,499.31	3,854,035,818.06	4,195,357,764.88	776,220
3. Other liabilities			**76,093,481.13**	**29,046**
4. Accruals and deferrals			**19,730,520.78**	**14,695**
5. Provisions				
a) Provisions for pensions and similar obligations		30,031,200.62		26,371
b) Tax provisions		46,982,024.90		1,869
c) Other provisions		80,609,566.66	157,622,792.18	8,538
6. Subordinate liabilities			**892,914,111.68**	**0**
7. Fund for general bank risks			**55,158,441.49**	**41,663**
8. Equity				
a) Subscribed capital		66,467,945.00		66,468
b) Capital reserve		612,239,212.58		0
c) Revenue reserves				
ca) legal reserve	6,646,794.46			6,647
cb) other revenue reserves	208,918,169.70	215,564,964.16		208,918
d) Unappropriated profit		53,188,255.71	947,460,377.45	16,684
Total liabilities			**7,855,287,047.77**	**3,248,856**
1. Contingent liabilities				
a) Liabilities from guarantees and indemnity agreements			145,815,874.39	17,202
2. Other commitments				
a) Irrevocable undrawn credit lines			219,801,428.69	57,053

PROFIT AND LOSS ACCOUNT OF VTB BANK (EUROPE) SE
FOR THE PERIOD FROM 1 JANUARY TO 31 DECEMBER 2017

Expenses	EUR	EUR	EUR	Prev. year, EUR thousand
1. Interest expenses				
Interest expenses from the bank business		68,027,958.32		24,579
less positive interest from the bank business		-3,968,587.35	64,059,370.97	(917)
2. Commission expenses			**7,388,048.95**	**2,611**
3. General administrative expenses				
a) Staff expenses				
aa) Wages and salaries	28,231,564.70			11,152
ab) Social security contributions, pension and welfare expenses	4,885,044.58	33,116,609.28		1,805
of which: for pensions EUR 1,771,006.21 (Prev. year, EUR 596 thousand)				
b) Other administrative expenses		33,793,474.21	66,910,083.49	9,711
4. Depreciation, amortisation and write-downs on intangible and fixed assets			**3,236,410.18**	**1,623**
5. Other operating expenses			**21,668,448.49**	**1,757**
6. Allocation to fund for general bank risks			**0.00**	**0**
7. Depreciation, amortisation and write-downs on receivables and certain securities as well as allocations to provisions relating to the lending business			**29,693,971.68**	**13,558**
8. Depreciation, amortisation and write-downs on participations, shares in affiliated companies and securities treated as fixed assets			**0.00**	**2,917**
9. Expenses from loss assumed			**0.00**	**1**
10. Extraordinary expenses			**163,040.00**	**163**
11. Taxes on income and profit			**18,774,780.88**	**8,096**
12. Other taxes, if not shown under item 5			**2,176.00**	**4**
13. Annual profit			**20,613,089.63**	**16,684**
Total expenses			**232,509,420.27**	**93,744**

Income	EUR	EUR	EUR	Prev. year, EUR thousand
1. Interest income from				
a) lending and money market transactions	172,940,978.78			71,243
less negative interest from lending and money market transactions	-6,386,220.28	166,554,758.50		(2,337)
b) fixed-interest securities and debt register claims		15,186,182.24	181,740,940.74	10,726
2. Income from profit pools, profit transfer or partial profit transfer agreements			**68,879.28**	**0**
3. Commission income			**20,692,812.46**	**9,445**
4. Income from write-ups of participating interests, shares in affiliated companies and securities treated as fixed assets			**7,878,045.84**	**0**
5. Other operating income			**11,748,527.49**	**4,667**
6. Extraordinary income			**10,380,214.46**	**0**
Total income			**232,509,420.27**	**93,744**
1. Annual profit			**20,613,089.63**	**16,684**
2. Withdrawals from capital reserve			**32,575,166.08**	**0**
3. Unappropriated profit			**53,188,255.71**	**16,684**

NOTES

APPLICABLE REGULATIONS

The annual financial statements of VTB Bank (Europe) SE for 31 December 2017 have been prepared according to the relevant regulations of the German Commercial Code (HGB), the Regulations on the Accounting of Banks and Financial Institutions (RechKredV) and the German Stock Corporation Act (AktG). The account form was used as the basis for the profit and loss account. The statutory offset options for the profit and loss account have been utilised.

Insofar as information can be optionally included in the balance sheet or the Notes, such information has been included in the Notes.

ACCOUNTING AND VALUATION METHODS WITHIN THE FRAMEWORK OF THE MERGER

Within the framework of the merger of the former parent company VTB Bank (Austria) AG, Vienna, with effect as of 30 June 2017 and the former affiliate VTB Bank (France) SA, Paris, with effect as of 29 December 2017 to form VTB Bank (Europe) SE, the carrying amounts from the closing balance sheets of the acquiring legal entities were shown as costs of acquisition (book value carryover pursuant to § 24 of the Transformation Act [Umwandlungsgesetz]). If the closing balance sheets of the acquiring legal entities contain items that may not be shown in accordance with German commercial law, these were not carried over.

The differences between the transferred carrying amounts for assets and liabilities (net assets) are allocated to VTB Bank (Austria) AG, Vienna, accordingly under capital reserve. For VTB Bank (France) SA, Paris, this is recorded under other operating income.

The accounting and valuation of assets and liabilities on the balance sheet date have been carried out pursuant to German accounting regulations.

Given the merger and the associated transfer of assets and liabilities to the bank, a comparison with the values of previous years is not possible at all or only on a limited basis. Where figures from previous years are quoted, these are values relating to VTB Bank (Deutschland) AG, Frankfurt/Main, as the bank's legal predecessor.

ACCOUNTING AND VALUATION METHODS IN GENERAL

The accounting and valuation methods remained unchanged by comparison with the previous year.

The **cash reserve** is shown in the balance sheet at its face value.

Receivables from banks and **receivables** from customers are shown at their nominal value including deferred interest.

