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TRANSLATION

TO THE SHAREHOLDERS

UNIVERSAL CAPITAL BANKA AD, PODGORICA

Independent Auditor's Report

We have audited the accompanying separate financial statements of Universal Capital Bank AD, Podgorica ("the Bank"), which comprise the separate balance sheet as at 31 December 2016, separate income statement, separate statement of changes in equity and separate cash flow statement for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Separate Financial Statements

Management is responsible for the preparation and true and objective presentation of these separate financial statements in accordance with the applicable legislation that regulates financial reporting of banks in Montenegro, and for such internal control as management determines is necessary to enable the preparation of separate financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these separate financial statements based on our audit. We conducted our audit in accordance with the applicable legislation that regulates audit of financial statements in Montenegro. This legislation which regulates accounting and auditing require that we comply with relevant ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the separate financial statements are free of material misstatement.

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

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

KPMG d.o.o. Podgorica, a Montenegrin limited liability company and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity.

Hipotekarna banka a.d. Podgorica, račun 520-1370100-53
Erste Bank a.d. Podgorica, račun 540-1000032318221-33
PIB 02626837 PDV 30/31-05509-0

T R A N S L A T I O N

Opinion

In our opinion, separate financial statements present truly and objectively unconsolidated financial position of the Bank as at 31 December 2016, unconsolidated financial performance and unconsolidated cash flows for the year then ended in accordance with the applicable legislation that regulates financial reporting of banks in Montenegro.

Other Matter

The Bank's separate financial statements as at and for the year ended 31 December 2015 were audited by another auditor who on 31 May 2016 issued an unqualified opinion on these financial statements with emphasis of matter that the Bank was not in compliance with the prescribed limit of certain performance indicators defined in accordance with the applicable legislation that regulates financial reporting of banks in Montenegro.

Podgorica, 31 May 2017 KPMG d.o.o. Podgorica

(L.S.)

Branko Vojnović
Certified Auditor

This is a translation of the original Independent Auditors' Report issued in the Montenegrin language. All due care has been taken to produce a translation that is as faithful as possible to the original. However, if any questions arise related to interpretation of the information contained in the translation, the Montenegrin version of the document shall prevail. We assume no responsibility for the correctness of the English translation of the Bank's separate financial statements.

Podgorica, 31 May 2017 KPMG d.o.o. Podgorica

DRUŠTVO ZA KONSALTING I REVIZIJU D.O.O. PODGORICA KPMG

(L.S.)

Branko Vojnović
Certified Auditor

TRANSLATION

**UNIVERSAL CAPITAL BANK AD,
PODGORICA**

**SEPARATE FINANCIAL STATEMENTS FOR
THE YEAR ENDED DECEMBER 31, 2016**

CONTENTS

SEPARATE INCOME STATEMENT
In the period from January 1 to December 31, 2016
(in thousands EUR)

	Notes	2016	2015
Interest income	3.1, 5a	2,779	1,934
Interest expense	3.1, 5b	(913)	(508)
NET INTEREST INCOME		1,866	1,426
Impairment losses	3.7, 6a	(280)	(9)
Provision charges	6b	2	(5)
Fee and commission income	3.1, 7a	877	1,188
Fee and commission expenses	3.1, 7b	(761)	(507)
NET FEE INCOME		116	681
Net losses from financial assets held for trading	8	(789)	-
Net gains from investment securities		479	-
Foreign exchange gains, net	3.2	1,072	210
Staff costs	3.13, 9	(1,164)	(1,128)
General and administrative costs	10	(711)	(729)
Depreciation/amortization charge	3.9, 10a	(248)	(211)
Other expenses		(25)	(4)
Other income	11	57	78
OPERATING PROFIT		375	309
Income tax	3.4, 12	(51)	(15)
NET PROFIT		324	294

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

Signed on behalf of Universal Capital bank AD, Podgorica as at May 15, 2017 by:

Đorđe Đurđić
Chief Executive Officer

Miloš Pavlović
Executive Director

Kolja Krcić
Head of Finance and Accounting

SEPARATE BALANCE SHEET
As at December 31, 2016
(in thousands EUR)

	Notes	December 31, 2016	December 31, 2015
ASSETS			
Cash and deposit accounts held with central banks	3.5, 13	14,309	10,182
Loans and receivables from banks	3.5, 14	17,875	31,452
Loans and receivables from customers	3.6, 15	62,335	33,890
Investment securities			
- available for sale	3.8, 16	10,132	-
- held to maturity	3.8, 16	1,750	1,500
Investments in subsidiaries	3.8, 17	730	755
Property, plant and equipment	3.9, 3.10, 18	3,359	3,534
Intangible assets	3.9, 3.10, 19	374	205
Other financial receivables		751	264
Other operating receivables	3.12, 20	4,556	4,260
TOTAL ASSETS		**116,171**	**86,042**
LIABILITIES			
Deposits from clients	21	98,172	72,142
Borrowings from banks		8	-
Borrowings from clients	22	6,890	5,087
Derivative financial liabilities as hedging instrument	23	757	-
Reserves		11	10
Current tax liabilities		45	1
Deferred tax liabilities		24	15
Other liabilities	24	238	120
Subordinated debt	25	1,002	-
TOTAL LIABILITIES		**107,147**	**77,375**
EQUITY			
Share capital	26	16,002	16,002
Retained earnings		(7,904)	(7,730)
Profit for the year		324	294
Other reserves		602	101
TOTAL EQUITY		**9,024**	**8,667**
TOTAL EQUITY AND LIABILITIES		**116,171**	**86,042**
OFF-BALANCE SHEET ITEMS	28	**98,058**	**75,188**

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

SEPARATE STATEMENT OF CHANGES IN EQUITY
In the period from January 1 to December 31, 2016
(in thousands EUR)

	Share Capital	Retained earnings	Profit for the year	Other reserves	Total
Balance, as at January 1, 2015	13,714	(7,842)	112	101	6,085
Issuing of shares	2,288	-	-	-	2,288
Distribution previous year profit	-	112	(112)	-	-
Profit for the year	-	-	294	-	294
Other	-	(174)	-	174	-
Balance, as at December 31, 2015	**16,002**	**(7,904)**	**294**	**275**	**8,667**
Distribution previous year profit	-	-	(294)	294	-
Profit for the year	-	-	324	-	324
Effects of valuation of securities available for sale	-	-	-	32	32
Balance, as at December 31, 2016	16,002	(7,904)	324	602	9,023

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

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SEPARATE STATEMENT OF CASH FLOW
In the period from January 1 to December 31, 2016
(in thousands EUR)

	2016	2015
CASH FLOWS FROM OPERATING ACTIVITIES		
Inflows from interest and similar income	2,611	1,766
Outflows from interest and similar expense	(887)	(389)
Inflows from fees and commissions	896	1,161
Outflows from fees and commissions	(761)	(507)
Cash paid to employees and suppliers	(2,127)	(1,828)
Increase in loans and other assets	(38,089)	(17,533)
Inflows from deposits	27,059	24,509
Other inflows	328	167
Net cash (outflow)/inflow from operating activities	(10,970)	7,346
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of property, plant and equipment	(132)	(277)
Purchase of intangible assets	(161)	(97)
Treasury bills and treasury bonds	(250)	(1,333)
Income from sale of tangible and fixed assets	27	146
Net cash outflow from investing activities	(516)	(1,561)
CASH FLOWS FROM FINANCING ACTIVITIES		
Increase in borrowings	1,757	(591)
Net cash (outflow)/inflow from financing activities	1,757	(591)
Effects of foreign exchange in cash and cash equivalents	284	204
Net (decrease)/increase in cash and cash equivalents	(9,450)	5,398
Cash and cash equivalents, beginning of year	41,634	36,236
Cash and cash equivalents, end of year (Note 13 and 14)	32,184	41,634

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

1. FOUNDATION AND BUSINESS ACTIVITY OF THE BANK

Universal Capital Bank AD, Podgorica was founded under the name First Financial Bank AD, Podgorica (hereinafter: the Bank) established on October 18, 2007. The name First Financial Bank AD, Podgorica was changed to Universal Capital Bank AD, Podgorica as at June 04, 2014. The Decision of the Shareholders Assembly of the Bank's name change was adopted at the session held on May 30, 2014. The Bank is headquartered in Podgorica, at Stanka Dragojevića Street bb.

The Bank has obtained a permit from the Central Bank of Montenegro (Decision No. 0101-2933/3-2 dated July 12, 2007). The Bank is inscribed in the Register of the issuers of securities maintained by the Securities Commission under the number 472 (Decision No. 02/3-33/2-07 dated October 31, 2007).

In accordance with the Law on Banks, the Decision on Incorporation and the Articles of Incorporation, the Bank performs banking operations i.e. activities of reception of cash deposits and approval of loans for its own account.