Discounts and premiums are shown under deferred items and systematically released over the term of the underlying transaction.

Where credit risks and country risks were identified, allowances and country risk provisions are provided. In addition, general allowances and provisions cover deferred credit risks. If the reasons for establishing an allowance no longer apply, the allowance is released accordingly.

Debt securities and other fixed-interest securities in the liquidity reserve are measured on the strict principle of the lower of cost or market at their cost of acquisition or their stock exchange or market price if lower or their lower attributable value.

On the other hand, securities treated as fixed assets are valued in accordance with the moderate lower of cost or market principle. They are shown at their cost of acquisition after deducting an impairment loss which is likely to be permanent. Premiums are included in the acquisition costs and systematically released. Write-ups are applied up to a maximum of the original cost of acquisition if the reasons for the impairment loss no longer apply.

Participations and shares in affiliated companies are entered at acquisition costs or the lower attributable value on the balance sheet date. Write-ups are made if the reason for former depreciations no longer applies.

Fixed assets and intangible assets are shown at the cost of acquisition less regular depreciation. Depreciation is applied on the straight-line method in accordance with the expected useful life.
Low value assets (net cost of acquisition or manufacture up to EUR 410) are written off in full in the year of acquisition. The bank has not made use of its option pursuant to sec. 248 para. 2 HGB.

Other assets are shown at the nominal value or the attributable value on the balance sheet date.

Prepaid expenses consist of expenses paid before the balance sheet date that relate to expenses for a certain period after that date. This item is reversed over the term of the underlying transactions.

If there are differences between the commercial valuations of assets, debts and deferred items and their fiscal valuations which are expected to be settled in later financial years, any resulting tax liabilities are shown as **deferred tax liabilities** and any resulting tax relief as deferred tax assets. For the purposes of measuring deferred taxes, the tax rates probably applicable to the individual company at the time when the differences are expected to be recovered or settled, are the operative rates.

Liabilities are shown at their repayment amount.

The **deferred income item** refers to earnings before the balance sheet date that relate to earnings for a certain period after that date. This item is reversed over the term of the underlying transactions.

Provisions for pensions and similar obligations were established on the basis of actuarial appraisal. **Tax provisions** and **other provisions** for uncertain liabilities or imminent losses from pending transactions were created in accordance with sec. 253 para. 1 HBG based on a reasonable business assessment. Provisions with a residual term of more than one year are discounted pursuant to sec. 253 para. 2 sentence 1 HGB.

The bank has checked in accordance with sec. 340a in conjunction with sec. 249 para. 1 sentence 1 alt. 2 HGB whether it has to form a provision for any possible commitment surplus resulting from transactions with interest-related financial instruments in its non-trading portfolio. All balance sheet and off-balance sheet interest-related financial instruments outside of the trading portfolio were included, based on the bank's portfolio structure. The present value approach was selected by the bank for this purpose. Payment flows of the financial instruments in the non-trading portfolio are discounted at term-congruent interest rates. Risk and administrative costs are included as a discount on the payment flows. The calculations did not lead to a commitment surplus with the result that there was no requirement to create a provision for the same on the balance sheet date.

Use was made in the past financial year of the option pursuant to sec. 340g HGB (**fund for general bank risks**).

Equity is the result of the residual parameter from the sum of assets shown on the balance sheet less obligations shown on the balance sheet. The share capital is shown on the balance sheet at its nominal value.

The valuation of **derivatives** depends on whether the financial instruments are traded on liquid markets.

Derivatives that can be traded on liquid markets (e.g. interest swaps and options, transactions involving foreign currencies and options, credit default swaps) are valued using standard valuation models. These models comprise discounted cash flow models and Black-Scholes and Hull-White option price models. The models are calibrated to quoted market data.

Derivatives not quoted on a liquid or active market are valued using generally recognised models. This involves the use of discounted cash flow models that in turn use quoted market data such as yield curves. Studies by international rating agencies are used to determine the probability of default.

For the conversion of pending currency forward transactions which hedge interest-bearing balance sheet items, the swap amounts are deferred pro rata temporis and shown in the adjustment item for foreign exchange transactions together with the spot rate differences under „other assets" and „other liabilities". The amounts resulting from the deferral of the swaps pro rata temporis are shown in the items „interest expenses" and „interest income from lending and money market transactions".

Deferred interest resulting from interest rate swaps are shown in the balance sheet in the items „Receivables from bank" and „Liabilities to banks". The interest income resulting from interest rate swaps are shown in the items „interest expenses" and „interest income from lending and money market transactions".

Currencies are converted pursuant to the principles set out in sec. 340h HGB in conjunction with sec. 256a HGB. Fixed assets in foreign currencies are converted into Euro at the acquisition rate, as long as there is no special cover in this regard. The mid spot exchange rate on the balance sheet date is used for assets and debt in foreign currency.

No **valuation units** pursuant to sec. 254 HGB were created.

NOTES TO THE ANNUAL FINANCIAL STATEMENTS

Receivables, securities and liabilities refer solely to non-securitised assets and obligations.

I. BREAKDOWN OF RESIDUAL TERMS

EUR thousand	31/12/2017
Other receivables from banks	**343,045**
of which with a residual term of	
up to three months	154,519
more than three months to one year	178,983
more than one year to five years	9,543
more than five years	0
Receivables from customers	**4,567,051**
with a residual term of	
up to three months	394,147
more than three months to one year	760,231
more than one year to five years	2,432,906
more than five years	979,767
Liabilities to banks with agreed term or notice period	**434,731**
of which with a residual term of	
up to three months	11,243
more than three months to one year	25,032
more than one year to five years	23,313
more than five years	375,143
Savings with an agreed notice period of more than three months	**324,552**
up to three months	134,199
more than three months to one year	70,546
more than one year to five years	118,991
more than five years	816
Other liabilities to customers with agreed term or notice period	**2,370,336**
of which with a residual term of	
up to three months	502,539
more than three months to one year	700,867
more than one year to five years	1,102,932
more than five years	63,998

II. FOREIGN CURRENCY HOLDINGS

EUR thousand	31/12/2017	31/12/2016
Assets	2,308,891	1,121,945
Liabilities	2,555,097	1,114,876

III. RELATIONS WITH AFFILIATED COMPANIES AND COMPANIES IN WHICH PARTICIPATIONS ARE HELD

EUR thousand	Affiliated companies	Participations
Receivables from banks	5,246	0
Receivables from customers	0	0
Debt securities and other fixed-interest securities	0	0
Other assets	0	4,667
Liabilities to banks	102,579	2,001
Liabilities to customers	147,658	0
Other liabilities	0	0
Securitised liabilities	0	0
Subordinate liabilities	879,173	0
Contingent liabilities	26,273	0

IV. GROWTH OF FIXED ASSETS

Intangible assets / Fixed assets										
Statement of changes in fixed assets (EUR thousand)	Cost of acquisition / manufacture 01/01/2017	Additions	Disposals	Cost of acquisition / manufacture 31/12/2017	Depreciation 01/01/2017	Depreciation Current year	Disposals Current year	Depreciation 31/12/2017	Residual book value Financial year	Residual book value Previous year
Intangible assets	14,313	9,439	1,045	22,707	6,116	2,542	730	7,928	14,779	8,197
Fixed assets /	0	393	0	393	0	0	0	0	393	0
Operating and business equipment	4,769	1,612	884	5,497	2,503	694	702	2,495	3,002	2,266
Prepayments	0	290	0	290	0	0	0	0	290	0
Total	**19,082**	**11,734**	**1,929**	**28,887**	**8,619**	**3,236**	**1,432**	**10,423**	**18,464**	**10,463**

Additions of EUR 2,853 thousand to cost of acquisition and manufacture over the past financial year relate to the carrying amounts for the acquiring companies recorded as part of the merger. Amortisation and depreciation of EUR 330 thousand as at 31/12/2017 relates to assets acquired as part of the merger.

Amortisation and depreciation was calculated in accordance with the rates recognised for commercial law purposes.

V. OWNERSHIP INTERESTS HELD PURSUANT TO SEC. 285 NO. 11 HGB

Name / Head Office	Capital share in %	Equity in EUR million	Earnings in 2017 in EUR million
		(2016)	(2016)
Evrofinance Mosnarbank JSC Moskau	7.97	178.2	4.3
Ost-West Vermögensanlagen GmbH Frankfurt/Main	100.00	0.4	0.0
Russ Euro EEIG London	33.33	0.0	0.0

In accordance with sec. 296 para. 2 HGB, the subsidiary Ost-West Vermögensanlagen GmbH, Frankfurt/Main is of subordinate importance for the representation of the bank's assets, financial and earnings position. A profit and loss transfer agreement has been concluded with Ost-West Vermögensanlagen GmbH. There is also a fiscal union with Ost-West Vermögensanlagen GmbH as a controlled company for the purposes of corporation tax, business tax and VAT.

VI. FINANCIAL INVESTMENTS AND SECURITIES

A) FINANCIAL INVESTMENTS

Statement of changes in fixed assets (EUR thousand)	Cost of acquisition/ anufacture 01/01/2017	Additions	Disposals	Exchange rate losses / gains	Cost of acquisition /anufacture 31/12/2017	Depre-ciation 01/01/ 2017	Write-downs 01/01/ 2017	Depre-ciation Current year	Write-downs Current year	Dis-posals Current year	Depre-ciation/ write-downs 31/12/ 2017	Residual book value Financial year	Residual book value Previous year
Participations	92	15,246	0	0	15,338	0	0	0	0	0	0	15,338	92
Shares in affiliated companies	424	0	0	-2*	422	0	0	0	0	0	0	422	424
Debt securities and other fixed-interest securities	44,853	24,092	36,667	267**	32,545	11,485	6,527	0	0	0	4,958	27,587	33,369
Total	**45,370**	**39,338**	**36,667**	**265**	**48,306**	**11,485**	**6,527**	**0**	**0**	**0**	**4,958**	**43,348**	**33,885**

* The change results from EUR / RUB exchange rate effects ** The change results from EUR / RUB exchange rate effects.

Additions to cost of acquisition and manufacture over the past financial year relate exclusively to the merger.

No write-downs were performed on fixed-interest securities in fixed assets on the assumption of a probably permanent impairment loss as of the balance sheet date. Moreover, write-downs on fixed-interest securities in fixed assets were avoided due to the application of the moderate lower of cost or market principle.

B) SECURITIES / PARTICIPATIONS / AFFILIATED COMPANIES

EUR thousand	total	tradable	listed
Debt securities and other fixed-interest securities (without accrued interest)	833,939	830,086	830,086
Participations	15,338	-	-
shares in affiliated companies	422	-	-

The balance sheet item, debt securities and other fixed-interest securities, contains nominal amounts of EUR 380,927 thousand that will be due by 31 December 2018.

As in the previous year, no assets had been sold under repurchase agreements on the balance sheet date.

VII. OTHER ASSETS AND LIABILITIES

Other assets of EUR 102,989 thousand consist mainly of positive values for currency swap transactions totalling EUR 68,386 thousand, receivables from European banks from so-called margin accounts totalling EUR 25,155 thousand and premiums paid as part of pending derivative transactions totalling EUR 8,256 thousand.

Other liabilities of EUR 76,093 thousand consist mainly of liabilities from so-called margin accounts totalling EUR 47,494 thousand, deductible capital gains tax totalling EUR 5,909 thousand, liabilities to own staff totalling EUR 5,146 thousand and premiums received as part of pending derivative transactions totalling EUR 4,569 thousand.

VIII. DEFERRED TAXES

The bank has booked deferred taxes for differences between the tax balance sheet and the commercial balance sheet. With respect to corporate income tax, we have taken into account a tax rate of 15% plus solidarity surcharge (5.5% on corporate income tax). A business tax of 3.5% and an assessment rate of 460% were used for the city of Frankfurt/Main. Valuation of deferred taxes for the Vienna branch is subject to Austrian corporate income tax of 25%.