In addition to these activities, the Bank may perform the following tasks:

1. Issuance of guarantees and undertaking of other off-balance sheet commitments;
2. The purchase, sale and collection of receivables (factoring, forfeiting and other);
3. The issuance, processing and recording of payment instruments;
4. Payments in the country and abroad, in accordance with the relevant regulations;
5. Financial leasing;
6. The activities with securities, in accordance with the law governing the securities;
7. Trading in its own name and for its own account or on behalf of clients: with foreign currencies, including exchange transactions in financial derivatives;
8. Depot operations;
9. Analysis and provision of information and advice on the creditworthiness of companies and entrepreneurs and other issues regarding operations;
10. Rental of safe deposit boxes;
11. The activities that are part of banking operations, ancillary tasks in relation to the operations of the Bank, other activities directly related to the operations of the Bank in accordance with the Articles of Incorporation.

With prior approval of the Central Bank, the Bank may perform other activities in accordance with the law.

As at December 31, 2016, the Bank comprised a Central Office located in Podgorica and one branch office located in Sveti Stefan. The Bank has 51 employees (December 31, 2015: 59 employees).

The Bank has a subsidiary, Universal Capital Development d.o.o. with 100% equity stake. The main activity of the company is buying and selling of own real estate.

As at December 31, 2016, the Members of the Board of Directors were the following:

Name and surname	Position
Božo Milatović	President of the Board of Directors
Georgios Lychnos	Member of the Board of Directors
Đorđe Đurđić	Member of the Board of Directors
Jurij Daneu	Member of the Board of Directors
Nasrulla Babayev	Member of the Board of Directors

As at December 31, 2016, the Executive Directors were as follows:

Name and surname	Position
Đorđe Đurđić	Chief Executive Officer
Miloš Pavlović	Executive Director

As at December 31, 2016, the Members of the Board for Auditing were as follows:

Name and surname	Position
Stylianos Katevatis	President
Petros Stathis	Deputy President
Niki Pantzali	Member

As at December 31, 2016, the Members of the Committee for Management of Assets, Equity and Liabilities were as follows

Name and surname	Position
Đorđe Đurđić	Chief Executive Officer
Miloš Pavlović	Executive Director
Mirza Redžepagić	Head of the Funds Management Department

As at December 31, 2016, the internal auditor of the Bank was Lana Kalezić, who is Head of Finance and Accounting as of April 1, 2017.

2. BASIS FOR PREPARATION AND PRESENTATION OF THE SEPARATE FINANCIAL STATEMENTS

2.1. Basis for preparation and presentation of the separate financial statements

Bank prepares separate financial statements (hereinafter: financial statements) in accordance with the Law on Accounting (“Official Gazette of Montenegro", no. 052/16), the Law on banks ("Official Gazette of Montenegro", No. 17/08 , 44/10 and 40/11) and other laws governing financial reporting of banks.

The accompanying financial statements are prepared in accordance with the Decision on the Contents, Deadlines and Manner of Preparation and Submission of the financial Statements of Banks (Official Gazette of Montenegro, no. 15/12 and 18/13).

In preparation of these financial statements the Bank applied policies in conformity with the regulations of the Central Bank of Montenegro, which however, in the part regarding recording receivables eligible for derecognition from the Bank's balance sheet and in the form for presentation of the financial statements depart from the requirements of IFRS and IAS effective as at December 31, 2016.

In accordance with the local regulations, the International Accounting Standards ("IAS") and International Financial Reporting Standards ("IFRS") published by the International Accounting Standards Board, should be adopted and published by a respective competent authority of Montenegro who got the right on translation and publishing from the International Federation of Accountants (IFAC). Therefore, only IFRS and IAS officially adopted and published by the respective and competent authority of Montenegro may be applicable. The last officially translated IAS and IFRS are those translated in 2009 (except for IFRS 7) and newly adopted IFRS 10, 11, 12 and 13, which are applicable from 2013.

Bearing in mind the effects that differences of accounting regulations of Montenegro from IFRS and IAS may have on the presentation of the Bank’s financial statements, the accompanying financial statements in that section are different and differ from IFRS and IAS and cannot be treated as having been prepared in accordance with IFRS and IAS.

These financial statements include only the receivables, liabilities, operating results, changes in equity and cash flows of the Bank without the involvement of the subsidiary (Universal Capital Development d.o.o.). These financial statements have been prepared on separate (nonconsolidated) basis. The Bank does not prepare consolidated financial statements on the same date as the separate financial statements.

These financial statements have been prepared in accordance with the historical cost convention, unless otherwise stated in the accounting policies.

In the preparation of the accompanying financial statements, the Bank has adhered to the accounting policies described in Note 3. The adopted accounting policies used for the preparation of the financial statements as at December 31, 2016 are consistent with the accounting policies applied in the previous financial year.

The financial statements of the Bank are presented in thousands of euros (EUR), which is the functional currency of the Bank and the official currency in which financial statements are to be submitted in Montenegro. Unless otherwise indicated, all amounts are stated in thousands of EUR.

2.2. Use of Estimates

The presentation of financial statements requires the Bank’s management to make the best possible estimates and reasonable assumptions that affect the presented values of assets and liabilities, as well as the disclosure of contingent liabilities and receivables as at the date of the preparation of the financial statements, and the income and expenses arising during the accounting period. These estimations and assumptions are based on information available to us as at the financial statements preparation date. However, the actual results may differ from the values estimated in this manner. The most significant estimates and assumptions were made in the following balance sheet positions:

- Provisions for loans and receivables from clients
- Provisions for loans and receivables from other banks
- Provisions for investments in subsidiaries
- Provisions for off-balance sheet items
- Provisions for employee benefits
- Provisions for litigations and claims
- Useful life of intangible assets, property, plant and equipment.

2.3. Going Concern

The financial statements are prepared in accordance with the going concern basis, which presupposes that the Bank will continue to operate over an unlimited period in the near future.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

3.1. Income and Expenses on the basis of Interests and Fees

Interest income and expense are recognized in the income statement for all interest bearing instruments measured at amortized cost using the effective interest rate method.

The effective interest rate method is a method of calculating the amortized cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that discounts estimated future cash payments or receipts over the expected life of a financial instrument or, where appropriate, a shorter period, to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the bank estimates cash flows considering all contractual terms of the financial instrument (i.e. prepayment options) but does not consider future credit losses. The calculations include all fees and commissions paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

Interest income and interest expense, including penalty interest and operating income and expenses related to interest-bearing assets and liabilities are accounted for on an accrual basis of income and expenses.

Fees for banking services and fee and commission expenses are recorded when due, i.e., when realized.

Income and expenses arising from loan and guarantee origination are accounted for on an accrual basis using effective interest method.

3.2. Foreign Exchange Translation

Transactions denominated in foreign currencies are translated into EUR using official average exchange rates determined on the Interbank Market effective on date of each transaction.

Assets and liabilities denominated in foreign currencies on the balance sheet date are translated into EUR by applying the official average exchange rates, as determined on the Interbank Market, effective on the balance sheet date.

Net foreign exchange gains or losses arising from transactions in foreign currencies and from translation of balance sheet items denominated in foreign currencies are credited or charged to the income statement, as positive or negative foreign exchange differences.

Commitments and contingent liabilities denominated in foreign currencies are translated into EUR by applying the official average exchange rates, as determined on the Interbank Market, effective on the balance sheet date.

3.3. Leasing

The leases entered into by the Bank are operating leases. The payments made under operating lease are charged to operating expenses on a straight-line basis over the period of the lease agreement duration.

3.4. Taxes and Contributions

Income Taxes

Current income taxes

Income taxes are calculated and paid in accordance with the Corporate Income Tax Law (Official Gazette of Montenegro, No. 80/04, 40/08, 86/09, 14/12, 61/13 and 055/16). The income tax rate is a proportionate rate of 9% applied to the tax base.

Capital losses may be offset against capital gains earned in the same year. In case there are outstanding capital losses even after the offset of capital losses against capital gains earned in the same year, these outstanding losses are carried forward in the following 5 years

Montenegrin tax regulations do not provide for any tax losses of the current period to be used to recover taxes paid in prior periods. However, current year losses reported in the tax return can be used to decrease taxable profits for future periods, but no longer than five years.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.4. Taxes and Contributions (Continued)

Income Taxes (Continued)

Deferred income taxes

Deferred income tax is determined using the balance sheet liability method, for the temporary differences arising between the tax bases of assets and liabilities, and their book values. The tax rates effective at the balance sheet date, or the tax rates that came into effect after that date are used to determine the deferred income tax amount. Deferred tax liabilities are recognized for all taxable temporary differences. Deferred tax assets are recognized for the deductible temporary differences, and the tax effects of income tax losses and credits available for carry forward, to the extent that it is probable that future taxable profit will be available against which deferred tax assets may be utilized.

Taxes, contributions and other duties not related to operating results

Taxes, contributions and other duties that are not related to the bank’s operating result, include property taxes and other various taxes, fees and contributions paid pursuant to republic and municipal regulations.

3.5. Cash and Cash Equivalents

Cash and cash equivalents comprise cash (EUR and foreign currencies), balances with the Central Bank of Montenegro, including both the obligatory reserves, and balances on accounts with other banks in the country and abroad.

3.6. Loans

Loans approved by the bank are recorded in the books when funds are transferred to the loan beneficiary’s account.