The differences between the tax balance sheet and commercial balance sheet are based on risk provisions, valuations and discount rates that vary for tax purposes. There were no deferred tax liabilities on the closing date.

X. PROVISIONS

Pension provisions totalling EUR 30,031 thousand included EUR 2,434 for the Vienna branch. The pension provisions were calculated in accordance with HGB stipulations based on actuarial methods. They were valued in accordance with accepted actuarial principles, using the so-called „projected unit credit method“ (PUC method). The provision amount pursuant to the PUC method is defined as the actuarial present value of pension obligations generated by the employees up to that point pursuant to the pension formula and vesting provision, based on their past working hours.

The „2005 Guidelines Tables“ by Klaus Heubeck were used as the biometric calculation in this regard. The following assumptions were made regarding future trends:

Actuarial interest rate p.a.:	3.68 %
Salary trend p.a.:	Pay scale employee 2018: 2.21%, Other: 2% p.a. (3% Vienna branch)
Pension trend p.a.:	1.50% (2% Vienna branch)

The valuation of pension provisions is based, according to new legal regulations in force for the first time as of the balance sheet date, on the average market interest rate of the previous ten financial years. Application of the average market interest rate of the previous seven financial years would result in an amount of EUR 33,943 thousand. The difference between valuations based on old and new accounting standards amounts to EUR 3,912 thousand.

The conversion of the valuation of pension provisions according to BilMoG in 2009 resulted in an additional one-time provision requirement totalling EUR 2,446 thousand. The bank applied the transitional rule pursuant to sec. 67 para. 1 sentence 2 EGHGB, and an amount of EUR 163 thousand was allocated to pension provisions (one-fifteenth of the difference is EUR 163 thousand). The allocation is shown as extraordinary expenses in the profit and loss account. The amount of EUR 238 thousand resulting from the initial application, which is not yet shown in the balance sheet, will be allocated to the pension provisions during the remaining transitional period.

Tax provisions totalling EUR 46,982 thousand consist of provisions for domestic taxes on income totalling EUR 10,982 thousand and provisions for foreign taxes on income totalling EUR 35,997 thousand. EUR 42,208 thousand of the tax provisions relate to the past financial year and EUR 4,696 thousand to previous years. There are also liabilities in connection with foreign withholding taxes totalling EUR 78 thousand.

The **other provisions** of EUR 80,610 thousand essentially contain expenses for staff, imminent losses from pending derivative transactions, restructuring consultation and services, flat-rate allowance for credit risks, the archiving of business documents, account maintenance fees, expenses in connection with the annual financial statements as well as expense provisions for rent-free periods from the lease of offices.

Expenses from the compounding of longer-term provisions to the amount of EUR 1,117 thousand are included in other operating expenses.

IX. SUBORDINATE LIABILITIES

As part of the merger, the bank took on subordinate liabilities totalling EUR 892,914 thousand from the former VTB Bank (France), Paris.

The subordinate liabilities are entirely to affiliated companies.

There were no further borrowings in the form of subordinate liabilities between the merger date and the balance sheet date.

XI. SUBSCRIBED CAPITAL

EUR thousand	
Position at the end of the financial year – 66,467,945 no-par shares subject to transfer restrictions	66,468

VTB Bank (Austria) AG, Vienna, held all 66,467,945 shares in the subscribed capital of the former VTB Bank (Deutschland) AG until 29 December 2017. The companies merged on the aforementioned date. As of 31/12/2017, JSC VTB Bank domiciled in 29, Bolshaya Morskaya Street, St. Petersburg, 190000 Russia, held 99.39% of the company's subscribed capital. VO Novoexport held the remaining 0.61% of shares in VTB Bank (Europe) SE as of the end of the financial year.

XII. CAPITAL RESERVE

The first-time disclosure of a capital reserve totalling EUR 612,239 thousand is based on the net assets of the former parent company VTB Bank (Austria) AG, Vienna, and its former affiliate VTB Bank (France), Paris, acquired as part of the merger. Formally, this is a capital reserve pursuant to sec. 272 para. 2 no. 4 HGB (other capital contribution by shareholders to equity).

XIII. REVENUE RESERVES

Revenue reserves of EUR 215,565 thousand consist of legal reserves of EUR 6,647 thousand and other revenue reserves of EUR 208,918 thousand.

The legal reserve is 10% of the subscribed capital pursuant to sec. 150 para. 2 AktG.

The profit for the previous year amounted to EUR 16,684 thousand. In accordance with a resolution passed by the Shareholders' meeting, the entire profit was distributed to the shareholder.

As at 31 December 2017, the bank shows deferred tax assets of EUR 21,209 thousand. Hence an amount equal to EUR 21,209 thousand in the reserves is blocked for distribution.

XIV. ITEMS OF THE PROFIT AND LOSS ACCOUNT

Allocation of income is broken down by geographic markets as follows:

EUR thousand	Home	Abroad	Total
Interest income	1,785	179,956	181,741
Commission income	3,631	17,062	20,693
Other income	1,760	9,989	11,749

The negative interest from lending and money market transactions contained in interest income result from the reserve credit balance with the ECB exceeding the bank's minimum reserve requirement and from credit balances in current nostro accounts and margin accounts.

The positive interest from the bank business contained in interest expenses result from money market transactions with banks and from deposits due on demand.

Other operating expenses totalling EUR 21,668 thousand consist of EUR 13,735 thousand in expenses for additions to contingency provisions and for option premiums paid for derivative transactions. They also include expenses for legal risks totalling EUR 2,780 thousand, interest expenses from the compounding of pension provisions totalling EUR 1,054 thousand and negative results from currency conversion totalling EUR 3,023 thousand.

Other operating income totalling EUR 11,749 thousand comprises earnings from reversal of provisions totalling EUR 9,068 thousand and reimbursements of overpaid VAT totalling EUR 1,192 thousand.