Loans are stated in the balance sheet for loan increased for matured interest, decreased by the principal and interest repaid and allowance for impairment that is based on the assessment of precisely identified risks inherent in certain placements and risks, which have been historically identified in the credit portfolio.

3.7. Provisions and Allowances for Impairment of Loans and Receivables

In accordance with the Decision issued by the Central Bank of Montenegro regarding minimal standards for credit risks management in banks (Official Gazette of Montenegro, no. 22/12, 55/12 and 57/13) the following were established: elements of credit risk management, minimum criteria and manner of classifying assets and off-balance sheet items which render the bank is exposed to credit risk and the manner of determining the minimum provisions for potential losses arising from credit risk exposure. The bank's risk-weighted assets, within the meaning of this Decision, comprised loans, borrowings, interest, fees and commissions, lease receivables, deposits with banks, advances and all other items included in the balance sheet exposing the bank to default risk, as well as guarantees issued, other sureties, effectuated letters of credit and approved, but undrawn loan facilities, as well as all other off-balance sheet items being the bank's contingent liabilities.

In accordance with the Decision on Minimum standards for credit risk management in banks (Official Gazette of Montenegro, no. 22/12, 55/12 and 57/13) the bank shall perform at least once in a quarter an impairment assessment (for balance sheet items) and assessment of probable loss (for off-balance sheet items) for balance sheet assets and off-balance sheet items based on which it is exposed to credit risk and classify them into appropriate classification categories. According to IAS 39 the Bank is also required to establish a methodology for assessing impairment of balance sheet assets and probable losses related to off-balance sheet items.

For the purpose of calculation of allowances for impairment of credit receivables and probable loss for off-balance items, the Bank applies Methodology for assessment of asset impairment and probable loss for off-balance items.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.7. Provisions and Allowances for Impairment of Loans and Receivables (Continued)

When assessing the value of impairment of financial assets, the Bank complies with the requirements of IAS 39 that follows:

- The estimation of impairment is based on incurred losses, instead of the expected or future losses. The Impairment is only recognized as incurred;
- There must be objective evidence of impairment, which is derived from one or more events that occurred after the initial recognition of the asset (loss event);
- It is necessary to ensure that impairment is not recognized on initial recognition of assets;
- Impairment is recognized both individually and on a group (portfolio) basis;
- Impairment calculation is based on an estimation of expected future cash flows of the financial asset;
- Cash flows of a financial asset carried at amortized cost is discounted at the effective interest rate;

IFRS require individual estimation for individually significant receivables and group estimation of receivables that are not individually significant. Accordingly, the Bank identifies the items of balance sheet assets and probable loss on off-balance sheet items and calculates an adequate amount of that impairment, or probable loss on:

- individual basis (individual estimation for individually significant receivables)
- group basis (group estimation of receivables that are not individually significant)
- group basis (group estimation of individually significant items for which the estimates are first carried out on an individual basis but not individually devalued).

Bank on a quarterly basis estimates whether there is an objective reason for the devaluation of exposure or group of exposures. If the bank assesses that an event with a negative effect on expected cash flows has occurred, exposure will be reclassified from healthy to defaulted loans/exposures

The objective evidence of assets impairment i.e. probable loss per off-balance items is data on one or more events that have negative influence on debtor's ability to regularly settle its obligations towards the Bank.

The bank is obliged to perform individual assessment of assets impairment and probable loss per off-balance items for individually significant receivables.

An exposure to a single party or group of related parties should be considered significant if it exceeds EUR 20 thousand (for legal entities and individuals). Existence of a default on materially significant amounts (delay in repayment of the loans exceeding 30 days for legal entities i.e. 90 days for individuals, above the established limit of materiality of EUR 200 for legal entities, or EUR 20 for individuals) should also be considered individually significant.

Objective proofs of impairment are specified for legal entities and individuals separately. As for the SME portfolio, the Bank applies the same criteria as applied for the legal entities.

If there is an objective proof of impairment, impairment test is performed and impairment loss for balance sheet items and probable loss for off-balance sheet items is recognised, if necessary. Impairment or a loss should be recognized at the moment of determination that receivable will not be fully reimbursed.

Assessment of future cash flows is performed based on days of delay, client's financial situation and collateral and direct selling costs of collateral.

Corporate loans (including SMEs)

All placements exceeding EUR 20 thousand shall be individually assessed. In addition, all loans given to legal entities are considered individually significant if there is a delay on materially significant amounts (delay in settling the obligations on the grounds of any loan to customers for more than 30 days, for all exposures exceeding EUR 200).

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.7. Provisions and Allowances for Impairment of Loans and Receivables (Continued)

Objective evidences indicating the impairment of corporate loans are as follows:

- Significant financial difficulties of the issuer or borrower;
- Breach of contract / or delay or non-settling of interest or principal;
- Bank approves to the debtor a concession caused by economic or legal reasons related to financial difficulties of the debtor, that the lender would not otherwise consider;
- It becomes probable that the borrower will enter bankruptcy or financial reorganization;
- Observable data indicating that there is a measurable reduction in future cash flows or group of financial assets from the initial recognition of those assets, although the reduction can still not be identified with the individual financial asset in the group, including: a) adverse changes in the payment status of the debtor or the debtor group (i.e. the increase in the number of delayed payments due to the problems in the sector) and b) adverse conditions in the market of the client’s business performance;
- The restructuring of the loan – if the terms of the contract were modified in favor of the borrower, without justification by improving creditworthiness or changes in market prices (or interest rates). These restructured loans also include loans that are not in accordance with the general Loan Policy of the Bank, pursuant to which new loans are to be approved;
- The worsening of liquidity of the client / decrease in working capital;
- Significant reduction in fixed assets;
- Loss exceeding equity;
- Significant reduction in capital;
- Other relevant information.

If the existence of one or more objective proofs of impairment is determined, the impairment shall be estimated on an individual basis for all placements given to the entity.

Placements for which no impairment was estimated on the individual estimation shall be estimated on a group basis, together with a portfolio of micro loans.

After a selection of individually significant loans is performed and determined the existence of one or more objective evidences of impairment of receivables, the impairment is assessed on an individual basis. The amount of the impairment loss in accordance with IFRS is calculated as the difference between the carrying amount and the present value of estimated cash flows discounted at the effective interest rate.

The assessment of a client consists of estimates of future cash flows. Expected future cash flows comprise the following:

- Future cash flows from collection of loans from operating activities;
- Future cash flows from the realization of collateral.

The estimation of loan repayment can be derived from the loan repayment plan, adjusting the original repayment plan, in a manner that is either agreed upon with the client or probable or some changes would better reflect the current situation of the client.

When assessing the cash flows from the collateral, the Bank starts from the list of eligible collateral. The Bank treats other collaterals as unacceptable or irrecoverable. The Bank will estimate the repayment from hard collateral by applying the appropriate haircut and within a defined repayment plan. Assessment of the recoverable amount from the collateral arises as a result of a combination of experience of the Bank, the direct costs of enforced collection and the value of the collateral at the time of sale. Depending on the frequency of updating the assessment collateral, in a case of an individual estimates, the Bank will consider the potential costs of forced collection of collateral and potential changes in the value of collateral.

Retail loans

All placements of a client or its related parties that are individually significant (total exposure exceeding EUR 20 thousand) are individually assessed. Additionally, all client placements, regardless of whether those are individually significant, but taking into consideration the fact if there is a delay in settlement of obligations exceeding 90 days, above the set limits of materiality (EUR 20) are individually assessed in order to determine if there is objective evidence of impairment.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.7. Provisions and Allowances for Impairment of Loans and Receivables (Continued)

The following are considered the objective proofs of impairment:

- Significant financial difficulties of the borrower (e.g. the total monthly liabilities of the borrower reach or exceed the amount of the monthly income of the borrower);
- Breach of Contract / i.e. delay or non-settlement of interest or principal;
- Litigation filing against the borrower;
- The restructuring of the loan – if the terms of the contract modified in favor of the borrower, without justification by improving creditworthiness or changes in market prices (or interest rates). These restructured loans also include loans that are not in accordance with the general Loan Policy of the Bank, pursuant to which new loans are to be approved;
- Blocked account of a physical entity;
- Other relevant information.

For all retail loans, for which no objective proof of impairment has been determined on an individual basis, the impairment calculation is performed on a group basis, together with the portfolio of micro loans.

Pursuant to the Decision on the Minimum Standards for Credit Risk Management in Banks (Official Gazette of Montenegro no. 22/12, 55/12 and 57/13), the Bank is obligated, depending on the probability of loss, to classify asset items into the following categories:

- A category (“Good Assets”) - including loan and other receivables for which there are firm documentary evidences that will be collected in full and as agreed

- B category (“Special Mention”) - with B1 and B2 subcategories - including loan for which there is remote probability of loss, but which, require special attention, as potential risk, if not adequately monitored, could diminish in terms of its collection

- C category (“Substandard assets”) – with C1 and C2 subcategories for which there is high probability of loss, due to the clearly identified collectability issues;

- D category (“Doubtful assets”) including loan the full collection of which is, taking into account the creditworthiness of the borrower, value and possibility of realization of collaterals, highly unlikely.

- E category (“Loss”) – including the items which are uncollectable in full, or will be collectable in an insignificant amount.

The calculation of provision is conducted on a monthly basis.

On monthly basis, based on the performed classification of balance sheet assets and off-balance sheet items, the Bank calculates provisions for potential losses, applying percentages in the following table:

Risk category	% Provisions	Days of delay
A	-	<30
B1	2	31-60
B2	7	61-90
C1	20	91-150
C2	40	151-270
D	70	271-365
E	100	>365

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.7. Provisions and Allowances for Impairment of Loans and Receivables (Continued)

The Bank shall determine the difference between the amount of loan loss provisions calculated in accordance with the above given table and the sum of the amount of allowances for impairment losses and provisions for off-balance sheet items calculated in accordance with the provisions of Decision regulating the manner of valuation of asset items by applying International Accounting Standards.

The positive difference between the accrued provisions for impairment losses and the sum of allowances for items of balance sheet assets and provisions for off-balance sheet items, is a required reserves for estimated losses. At the time of adoption of the annual financial statements the Bank is required to transfer amount of necessary reserves for estimated losses from the profit in the current year or retained earnings from previous years to the account of reserves for estimated losses on regulatory requirements.

The Bank has developed a comprehensive strategy to deal with non-performing loans for a period of three years and establish annual goals related to reducing the level of non-performing loans (operational objectives). "Non-performing loans" are considered the loans classified by the Bank, using the criteria provided in the Decision on Minimum Standards for Credit Risk Management, in the classification groups "C", "D" or "E". Through an adequate monitoring of structure and credit portfolio quality and credit risk arising from the credit portfolio, this strategy aims to provide an adequate management of non-performing loans. The positive effects that the Bank achieves relate to a) increase in stability by reducing the level of provisions, a reasonable increase in the likelihood of repayment of loans, and ultimately the establishment of effective risk management system, which contributes to the preservation of capital and b) mitigate losses - through effective restructuring (sustainable borrowers) and the speed of recovery.

In accordance with the Decision on Minimum Standards for Credit Risk Management in Banks ("Off. Gazette of Montenegro", 22/12, 55/12 and 57/13), if the conditions for derecognition of a bank's receivable are met, the bank is obliged to write off such a receivable and to disclose it at the debt amount in the internal records until the finalization of the collection process. Such exclusion of the receivable from the Bank's statements is carried out in the following cases: if the Bank in the process of collection of receivables estimates that the value of receivables measured at amortized cost will not be compensated and that the requirements for derecognition of financial assets are met, which includes the following cases:

1) for unsecured receivable - when the borrower is initialized a bankruptcy proceedings against for a period of more than one year, or - if the borrower is late with payments for more than two years;
2) for secured receivable - when the borrower is late with payments for more than four years, or if the Bank, during this period, received no payments from the realization of collateral.

3.8. Investment securities held to maturity, securities available for sale and investments in subsidiaries

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturity, for which management of the Bank has the positive intent and ability to hold to maturity. Purchases and sales of financial assets held to maturity are recognized on transaction-date - the date on which the Bank commits to purchase or sell the asset. Investments held to maturity are recorded at amortized cost using the effective interest rate method. Securities held to maturity refer to government bonds with a maturity of 182 days, issued by the Ministry of Finance of Montenegro. On a monthly basis the revenues from the approved (contracted) discount is being recognized. Part of the bonds was financed from the funds of the obligatory reserve which the Bank holds with the Central Bank of Montenegro.

Investments in securities available for sale, also, represent a way of engaging free cash, on the one hand, and an increase in income-earning substance of Banks, on the other hand.
Securities available for sale relate to bonds issued by the Ministry of Finance of Montenegro, which mature in 2020.

These investments are stated at cost of investment, which represents the expense plus acquisition costs of the investment and subsequent to initial recognition are measured at their fair value, without any deduction for transaction costs that may be incurred on sale or other disposal. Profit or loss derived from the change in fair value of investments in financial assets available for sale are recognized directly in equity through the statement of changes in equity, except for the costs of impairment losses and foreign exchange gains and losses.

When selling a financial asset the accumulated gain or loss previously recognized in equity will be recognized as profit or loss in the income statement. In addition, these investments do not require the separation of capital requirement for credit risk (in accordance with Article 20, paragraph 5 of the decision on capital adequacy).

Investments in subsidiaries that do not have a quoted market price in an active market and whose fair value cannot be reliably measured are recognized at cost less any accumulated impairment provision reflecting the reduction in value due to losses incurred in the operations of the legal entity.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.9. Property, Plant, Equipment and Intangible Assets

Property, Plant, Equipment and Intangible Assets on December 31, 2016 are recorded at cost less accumulated depreciation. Purchase value represents the prices billed by suppliers together with costs related to purchase and condition necessary for its intended use.

Depreciation is calculated on a straight-line basis on cost value using the following annual rates, in order to write them off over their expected useful lives. Calculation of depreciation commences when the assets are put into use.

		Rate in %
	2016	**2015**
Property	1	1
Intangible assets, Computer equipment, ATMs	20	20
Furniture and other equipment	11	11
Air conditioning system, vehicles	15	15

Pursuant to the Corporate Income Tax Law ("Official Gazette of Montenegro" No. 80/04, 40/08, 86/09, 14/12, 61/13 and 055/16) the value of buildings for tax purposes is calculated using the proportional method and value of equipment and application software by applying digressive method for the entire period, regardless the date of activation. Business premises belong to the group I for which is applied rate is of 5%, while the remaining fixed asset, equipment and software, are arranged in groups II to V, for which is applied rates are in range from 15% to 30%.

3.10. Impairment of tangible and intangible assets

On each balance sheet date, the bank’s management reviews the carrying amounts of the bank’s tangible and intangible assets. If there is any indication that such assets have been impaired, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss. If the recoverable amount of an asset is estimated to be less than its carrying value, the carrying amount of the asset is reduced to its recoverable amount.

An impairment loss is recognised as an expense of the current period and is recorded under other operating expenses. Where impairment loss recognized in previous years does not exist or is reduced, the carrying amount of the asset is increased up to the revised estimate of its recoverable value. However, this is performed so that the increased carrying amount does not exceed the carrying value that would have been determined had no impairment loss been recognised for the asset in prior years.

Management of Bank believes that the total value of tangible and intangible assets as at 31 December 2016 is not overrated.

3.11. Provisions

Provisions are recognised when the bank has a present legal or constructive obligation as a result of past events, and when it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made.

3.12. Acquired Assets

Acquired assets are assets that became the property of the Bank based on the collection of receivables for loans that were secured by such assets. Bank records the received assets at the lower of the gross carrying amount or market value of the collateral less costs to sell.

In accordance with the Decision on minimum standards for bank investments in real estate and fixed assets ("Official Gazette of Montenegro", No. 24/09, 66/10, 58/11, 61/12, 13/13, 51/13 and 16/15), the total investment of the Bank in real estate and fixed assets shall not be greater than 50% of the Bank's own funds. Exceptionally, the Bank may have investments in real estate and fixed assets even above the level of 50% of its own funds, if the following conditions are met:

1) the amount of investment in real estate and fixed assets exceeding 50% of own funds is treated by the Bank as a deduction item in the calculation of the total amount of own funds of the Bank
2) after the deduction of own funds of the Bank, performed in accordance with point 1), own funds and the solvency ratio of the Bank exceed the regulatory minimum.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

3.12. Acquired Assets (Continued)

For immovable property acquired in exchange for receivables in the process of debt restructuring, in bankruptcy or liquidation of the debtor of the Bank, in the process of reorganization of the debtor in accordance with the regulations governing bankruptcy or execution procedure for the settlement of claims, the Bank is obliged to, when calculating the total amount of investments in real estate and fixed assets, include in the calculation the value of the related real estate in the minimum following percentages:

1) 0% if no more than four years have passed since the date of acquisition of real estate;
2) 30% if more than four but not more than five years have passed since the date of acquisition of real estate;
3) 50% if more than five, but not more than six years have passed since the date of acquisition of immovable property;
4) 75% if more than six years have passed since the date of acquisition of real estate.

3.13. Employee Benefits

/a/ Contributions for Social Security of Employees

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

/b/ Retirement Benefits

The present value of future obligations under the General Collective Agreement in Montenegro, such as severance payments for retirement after fulfilling the conditions, as assessed by the Bank's management does not have a material effect on the financial statements taken as a whole, and, therefore, these financial statements do not comprise provisions based on the above employee benefits.

3.14. Financial Liabilities – Borrowings

Borrowings are initially recognised at fair value less transaction costs. Subsequently, borrowings are carried at their amortized value; all differences between the realized inflows (less transaction costs) and the amounts repaid are carried through profit and loss over the period of using the amounts borrowed by applying the effective interest rate method.

3.15. Fair Value

International Financial Reporting Standards 13 "Fair Value Measurement" provides disclosure of the fair value of financial assets and financial liabilities in the notes to the financial statements. For these purposes, the fair value is defined as an amount at which an asset can be exchanged, or a liability settled, between knowledgeable willing parties in an arm's-length transaction. The Bank is obliged to disclose the fair value information of those components of assets and liabilities for which market information is readily available, and for which their fair value is materially different from their recorded amounts.