The extraordinary expenses relate to an addition to pension provisions on account of the transitional rule pursuant to sec. 67 para. 1 sentence 2 EGHGB.

Extraordinary income relates to the positive difference between the carrying amount of the net assets acquired from VTB Bank (France) SA, Paris, and the carrying amount of the cancelled shares in VTB Bank (France) SA, Paris.

Taxes on income relate to the legal tax burden, taking into account changes to deferred taxes. Tax expenses of EUR 18,775 thousand contain expenses from taxes on income in the amount of EUR 32,070 thousand and earnings resulting from a reduction in deferred tax assets of EUR 13,295 thousand. Expenses for taxes on income are made up of EUR 32,039 thousand from ordinary business activities for the year 2017, as well as expenses for the previous year totalling EUR 31 thousand.

XV. ANNUAL RESULTS AND RECOMMENDED APPROPRIATION OF PROFITS

The bank's profit and loss account shows the following annual results:

	EUR	EUR thousand
1. Annual profit	20,613,089.63	16,684
2. Withdrawals from capital reserve	32,575,166.08	0
3. Profit	53,188,255.71	16,684

It is recommended to the Shareholders' Meeting to distribute the profit of EUR 53,188,255.71 to the shareholder.

XVI. DERIVATIVE FINANCIAL INSTRUMENTS / FUTURES

Derivative financial instruments are as follows:

EUR thousand	Nominal amount	Market value positive	Market value negative
Foreign currency transactions			
FX swaps	597,969	14,089	54
FX options	25,845	5,229	3,193
FX forward	41,378	107	103
Interest-related transactions			
Interest swaps	309,924	520	1,856
Interest options	1,334,653	19,794	19,794
Other forward and derivative transactions			
Credit default swaps	125,073	107	175
Currency swaps	823,305	49,300	693
Commodity forward	421,305	6,100	6,171

The risk of instruments consists of the counterparty's failure to perform at maturity as per the agreement.

The aforementioned transactions are primarily carried out to cover fluctuations in interest rates, exchange rates or market prices for commercial transactions.

XVII. CONTINGENT LIABILITIES AND OTHER COMMITMENTS

	EUR thousand
1) Contingent liabilities	
a) Liabilities from guarantees and indemnity agreements	
of which: Prepayment and payment guarantees	84,391
Letters of credit	84,225
Other guarantees	263
less collaterals	21,098
less adjustments / provisions	1,965
	145,816
2) Other commitments	
a) Irrevocable credit lines	221,615
less adjustments / provisions	1,814
	219,801

For the purpose of estimating the latent risk of contingent liabilities and other commitments an average model based on the past – supplemented with a risk surcharge – is used. The bank establishes contingency reserves accordingly. In view of the financial situation of our customers, we are of the opinion that our risk assessment and resulting provisions are currently appropriate. In addition, individual risk provisions are established when acute risks occur.

XVIII. CONSOLIDATED FINANCIAL STATEMENTS AND CONSOLIDATED COMPANIES

The company is a subsidiary of JSC VTB Bank domiciled in 29, Bolshaya Morskaya Street, St. Petersburg, 190000 Russia, which holds 99.39% of the company's shares and prepares the consolidated financial statements for the largest group of companies. The group financial statements may be viewed at the registered office of JSC VTB Bank in St. Petersburg; they are also published on the Internet at www.vtb.ru.

Ost-West Vermögensanlagen GmbH as the only subsidiary of VTB Bank (Europe) SE is of subordinate importance for the representation of the bank's assets, financial and earnings position. VTB Bank (Europe) SE utilises the rule pursuant to sec. 296 para. 2 HGB and does not prepare any subgroup financial statements.

XIX. TOTAL AUDITOR FEES

Expenditure on fees for our auditors amounted to EUR 1,384 thousand by 31 December 2017. They are broken down as follows:

EUR thousand		of which for previous years
Auditing services	872	-
Other confirmation services	12	-
Tax consultancy services	70	-
Other services	430	-
Total	**1,384**	**-**

The other services were carried out as part of the merger project. They primarily involved consultancy services relating to corporate law, tax law, commercial law and regulatory aspects when implementing the merger.

XX. NUMBER OF EMPLOYEES

Sites	Total	Female	Male
Frankfurt	129	54	75
Vienna	120	67	53
Total	**249**	**121**	**128**

XXI. STATUTORY BODIES

Supervisory Board	
Herbert Moos, Moscow	Chairman Member of the Board of PJSC Bank VTB
Victoria Vanurina, Moscow	Deputy Chairman Senior Vice President of PJSC Bank VTB
Alexey Krokhin, Vienna (till 14/05/2017)	Deputy Chairman Chairman of the Board of VTB Bank (Austria) AG
Vitaly Buzoveria, Moscow	Senior Vice President of PJSC Bank VTB
Alexey Yakovitsky, Moscow (from 24/08/2017)	Chief Executive Officer of JSC VTB Capital Holding, Moscow
Julian Simmonds, London (from 24/08/2017)	Independent Supervisory Board Member, London
Oleg Gorlinskiy, Moscow	Senior Vice President of PJSC Bank
Elvira Petrik, Bad Vilbel (till 29/12/2017)	Employee VTB Bank (Europe) SE
Stephan Schwind, Erlensee (till 29/12/2017)	Employee VTB Bank (Europe) SE
Florian Dorsch, Darmstadt	Employee VTB Bank (Europe) SE
Christoph Heger, Strasshof / Austria (from 29/12/2017 till 01/02/2018)	Employee VTB Bank (Europe) SE Vienna branch
Vladimir Zaytsev, Vienna (from 29/12/2017)	Employee VTB Bank (Europe) SE Vienna branch

Management Board	
Arthur Iliyav, Bad Homburg	Chairman
Alexander Frey, Friedrichsdorf	Member of the Board
Oleg Osipenko, Frankfurt/Main	Member of the Board
Oxana Kozliouk, Frankfurt/Main (from 29/12/2017)	Member of the Board

REMUNERATION PAID TO STATUTORY BODIES

Remuneration to members of the Management Board in the past financial year totalled EUR 3,593 thousand. Payments to former members of the Management Board amounted to EUR 1,007 thousand, while the pension provisions for this group totalled EUR 14,608 thousand. The remuneration for members of the Supervisory Board amounted to EUR 62 thousand.