In Montenegro, sufficient market experience, stability and liquidity do not exist for the purchase and sale of receivables, investments and other financial assets or liabilities, for which published market information is presently not available. Fair value cannot readily be determined in the absence of active capital and financial markets, as generally required under the provisions of IAS and IFRS. According to the opinion of the management of the bank, the reported carrying amounts are the most valid and useful reporting values under the present market conditions and accounting regulations of Montenegro and Central Bank's regulations for financial reporting. In the amount of the identified estimated risk that the carrying value will not be realized, a provision is recognised based on a relevant decision of the bank's management.

4. RISK MANAGEMENT

4.1. Introduction

Bank is exposed in its operation to a various risks, including the most important:

- credit risk;
- market risk;
- liquidity risk;
- operational risk.

The risk management strategies, policies, procedures and other documents are designed to identify and analyze risks, to define limits and controls required for risk management and to monitor Bank's exposure to each individual risk. Procedures for risk management are subject to regular control in order to adequately respond to the changes in the market, products and services.

Department for Risk monitoring, management and reporting is responsible for monitoring of the Bank's exposure to a certain risks which is reported to the Committee on asset and liability management and the Board of Directors on a monthly basis.

4.2. Credit risk

Banks is exposed to credit risk which is a risk that counterparty will be unable to pay full amount due to the bank and on time. Credit risk is identified as the most significant risk in the Bank's portfolio. Bank is creating provisions for impairment losses, related to losses expected on reporting date. Significant changes in the economic environment or certain industries included in bank's loan portfolio could result in losses that are different from the losses provided for in the statement of financial position. Therefore, management carefully manages Bank's exposure to credit risk

4.2.1. Credit risk management

Credit risk exposure is a risk of a financial loss resulting from the borrower's inability to meet all the contractual obligations toward the Bank. The strategic commitment of the Bank is directed towards increase in the participation in investments in small amounts granted to small and medium-sized companies and citizens; providing of financial support to sound projects (clients and sectors of small and medium enterprises) and ensuring optimal risk diversification and sources of income in the direction of increasing the profitability of the segment of existing products and services, as well as the promotion and affirmation of new ones. The bank manages the risk assumed by setting limits in respect of large loans, single borrowing entities and related parties. Such risks are monitored and reviewed on an ongoing basis.

Credit risk exposure is managed by means of regular analysis of the ability of borrowers and potential borrowers to repay the liabilities in terms of interest and principal.

Commitments and Contingent Liabilities

The primary purpose of these instruments is to ensure that funds are available to a customer as required. Guarantees and letters of credit represent irrevocable assurances that the Bank will make payments in the event that a customer cannot meet its obligations to third parties, and therefore carry the same credit risk as loans. Documentary and commercial letters of credit, which represent written undertakings of the Bank on behalf of a customer authorizing a third party to draw bills of exchange on the Bank up to the amount agreed under specific terms are secured by the underlying deliveries of goods that they relate to and therefore carry less risk than loans.

4.2.2. Impairment Losses in Accordance with Requirements of IAS 39

For the items of balance sheet and off-balance sheet items on the basis of which it is exposed to credit risk, the Bank assesses the impairment of balance sheet assets or the probable loss for off-balance sheet items. In accordance with its own methodology, the Bank has the financial resources divided into groups (portfolios) with similar credit risk characteristics, and, bearing in mind the current size and structure of the loan portfolio, the segmentation is made based on the following: loans for corporate clients (companies and entrepreneurs) and Retail loans. As at the reporting date, the Bank establishes if there was the impairment of financial assets. Objective proofs indicating that there has been impairment of loans are explained in Note 3.7.

4. RISK MANAGEMENT (Continued)

4.2. Credit risk (Continued)

4.2.3. Maximum exposure to credit risk for balance sheet and off balance sheet items

	(In thousands of EUR) 2016	2015
Balance sheet items		
Loans and receivables from banks	17,875	31,452
Loans and receivables from clients	62,335	33,890
Securities – available for sale	10,132	-
Securities – held to maturity	1,750	1,500
Other financial receivables	751	264
	92,843	67,106
Off-balance sheet items		
Payment guarantees	2,216	2,973
Performance guarantees	99	84
The customs guarantees	676	20
The tender guarantees	6	34
Letters of credit	20	-
Undrawn credit facilities	1,114	539
	4,131	3,650
Total exposure to credit risk	**96,974**	**70,756**

The catalogue of eligible collaterals defines the types of collateral (collateral of loan repayment collection of the Bank) and establishes the objects and rights treated as collateral, i.e. which objects and rights and under which conditions the Bank takes into account in the analysis and assessment of the credit risk of the borrower. Credit risk management is thus partially controlled.

Taking into account the risk of the value of collateral change, when estimating the cash flows from the collateral, the Bank applies to all immovable property the haircut of at least 30% (for real estates in Podgorica and Budva), up to 70% depending on the type of collateral and location.

Types of loan collaterals are:

- deposits;
- pledges placed against industrial machines, securities, inventories and vehicles;
- mortgages and fiduciary transfer of ownership;
- bills of exchange;
- authorizations;
- administrative injunctions;
- guarantors and
- insurance policies.

4. RISK MANAGEMENT (Continued)

4.2. Credit risk (Continued)

4.2.4. Loans and Advances

December 31, 2016	Neither Past due nor Impaired	Past Due but not Impaired	Individually estimated	Total, Gross	Individual Allowance for Impairment	Group Allowance for Impairment	Total Allowance for Impairment	Total, net
Liquidity (current assets)	23	-	12,261	12,284	58	-	58	12,226
Purchase of fixed assets	20	-	18,038	18,058	230	-	230	17,828
Overdraft	-	-	17,329	17,329	77	-	77	17,252
Preparation of tourist season	64	-	734	798	65	-	65	733
Housing loans	79	1	999	1,079	31	-	31	1,048
Other	46	-	6,419	6,465	34	-	34	6,431
Cash loans (general purpose)	2,090	51	1,398	3,539	118	44	162	3,377
Refinancing of liabilities towards to other banks	-	-	3,228	3,228	69	-	69	3,159
Interest receivables and prepayments	-	-	355	355	74	-	74	281
	2,322	52	60,761	63,135	756	44	800	62,335

December 31, 2015	Neither Past due nor Impaired	Past Due but not Impaired	Individually estimated	Total, Gross	Individual Allowance for Impairment	Group Allowance for Impairment	Total Allowance for Impairment	Total, net
Liquidity (current assets)	39	-	1,251	1,290	20	-	20	1,270
Purchase of fixed assets	29	5	20,376	20,410	130	-	130	20,280
Overdraft	13	-	2,074	2,087	47	-	47	2,040
Preparation of tourist season	87	1	570	658	16	-	16	642
Housing loans	82	-	1,090	1,172	23	-	23	1,149
Other	25	3	7	35	6	1	7	28
Cash loans (general purpose)	2,361	32	2,217	4,610	128	49	177	4,433
Refinancing of liabilities towards to other banks	11	-	3,845	3,856	55	-	55	3,801
Interest receivables and prepayments	-	-	284	284	37	-	37	247
	2,647	41	31,714	34,402	462	50	512	33,890

4. RISK MANAGEMENT (Continued)

4.2. Credit risk (Continued)

4.2.4. Loans and Advances (Continued)

a) Past Due but not Impaired loans and advances

(In thousands of EUR)

	Past due up to 30 days	Past due 31- 90 days	Past due 91-270 days	Past due 270- 365 days	Over 356 days	Total
December 31, 2016						
Loans to legal entities	-	-	-	-	-	-
Loans to entrepreneurs	-	-	-	-	-	-
Loans to individuals –residents	27	25	-	-	-	52
Loans to individuals - non-residents	-	-	-	-	-	-
	27	25	-	-	-	52
December 31, 2015						
Loans to legal entities	2	-	-	-	-	2
Loans to entrepreneurs	3	-	-	-	-	3
Loans to individuals –residents	13	23	-	-	-	36
Loans to individuals - non-residents	-	-	-	-	-	-
	18	23	-	-	-	41

4. RISK MANAGEMENT (Continued)

4.2. Credit risk (Continued)

4.2.4. Loans and Advances (Continued)

c) Restructured Loans and Advances

The Bank has restructured a loan if the borrower has, due to deterioration of the debtor's creditworthiness:

- extended the principal and interest maturity,
- decreased the interest rate on the loan approved,
- took over the receivable that the borrower has towards a third party, on behalf of the full or partial loan repayment;
- reduced the amount of debt, principal or interest;
- capitalized the interest on the loan approved to a borrower;
- replaced the existing loan or existing loans with new loans (revolving);
- made other concessions that place the borrower in a better financial position.