The following credit lines were extended to members of the Management Board as at the balance sheet date, whereby they represent the limits on company credit cards issued:

	EUR
Arthur Iliyav	10,000.00
Alexander Frey	7,000.00
Oleg Osipenko	10,000.00
Oxana Kozliouk	10,000.00

No loans were granted to members of the Supervisory Board

XXII. OTHER FINANCIAL OBLIGATIONS

The business premises of VTB Bank (Europe) SE in Frankfurt/Main in use on the balance sheet date are subject to a lease until 2024. The total liabilities owed until the contract term expires amount to EUR 13,128 thousand.

XXIII. SIGNIFICANT EVENTS AFTER THE END OF THE FINANCIAL YEAR

As the result of the restructuring of corporate policy within the VTB Group, the intention is to transfer a loan portfolio of up to approx. EUR 500 million from Group companies to VTB Bank (Europe) SE in the 2018 financial year.

The bank concluded a contract for the development and implementation of new core banking software with a software provider in 2013. It became apparent in 2015 that the contractual partner for this project would be unable to fulfil the bank's expectations, which led to the bank withdrawing from the contract. Along with a request for reimbursement of the payments already made, the bank also asserted a claim for compensation based on the poor performance of the provider. The former contractual partners reacted by asserting a counter-claim. The contractual partner's claim amounts to EUR 13.9 million. The case will be heard by a Swiss court of arbitration as agreed. The bank currently assumes that it will win the case, but has included provisions of EUR 2.8 million in its annual financial statements as a precaution. The bank expects a decision to be made in August 2018.

The bank has recorded a credit exposure of EUR 211.2 million under receivables from customers. The credit exposure was value-adjusted by approx. 34% at the end of the year. The borrower is currently being run by a court-appointed administrator after suffering financial issues at the beginning of 2017. The company is undergoing restructuring.

There were otherwise no events after the end of the financial year that are of importance for the company's assets, financial and earnings position.

XXIV. OTHER INFORMATION

Members of the Management Board and employees held offices on supervisory committees or similar committees for the following corporations pursuant to sec. 267 para. 3 HGB or similar organisations in 2017:

Name	Company	Function
Kai Fabri	Raiffeisenbank Oberursel eG, Oberursel	Member of the Supervisory Board

The registered office of VTB Bank (Europe) SE is in Frankfurt/Main. The company is registered with Frankfurt/Main District Court under HRB 12169 in commercial register B. The merger was recorded on 29 December 2017.

Frankfurt/Main, 12/07/2018

The Management Board

A. Iliyav O. Osipenko A. Frey O. Kozliouk

INDEPENDENT AUDITOR'S REPORT

To VTB Bank (Europe) SE, Frankfurt/Main

REPORT ON THE AUDIT OF THE ANNUAL FINANCIAL STATEMENTS AND OF THE MANAGEMENT REPORT

OPINIONS

We have audited the annual financial statements of VTB Bank (Europe) SE, Frankfurt/Main, which comprise the balance sheet as at 31 December 2017, and the income statement for the fiscal year from 1 January 2017 to 31 December 2017, and notes to the financial statements, including the recognition and measurement policies presented therein. In addition, we have audited the management report of VTB Bank (Europe) SE for the fiscal year from 1 January 2017 to 31 December 2017.

In our opinion, on the basis of the knowledge obtained in the audit,

- the accompanying annual financial statements comply, in all material respects, with the requirements of German commercial law applicable to institutions and give a true and fair view of the assets, liabilities and financial position of the Institution as at 31 December 2017 and of its financial performance for the fiscal year from 1 January 2017 to 31 December 2017 in compliance with German legally required accounting principles, and

- the accompanying management report as a whole provides an appropriate view of the Institution's position. In all material respects, this management report is consistent with the annual financial statements, complies with German legal requirements and appropriately presents the opportunities and risks of future development.

Pursuant to Sec. 322 (3) Sentence 1 HGB ["Handelsgesetzbuch": German Commercial Code], we declare that our audit has not led to any reservations relating to the legal compliance of the annual financial statements and of the management report.

BASIS FOR THE OPINIONS

We conducted our audit of the annual financial statements and of the management report in accordance with Sec. 317 HGB and the EU Audit Regulation (No 537/2014, referred to subsequently as "EU Audit Regulation") and in compliance with German Generally Accepted Standards for Financial Statement Audits promulgated by the Institut der Wirtschaftsprüfer [Institute of Public Auditors in Germany] (IDW). Our responsibilities under those requirements and principles are further described in the "Auditor's responsibilities for the audit of the annual financial statements and of the management report" section of our auditor's report. We are independent of the Institution in accordance with the requirements of European law and German commercial and professional law, and we have fulfilled our other German professional responsibilities in accordance with these requirements. In addition, in accordance with Art. 10 (2) f) of the EU Audit Regulation, we declare that we have not provided non-audit services prohibited under Art. 5 (1) of the EU Audit Regulation. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinions on the annual financial statements and on the management report.

KEY AUDIT MATTERS IN THE AUDIT OF THE ANNUAL FINANCIAL STATEMENTS

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the annual financial statements for the fiscal year from 1 January 2017 to 31 December 2017. These matters were addressed in the context of our audit of the annual financial statements as a whole, and in forming our opinion thereon; we do not provide a separate opinion on these matters.