Upon restructuring of the loan, the Bank performs financial analysis of the borrower and assesses its capacitates to realize cash flows necessary for the repayment of the loan principal, as well as the corresponding interest once the loan is restructured. During 2016, the Bank restructured loans in the amount of EUR 1,977 thousand, out of which the amount of EUR 1,475 thousand related to legal entities, and EUR 502 thousand to individuals (2015: EUR 2,732 thousand).

d) Geographic Concentration

Geographic concentration of the Bank's exposure to the credit risk is as follows:

(In thousands of EUR)

	Montenegro	European Union	USA and Canada	Other	Total
Loans and receivables from banks	-	10,700	-	7,175	17,875
Loans and receivables from clients	60,580	851	-	904	62,335
Securities held to maturity	1,750	-	-	-	1,750
Securities available for sale	10,132	-	-	-	10,132
Other financial receivables	751	-	-	-	751
December 31, 2016	**73,213**	**11,551**	**-**	**8,079**	**92,843**
December 31, 2015	**35,480**	**22,739**	**7,524**	**1,363**	**67,106**

4. RISK MANAGEMENT (Continued)

4.2. Credit risk (Continued)

4.2.4. Loans and Advances (Continued)

e) Industry Concentration

Industry concentration of the Bank's exposure to the credit risk is as follows:

	Finances	Transportation, traffic and telecommunication	Services, tourism and hospitality	Trade	Building and construction	Mining	Admini stration	Professional, scientific and technologica l activities	Agriculture, hunting and fishing	Manufac turing	Other	Individuals	Total
Loans and receivables from banks	-	-	-	-	-	-	-	-	-	-	17,875	-	17,875
Loans and receivables from customers	5,000	1,456	16,064	4,368	16,199	1,079	1,018	5,157	106	1,318	3,488	7,082	62,335
Securities available for sale	10,132	-	-	-	-	-	-	-	-	-	-	-	10,132
Securities held to maturity	1,750	-	-	-	-	-	-	-	-	-	-	-	1,750
Other financial receivables	157	-	-	-	-	-	-	-	-	-	594	-	751
December 31, 2016	17,039	1,456	16,064	4,368	16,199	1,079	1,018	5,157	106	1,318	21,957	7,082	92,843
December 31, 2015	1,674	1,813	1,128	1,753	15,998	1,069	1,802	1,410	162	1,046	32,337	6,914	67,106

4. RISK MANAGEMENT (Continued)

4.2. Credit risk (Continued)

4.2.5. Off-Balance Sheet Items

The maturities of off-balance sheet items exposing the Bank to credit risk are as follows:

(In thousands of EUR)

	Undrawn Loan Facilities	Guarantees	Uncovered Letters of Credit	Total
December 31, 2016				
Up to one year	1,042	1,424	20	2,486
From 1 to 5 years	72	1,573	-	1,645
	1,114	2,997	20	4,131

(In thousands of EUR)

	Undrawn Loan Facilities	Guarantees	Uncovered Letters of Credit	Total
December 31, 2015				
Up to one year	26	290	-	316
From 1 to 5 years	513	2,821	-	3,334
	539	3,111	-	3,650

4.3. Market Risk

The Bank takes on exposure to market risks. Market risks arise from open positions, due to changes in interest rates, changes in exchange rates and changes in the price of securities that change in accordance with market fluctuations. Exposure limits to market risks are internally prescribed, and in compliance with the prescribed limits by the Central Bank of Montenegro.

4.3.1. Foreign Exchange Risk

The Bank takes on exposure to effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows. The exposure to currency risk is regularly monitored by harmonizing them with the limits prescribed by the Central Bank of Montenegro. The exposure to the exchange rate as at December 31, 2016 is shown in the following table:

(In thousands of EUR)	USD	GBP	CHF	Other	Total
Assets in foreign currencies	4,252	13,299	144	514	18,209
Liabilities in foreign currencies	4,283	13,283	81	507	18,154
Net open position:					
- December 31, 2016	(31)	16	63	7	55
- December 31, 2015	103	21	36	2	162
% of share capital:					
- December 31, 2016	(1%)	0%	1%	0%	
- December 31, 2015	2%	0%	1%	0%	
Aggregate open position:					
- December 31, 2016	55				
- December 31, 2015	162				
% of share capital:					
- December 31, 2016	1.04%				
- December 31,2015	2.76%				

4. RISK MANAGEMENT (Continued)

4.3. Market Risk (Continued)

4.3.1. Foreign Exchange Risk (Continued)

In thousands of EUR

	GBP	Other currencies	Total foreign currencies	Local Currency (EUR)	Total
FINANCIAL ASSETS					
Cash and deposits with the central banks	4	89	93	14,216	14,309
Loans and receivables from banks	4,104	4,821	8,925	8,950	17,875
Loans and advances to customers	-	-	-	62,335	62,335
Securities available for sale	-	-	-	10,132	10,132
Securities held to maturity	-	-	-	1,750	1,750
Other financial receivables	-	-	-	751	751
Total financial assets	4,108	4,910	9,018	98,134	107,152
FINANCIAL LIABILITIES					
Deposits due to clients	12,700	4,833	17,533	80,639	98,172
Borrowings from other clients and banks	584	-	584	6,314	6,898
Subordinated debt	-	-	-	1,002	1,002
Total financial liabilities	13,284	4,833	18,117	87,955	106,072
Net foreign exchange exposure:					
- December 31, 2016	(9,176)	77	(9,099)	10,179	1,080
- December 31, 2015	21	142	163	(365)	(205)

4.3.2. Interest Rate Risk

Interest rate risk is the risk that the future cash flows of a financial instrument will fluctuate due to changes in market interest rates. Fair value interest rate risk is the risk that the value of a financial instrument will fluctuate because of changes in market interest rates. The Bank assumes exposure to the effects of fluctuations in the prevailing levels of market interest rates on cash flows. Interest margins may increase because of such changes; however, these may reduce profit or give rise to losses in instances of unexpected fluctuations. Interest rates are based on market rates and the Bank performs regular repricing.

The following table presents the Bank's interest bearing and non-interest bearing assets and liabilities as at December 31, 2016:

(In thousands of EUR)

	Interest bearing	Non-interest bearing	Total
FINANCIAL ASSETS			
Cash balances and deposits with central banks	2,294	12,015	14,309
Loans and receivables from banks	-	17,875	17,875
Loans and receivables from clients	62,335	-	62,335
Held-to-maturity securities	10,132	-	10,132
Available for sale securities	1,750	-	1,750
Other financial receivables	-	751	751
Total financial assets	76,511	30,641	107,152
FINANCIAL LIABILITIES			
Deposits due to clients	41,911	56,261	98,172
Borrowings from other clients and banks	6,890	-	6,898
Subordinated debt	1,002	-	1,002
Total financial liabilities	49,811	56,261	106,072
Interest rate risk exposure:			
- December 31, 2016	26,700	(25,620)	1,080
- December 31, 2015	(3,219)	2,521	(698)

4. RISK MANAGEMENT (Continued)

4.3. Market Risk (Continued)

4.3.2. Interest Rate Risk (Continued)

Loans to legal entities are granted as per following interest rates:

- Short-term loans with fixed interest rate: 3.60% - 12.00%
- Long-term loans with fixed interest rate: 4.50% - 12.00%
- Loans with cash collateral with fixed interest rate: 2.50% - 7.50%

Lending interest rates applied to loans granted to individuals during 2016 are as follows:

Type of a loan	Interest rate
Cash loans	7.00% -11.00%
Loans to students	7.50%
Loans for tourism developments	9.00%
Micro loans	13.00%
Loans to pensioners	7.95% - 10.50%
Vehicle loans	9.90%

Deposit interest rates which were applicable on deposits of legal entities during 2016 were as follows:

Deposit type	Interest rate
Short-term deposits	0.50%-1.50%
Long-term deposits	1.50%-2.50%

Deposit interest rates which were applicable on deposits of individuals during 2016 were as follows:

Deposit type	Interest rate
Deposits on demand	
Savings on demand:	
- EUR	0.03%
Term deposits in EUR:	
- from 1 to 3 months	0.30% - 0.50%
- from 3 to 6 months	0.50% - 0.80%
- from 7 to 12 months	1.20% - 1.50%
- from 13 to 24 months	1.50% - 1.70%
- over 24 months	2.20%
Term deposits in foreign currencies:	
- from 1 to 6	0.20%
- from 9 to 12	0.70%
- from 24 or more	1.00%

4. RISK MANAGEMENT (Continued)

4.4 Liquidity Risk

Liquidity risk includes both the risk of being unable to provide cash to settle liabilities at appropriate maturities and the risk of being unable to liquidate an asset at a reasonable price and in an appropriate time frame.

4.4.1. Liquidity Risk Management

The matching and controlled mismatching between the maturities and interest rates of assets and of liabilities is fundamental to the management of the Bank. It is unusual for banks to completely remove the liquidity gap since business transactions are often of uncertain term and of different types. An unmatched position potentially enhances profitability, but also increases the risk of losses. The maturities of assets and liabilities and the ability of the Bank to replace, at an acceptable cost, interest-bearing liabilities as they mature, are important factors in assessing the liquidity of the Bank and its exposure to changes in interest rates and exchange rates. Liquidity requirements to support calls under guarantees and standby letters of credit are considerably less than the amount of the commitment because the Bank does not generally expect the third party to draw funds under the agreement. The total outstanding contractual amount of commitments to extend credit does not necessarily represent future cash requirements, since many of these commitments will expire or terminate without being funded. The Bank is exposed to daily calls on its available cash resources which influence the available cash held on the current accounts or as deposits. The Bank does not maintain cash to meet all of these needs since historical experience demonstrates that a minimum level of reinvestment of maturing funds can be predicted with a high degree of certainty.