Below, we describe what we consider to be the key audit matters:

Presentation and explanation of the mergers with the former VTB Bank (Austria) AG (VTBA) and VTB Bank (France) SA (VTBF) in the annual financial statements as of 31 December 2017

REASONS WHY THE MATTER WAS DETERMINED TO BE A KEY AUDIT MATTER

As of 29 December 2017, VTBA was merged into the former subsidiary VTBD to establish VTB SE (with retroactive effect from 1 July 2017) and VTBF, which thus became a subsidiary of VTB SE, was merged into VTB SE (as of 29 December 2017). These are significant matters for VTB SE as these transactions led to a significant increase in total assets with all balance sheet items and, due to the retroactive effect of the merger of the former parent institution VTBA as of 1 July 2017, items of the income statement significantly affected.

Given the complexity and volume of postings as a result of the cross-border mergers, the accurate presentation and explanation of the mergers with the former VTBA and VTBF in the annual financial statements as of 31 December 2017 was a key audit matter.

AUDITOR'S RESPONSE

Prior to the implementation of the respective merger, the members of the management board and executives presented the planned approach for the mergers to establish VTB SE to us in order for us to then test the design and operating effectiveness of the controls implemented in the procedures.

We tested the plausibility of the data migration as of 29 December 2017 based on the migration design and the test documentation for the transfer of the data from the various systems of VTBA and VTBF to the core banking system of VTB SE.

We reperformed the transfer of the balance sheet items from VTBF on 29 December 2017 using the bank's work steps and controls and reconciled the acquired book values with the closing balance sheet as of 31 December 2017.

We likewise reperformed the transfer of the balance sheet items from VTBA on 29 December 2017 using the bank's work steps and controls and verified whether the book values of the opening balance sheet as of 1 July 2017 match the figures as of 30 June 2017 audited by local auditors. The amounts as of 31 December 2017 transferred to the balance sheet of VTB SE on 29 December 2017 were reconciled with the balance sheet items audited by local auditors who proceeded according to our instructions and reported their findings to us.

We obtained an understanding of and assessed the book values of the assets and liabilities of VTBA and VTBF in terms of the valuation permissible under German commercial law and, accordingly, the value adjustments made in individual cases.

We assessed whether the income and expenses for the period from 1 July to 31 December 2017 were appropriately transferred from the former VTBA based on the income statement for fiscal year 2017 and by reperforming the adjustments made. We consulted local auditors in our audit of the income statement who proceeded according to our instructions and reported their findings to us. We evaluated and reviewed the findings.

We checked that the positive difference between the book value of the acquired shares in VTBD and the book value of the net assets acquired from VTBA in connection the merger of VTBA was transferred to the capital reserves pursuant to Sec. 272 (2) No. 4 HGB. We checked that the positive difference between the book value of the acquired shares in VTBF and the book value of the net assets acquired from VTBF in connection the merger of VTBF was recognized in full in the income statement.

We reconciled the related disclosures in the notes to the financial statements in the chapter “Accounting and valuation methods in connection with the merger” with the documentation provided to us and the findings from the abovementioned audit procedures.

Our audit of the presentation and explanation of the mergers with the former VTBA and VTBF in the annual financial statements as of 31 December 2017 has not led to any major reservations.

REFERENCE TO RELATED DISCLOSURES

For disclosures on the mergers, refer to the chapter “Accounting and valuation methods in connection with the merger” in the notes to the financial statements.

RESPONSIBILITIES OF THE EXECUTIVE DIRECTORS AND THE SUPERVISORY BOARD FOR THE ANNUAL FINANCIAL STATEMENTS AND THE MANAGEMENT REPORT

The executive directors are responsible for the preparation of the annual financial statements that comply, in all material respects, with the requirements of German commercial law applicable to institutions, and that the annual financial statements give a true and fair view of the assets, liabilities, financial position and financial performance of the Institution in compliance with German legally required accounting principles. In addition, the executive directors are responsible for such internal control as they, in accordance with German legally required accounting principles, have determined necessary to enable the preparation of annual financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the annual financial statements, the executive directors are responsible for assessing the Institution’s ability to continue as a going concern. They also have the responsibility for disclosing, as applicable, matters related to going concern. In addition, they are responsible for financial reporting based on the going concern basis of accounting, provided no actual or legal circumstances conflict therewith.

Furthermore, the executive directors are responsible for the preparation of the management report that, as a whole, provides an appropriate view of the Institution’s position and is, in all material respects, consistent with the annual financial statements, complies with German legal requirements and appropriately presents the opportunities and risks of future development. In addition, the executive directors are responsible for such arrangements and measures (systems) as they have considered necessary to enable the preparation of a management report that is in accordance with the applicable German legal requirements, and to be able to provide sufficient appropriate evidence for the assertions in the management report.

The supervisory board is responsible for overseeing the Institution’s financial reporting process for the preparation of the annual financial statements and of the management report.

AUDITOR’S RESPONSIBILITIES FOR THE AUDIT OF THE ANNUAL FINANCIAL STATEMENTS AND OF THE MANAGEMENT REPORT

Our objectives are to obtain reasonable assurance about whether the annual financial statements as a whole are free from material misstatement, whether due to fraud or error, and whether the management report as a whole provides an appropriate view of the Institution’s position and, in all material respects, is consistent with the annual financial statements and the knowledge obtained in the audit, complies with the German legal requirements and appropriately presents the opportunities and risks of future development, as well as to issue an auditor’s report that includes our opinions on the annual financial statements and on the management report.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Sec. 317 HGB and the EU Audit Regulation and in compliance with German Generally Accepted Standards for Financial Statement Audits promulgated by the Institut der Wirtschaftsprüfer (IDW) will always detect a material misstatement. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these annual financial statements and this management report.

We exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the annual financial statements and of the management report, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinions. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit of the annual financial statements and of arrangements and measures (systems) relevant to the audit of the management report in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of these systems of the Institution.

- Evaluate the appropriateness of accounting policies used by the executive directors and the reasonableness of estimates made by the executive directors and related disclosures.

- Conclude on the appropriateness of the executive directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Institution's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in the auditor's report to the related disclosures in the annual financial statements and in the management report or, if such disclosures are inadequate, to modify our respective opinions. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Institution to cease to be able to continue as a going concern.