The expected maturities of the Bank's asset and liability components as at December 31, 2016 were as follows:

(In thousands of EUR)

	Up to one month	From 1 to 3 months	From 3 to 6 months	From 6 to 12 months	From 1 to 5 years	Over 5 years	Total
Financial assets							
Cash balances and deposit accounts with central banks	10,597	-	-	-	3,712	-	14,309
Loans and receivables from banks	16,509	1,366	-	-	-	-	17,875
Loans and receivables from clients	2,806	,479	6,477	8,156	34,976	6,441	62,335
Securities held to maturity	-	1,750	-	-	-	-	1,750
Securities available for sale	-	-	-	-	10,132	-	10,132
Other financial receivables	-	-	-	61	246	444	751
	29,911	6,596	6,477	8,217	49,066	6,885	107,152
Financial liabilities							
Deposits of clients	56,815	198	2,777	5,660	28,882	3,840	98,172
Borrowings from banks and other clients	75	304	250	700	4,282	1,287	6,898
Subordinated debt	-	-	-	-	1,002	-	1,002
	56,890	502	3,027	6,360	34,166	5,127	106,072
Maturity gap							
- December 31, 2016	(26,979)	6,094	3,450	1,857	14,900	1,758	1,080
Cumulative Gap	(26,979)	(20,885)	(17,435)	(15,578)	(678)	1,080	(80,475)
% of the total source of financing	(25.4%)	(19.7%)	(16.4%)	(14.7%)	(0.6%)	1.0%	-
- December 31, 2015	(10,755)	1,212	1,445	55	6,603	2,118	678
Cumulative Gap	(10,755)	(9,543)	(8,098)	(8,043)	(1,440)	414	(37,729)
% of the total source of financing	(13.9%)	(12.3%)	(10.4%)	(10.4%)	(2.2%)	0.5%	-

4. RISK MANAGEMENT (Continued)

4.4 Liquidity Risk (Continued)

4.4.1. Liquidity Risk Management (Continued)

As at December 31, 2016, the structure of assets and liabilities indicates the existence of non-conformities of remaining period of maturity of assets and liabilities within the maturity up to one month. The Bank's liquidity, as its ability to settle its liabilities when due, depends upon the balance sheet structure, and, on the other side, upon the compliance between inflows and outflows.

The resulting negative GAPs which are dominantly the consequence of non-compliance within 1-7 days caused a high level of demand deposits arranged in that time interval. Analyzes show that listed assumption is extremely rigorous and in the past the Bank had not a negative outflow of those deposits in such short time intervals. The Bank will develop a methodology for establishing a stable level of demand deposits with whose implementation will significantly change the image of the Bank on this issue, i.e. empirically adequate redistribution of demand deposit within the set of deadlines will be done.

Aware of challenges that the high level of demand deposits carries, the Bank has concluded a Letter of Intent with Hipotekarna banka a.d. Podgorica during 2017, in the amount of EUR 5,000 thousand, which serves to preserve liquidity on the one hand, and serves to cover the negative gap on the other hand.

4.4.2. Remaining Contractual Maturity Analysis for Financial Liabilities (Undiscounted Cash Flows)

(In thousands of EUR)

	On Demand	Up to 1 Month	From 1 to 3 Months	From 3 to 12 Months	From 1 to 5 Years	Over 5 Years	Total
December 31, 2016							
FINANCIAL LIABILITIES							
Liabilities to other customers and banks	75	-	304	950	4,282	1,287	6,898
Deposits of clients	56,261	557	199	8,253	29,041	3,861	98,172
Subordinated debt	-	-	-	-	1,002	-	1,002
	56,336	557	503	9,203	34,325	5,148	106,072

(In thousands of EUR)

	On Demand	Up to 1 Month	From 1 to 3 Months	From 3 to 12 Months	From 1 to 5 Years	Over 5 Years	Total
December 31, 2015							
FINANCIAL LIABILITIES							
Liabilities to other customers	-	129	184	758	2,374	1,642	5,087
Deposits of clients	19,080	31,340	483	2,296	18,234	709	72,142
Subordinated debt	-	-	-	-	-	-	-
	19,080	31,469	667	3,054	20,608	2,351	77,229

4.5 Fair Value of Financial Assets and Liabilities

(In thousands of EUR)

	Carrying Amount		Fair Value	
	2016	2015	2016	2015
Financial assets				
Loans and receivables from banks	17,875	31,452	17,875	31,452
Loans and receivables from clients	62,335	33,890	62,335	33,890
Securities held-to-maturity	1,750	1,500	1,750	1,500
Securities available for sale	10,132	-	10,132	-
Investments in subsidiaries	730	755	730	755
Financial liabilities				
Deposits of clients	98,172	72,142	98,172	72,142
Borrowed funds from other clients	6,890	5,087	6,890	5,087
Borrowed funds from banks	8	-	8	-
Subordinated debt	1,002	-	1,002	-

4.5. Fair Value of Financial Assets and Liabilities (Continued)

No readily available market prices exist for a certain portion of the Bank's financial instruments. In circumstances where the quoted market prices are not readily available, the fair value is estimated using discounted cash flow models or other pricing models as appropriate. Changes in underlying assumptions, including discount rates and estimated future cash flows, significantly affects the estimates. Therefore, the calculated fair market estimates cannot be realized in a current sale of the financial instrument.

In estimating the fair value of the Bank's financial instruments, the following methods and assumptions were used:

a) Loans and advances to banks

Loans and advances to banks include inter-bank placements and line items in the course of collection.

The fair value of floating rate placements and overnight deposits approximates their carrying amount at the statement of financial position date.

b) Loans and advances to customers

In order to determine the fair value of loans and advances to customers with fixed interest rate, measured at amortized cost, the Bank has performed comparison of the Bank's interest rate on loans and advances to customers with available information on the current market interest rates in the banking sector of the Montenegro (i.e. average weighted market rates by activities).

According to the Bank's management, the interest rates do not materially differ from prevailing market interest rates in the banking sector of Montenegro accordingly the fair value of loans to customers calculated as the present value of future cash flows discounted using current market rates, or the average weighted interest rate for the banking sector does not materially differ from the carrying value of the loans on the balance sheet date. According to the Bank's management, carrying values as presented in the Bank's financial statements represent values that are believed to be the most valid under the circumstances and most useful for the purposes of financial reporting.

c) Available for sale securities

Securities available for sale relate to bonds issued by the Ministry of Finance of Montenegro, which mature up to 2020. The Bank's management believes that the nominal value at which the following financial instruments are expressed not surrendered significantly from the fair value of similar instruments on the market on 31 December 2016.

d) Held-to-maturity securities

Held-to-maturity securities refer to government bonds with a maturity of 182 days, issued by the Ministry of Finance of Montenegro. Considering the maturity of those bonds, the Bank's management believes that the carrying value of these financial instruments reflect their fair value at the balance sheet date.

e) Investments in subsidiaries

In order to determine the fair value of investments in subsidiaries, the Bank's management believes that there is no objective evidence of impairment and carrying value of these investments reflects the real value of which in particular instances are the most valid and useful for disclosures of the fair value of this financial instruments.

f) *Financial liabilities*

For demand deposits and deposits with maturity less than one year, it is assumed that the estimated fair value is not materially different from their carrying values.

According to the Bank's management, Bank's interest rates are harmonized with the current market rates and the amounts stated in the financial statements represent the real values that are believed under the circumstances, to approximate the fair value of deposits with fixed interest rate and remaining maturity of over one year.

The carrying value of borrowings with floating interest rates approximates their fair value at the statement of financial position date.

4. RISK MANAGEMENT (Continued)

4.5. Fair Value of Financial Assets and Liabilities (Continued)

g) Fair value hierarchy

IFRS 13 requires disclosure of fair value measurement according to the following hierarchy levels:
- Quoted prices (unadjusted) on active markets for identical assets or liabilities (Level 1);
- Inputs other than quoted prices included within Level 1 that are observable for an asset or a liability, either directly (that is, as prices) or indirectly (that is, as derived from prices) - (Level 2),
- inputs for asset or a liability that are not based on observable market data - (Level 3).

The fair value of financial instruments traded in active markets is based on quoted market prices at the balance sheet date. The fair value of the financial instruments which are not being traded on the active market is determined by various evaluation techniques. The Bank applies different methods and makes assumptions that are based on market conditions existing at the balance sheet date. These methods include quoted market prices or quoted prices for similar instruments, and the estimated discounted value of cash flows.