- Evaluate the overall presentation, structure and content of the annual financial statements, including the disclosures, and whether the annual financial statements present the underlying transactions and events in a manner that the annual financial statements give a true and fair view of the assets, liabilities, financial position and financial performance of the Institution in compliance with German legally required accounting principles.

- Evaluate the consistency of the management report with the annual financial statements, its conformity with [German] law, and the view of the Institution's position it provides.

- Perform audit procedures on the prospective information presented by the executive directors in the management report. On the basis of sufficient appropriate audit evidence we evaluate, in particular, the significant assumptions used by the executive directors as a basis for the prospective information, and evaluate the proper derivation of the prospective information from these assumptions. We do not express a separate opinion on the prospective information and on the assumptions used as a basis. There is a substantial unavoidable risk that future events will differ materially from the prospective information.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with the relevant independence requirements, and communicate with them all relationships and other matters that may reasonably be thought to bear on our independence and where applicable, the related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the annual financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter.

OTHER LEGAL AND REGULATORY REQUIREMENTS

FURTHER INFORMATION PURSUANT TO ART. 10 OF THE EU AUDIT REGULATION

We were elected as auditor of VTB Bank (Deutschland) AG by the annual general meeting on 17 March 2017 and as auditor of VTB Bank (Europe) SE by the extraordinary general meeting on 17 November 2017. We were engaged by the supervisory board on 17 March 2017 and on 17 November 2017, respectively. We have been the auditor of VTB Bank (Europe) SE (formerly VTB Bank (Deutschland) AG) without interruption since fiscal year 2016.

We declare that the opinions expressed in this auditor's report are consistent with the additional report to the audit committee pursuant to Art. 11 of the EU Audit Regulation (long-form audit report).

GERMAN PUBLIC AUDITOR RESPONSIBLE FOR THE ENGAGEMENT

The German Public Auditor responsible for the engagement is Mr. Dirk Müller-Tronnier.

Eschborn/Frankfurt/Main, 16 July 2018

Ernst & Young GmbH

Wirtschaftsprüfungsgesellschaft

Müller-Tronnier	Šaihhova
Wirtschaftsprüfer	Wirtschaftsprüferin
[German Public Auditor]	[German Public Auditor]

REPORT OF THE SUPERVISORY BOARD

During the year under review, the Supervisory Board performed all tasks incumbent upon it under the applicable law and the Bank's Statutes.

The Supervisory Board was regularly informed by the members of the Management Board about the development of the Bank's business.

The auditor elected by the Annual General Meeting, Ernst & Young GmbH Wirtschaftsprüfungsgesellschaft, Eschborn / Frankfurt/Main, audited the Accounts, Annual Financial Statements and the Management Report, to the extent that latter adds explanatory notes to the Annual Financial Statements, and has no objections.

The Supervisory Board has duly noted the result of the audit.

Pursuant to Section 312 of the German Stock Corporation Act (AktG), the Management Board prepared a Report for the fiscal year 2017 on the Relationship with Affiliated Undertakings. No objections have been raised. Ernst & Young GmbH Wirtschaftsprüfungsgesellschaft audited the report and issued the following unqualified audit opinion:

"Following our audit, which we performed in accordance with professional standards, we confirm that:

1. the actual information given in the report is correct,

2. viewed in the context of the circumstances known at the time they were undertaken, the legal transactions specified herein do not constitute services which the Bank rendered without appropriate remuneration."

The Supervisory Board agrees with the result of this audit.

After reviewing the Annual Financial Statements and the Report of the Management Board on the Relationship with Affiliated Undertakings, the Supervisory Board raises no objections to any of these items.

The Supervisory Board approves the Annual Financial Statements, which are hereby adopted.

The Supervisory Board would like to express its gratitude and appreciation to the Management Board and the employees for their dedicated work during the year 2017.

Frankfurt/Main, July 2018

The Supervisory Board

DISCLOSURE ACCORDING TO CRR

The Bank is obliged pursuant to Section 26a (1) KWG to publish information referred to in Articles 435 et seq. of Regulation (EU) No. 575/2013 as amended from time to time. The Bank fulfils its obligation by publishing the data on the homepage www.vtb.eu under the category downloads.

COUNTRY BY COUNTRY REPORTING (PURSUANT TO SEC. 26A OF THE GERMAN BANKING ACT (KWG) AS AT 31 DECEMBER 2017)

CRR institutions shall include in an annex to the annual accounts, specifying, by member state of the European Union and by third countries in which they have establishments, the following information on a consolidated basis:

1) Names, nature of activities and geographical location of the branches

2) Turnover

3) Number of employees on a full-time equivalent basis

4) Profit or loss before tax

5) Tax on profit or loss

6) Public subsidies received

Turnover is considered to be net profit pursuant to the German Commercial Code (HGB) before consideration of consolidation effects, taxes, extraordinary income and expenses, risk provisions, administrative expenses and depreciation on fixed and intangible assets.

This results in the following allocations for VTB Bank (Europe) SEL

Country	Turnover (EUR)	No. of employees on a full-time equivalent basis	Profit before tax (EUR)	Tax on profit (EUR)	Public aid received (EUR)
Germany	76,786,906	129	36,393,097	13,278,123	0
Austria	44,348,385	120	2,996,949	5,498,834	0

Due to restructuring in 2017, the amounts for Austria only cover the period 1 July to 31 December 2017.

Companies included:

Company name	Activity type	Location	Country
VTB Bank (Europe) SE	Bank	Frankfurt/Main	Germany
VTB Bank (Europe) SE, Vienna branch	Bank	Vienna	Austria
VTB Bank (Europe) SE, Frankfurt/Main branch (Also known as: VTB Direktbank)	Bank	Frankfurt/Main	Germany

VTB Bank (Europe) SE

Rüsterstraße 7 – 9
60325 Frankfurt/Main
Germany
Telephone +49 69 2168-0
Telefax +49 69 2168-6319
Email: service@vtb.eu

S.W.I.F.T.:
OWHB DE FF

vtb.eu