4.6. Capital Management

The Bank's capital management objectives are:
- To comply with the capital requirements set by the regulator;
- To safeguard the Bank's ability to continue as a going concern so that it can continue to provide returns to shareholders and ensure benefits for other stakeholders; and
- To maintain a strong capital base to support the development of its business

The Bank's management controls capital adequacy by applying the methodologies and limits prescribed by the Central Bank of Montenegro in the Decision on Capital Adequacy (Official Gazette of Montenegro, No. 38/11 and 55/12). In accordance with the regulations, the Bank submits quarterly reports on the capital condition and structure to the Central Bank of Montenegro. The Bank's regulatory capital is divided in core capital and supplementary capital. The sum of core elements of regulatory capital deducted for the sum of deductible items represents core capital of the Bank

Core elements of regulatory capital of a bank are the following:
1) paid-in share capital at nominal value, excluding cumulative preferential shares;
2) collected issue premiums;
3) loan loss provisions under regulatory requirement established in accordance with the decision regulating minimum standards for credit risk management in banks;
4) reserves established against post-tax income (legal, statutory, and other reserves);
5) undistributed prior years profit;
6) current year income if the shareholders` assembly decided to allocate current year income in core capital of the Bank.

Deductible items in the calculation of core capital shall be as follows:
1) prior years losses;
2) current year loss;
3) intangible assets such as goodwill, licenses, patents, trademarks and concessions;
4) nominal amount of acquired own shares, excluding cumulative preferential shares;
5) unrealised loss on fair value adjustment of financial assets available for sale;
6) positive difference between the amount of calculated loan loss provisions and the sum of the amount of allowances for impairment on balance sheet and provisioning for off-balance sheet items;
7) excess of limit in investing in real estates and fixed assets specified under special regulation of the Central Bank.

The sum of supplementary elements of regulatory capital deducted for the sum of deductible items represents supplementary capital of the Bank.

Supplementary elements of regulatory capital to be included in the supplementary capital of a bank are the following:
1) nominal value of paid-in cumulative preferential shares;
2) paid issue premiums based on cumulative preferential shares;
3) general reserves up to 1.25% of total risk weighted assets at a maximum;
4) subordinated debt meeting the requirements set out in the CBoM Decision on capital adequacy;
5) hybrid instruments meeting the requirements set out in the CBoM Decision on capital adequacy;
6) revaluation reserves for real estate property owned by a bank.

4. RISK MANAGEMENT (Continued)

4.6. Capital Management (Continued)

Deductible items in the calculation of supplementary capital are the following:
1) acquired own cumulative preferential shares;
2) receivables and contingent liabilities secured by hybrid instruments or subordinated debt up to the amount these instruments have been included in supplementary capital.

In accordance with the requirements of the Central Bank of Montenegro, the Bank is under obligation to maintain a minimum capital adequacy ratio of 10%. The Bank is required to maintain certain minimum or maximum ratios with respect to its scope of activities and composition of risk assets in compliance with the Law on Banks of Montenegro and with the Central Bank of Montenegro Regulations. As at 31 December 2016, the solvency ratio calculated by the Bank amounted to 12.77% (2015: 15.65%). The Bank's compliance with regulatory indicators is given in Note 27.

4.7. Sensitivity analysis

4.7.1. Sensitivity analysis (Foreign Exchange Risk)

The management of foreign exchange risk, in addition to the analysis of Bank's assets and liabilities in foreign currency, includes the analysis of risk inherent in the fluctuations in foreign currency exchange rates. The table, which follows, sets out the scenario for the changes in the exchange rates ranging from +10% to -10% as compared to EUR.

(In thousands of EUR)

		2016	Change in Exchange Rate	
	Total	**Amount in foreign currency**	**10%**	**-10%**
Financial assets				
Loans and advances to banks	17,875	9,018	902	(902)
Off-balance sheet - Contracts for the purchase of foreign currency	9,192	9,192	919	(919)
Total financial assets	27,067	18,210	1,821	(1,821)
Financial liabilities				
Deposits of customers	98,172	18,156	1,815	(1,815)
Borrowings from other clients and banks	6,898	584	58	(58)
Total financial liabilities	105,070	18,740	1,873	(1,873)
Net exposure to foreign exchange risk:				
- **December 31, 2016**			(52)	52
- **December 31, 2015**			16	16

As at December 31, 2016, under the assumption that all other parameters remain the same upon the change in the EUR exchange rate, as compared to other currencies, by +10%, i.e. -10%, the Bank's profit would decrease, i.e., increase by 52 thousand (December 31, 2015: decrease, i.e., increase by EUR 16 thousand). The reason why the Bank's exposure to currency risk is small is based on the fact that the major portion of the Bank's assets and liabilities is denominated in EUR.

4. RISK MANAGEMENT (Continued)

4.7.2. Sensitivity analysis (Interest Rate Risk)

In the process of interest rate risk management, the bank analyses sensitivity to changes in assets and liabilities with variable interest rates. The following table shows the effect of changes in variable interest rates on receivables and denominated in EUR in the range of +0.4% p.p. to -0.4% p.p.

(In thousands of EUR)

		Net effect of movements in interest rates	
	2016	**+0.4 b.p. EUR KS**	**-0.4 b.p. EUR KS**
Financial assets			
Cash and deposits with central banks	14,309	-	-
Loans and receivables from banks	17,875	-	-
Loans and receivables from clients	62,335	249	(249)
Securities available for sale	10,132	41	(41)
Securities held to maturity	1,750	7	(7)
Other financial receivables	751	-	-
	107,152	297	(297)
Financial liabilities			
Deposits of the clients	98,172	393	(393)
Borrowed funds from banks and other clients	6,898	27	(27)
Subordinated debt	1,002	4	(4)
	106,072	424	(424)
Net exposure to the interest rate risk:			
- **December 31, 2016**		(127)	127
- **December 31, 2015**		36	(36)

Under the assumption that all other parameters remain the same, the increase, or decrease in variable interest rates applied to assets and liabilities denominated in EUR by 0.4 p.p., the Bank's profit would increase, or decrease for EUR 127 thousand.

5. INTEREST INCOME AND EXPENSE

a) Interest Income

(In thousands of EUR)	**2016**	**2015**
Deposits with:		
- foreign banks	3	1
Loans:		
- corporate	1,879	1,104
- retail	682	862
	2,561	1,966
Securities available for sale	252	-
Securities held to maturities	10	4
	2,826	1,971
Allowances for interest receivables	(47)	(37)
	2,779	1,934

b) Interest Expense

(In thousands of EUR)	**2016**	**2015**
Deposits with:		
- financial institutions	-	1
- government	1	5
- corporate	486	144
- retail	230	183
Loans and other borrowings	196	175
	913	508

6. IMPAIRMENT LOSSES AND PROVISIONS

a) Impairment losses

(In thousands of EUR)	2016	2015
Impairment of loans	280	9

b) Provisions expenses

(In thousands of EUR)	2016	2015
Net (decrease)/ increase in provisions in respect of:		
- off-balance sheet items	(2)	5

c) Changes in allowances for impairment

2016

(In thousands of EUR)	Loans (Note 15)	Interest and other (Note 15)	Provisions for off-balance items	Total
Opening balance	475	37	10	522
Charge for the year	280	47	(2)	325
Transfer to off-balance sheet items	(29)	(10)	3	(36)
Balance at the end of the year	726	74	11	811

2015

(In thousands of EUR)	Loans (Note 15)	Interest and other (Note 15)	Provisions for off-balance items	Total
Opening balance	708	45	5	758
Charge for the year	9	8	5	22
Transfer to off-balance sheet items	(242)	(16)	-	(258)
Balance at the end of the year	475	37	10	522

7. FEE AND COMMISSION INCOME AND EXPENSE

a) Fees and Commissions Income

(In thousands of EUR)	2016	2015
Fees and commissions for foreign payments	404	787
Fees for opening and maintaining the account	125	27
Fees on credit card business	113	67
Fees and commissions income from transactions payments and e-banking	85	121
Fees from loans	73	87
Fees income from off-balance-sheet operations	51	75
Other fees and commissions income	26	24
	877	1,188

7. FEE AND COMMISSION INCOME AND EXPENSE (Continued)

b) Fees and Commissions Expense

(In thousands of EUR)	2016	2015
Deposit insurance premium fees	370	281
Fees of the Central Bank	155	45
Visa and Master card fees	92	55
International bank charges fees	52	86
Fees for electronic banking	47	40
Other fees and commissions	45	-
	761	507

8. NET LOSSES FROM FINANCIAL INSTRUMENTS HELD FOR TRADING

Net losses on financial instruments as at December 31, 2016 amounted to EUR 789 thousand (did not exist as at December 31, 2015) and were created by reducing Swap transaction at fair value. Namely, Swap has classified as financial assets at fair value through the profit and loss. This amount is the effect of reducing the contracted exchange rate relative to the reporting date.

9. STAFF COSTS

(In thousands of EUR)	2016	2015
Net salaries	575	575
Taxes, surtaxes and contributions	438	440
Remunerations to members of the Board of Directors	50	16
Travel expenses and per diems	39	9
Retirement benefits and jubilee awards	29	-
Fees for temporary jobs	27	75
Employees trainings	4	8
Other net payments to employees	-	5
Provisions for pensions	2	-
	1,164	1,128

10. GENERAL AND ADMINISTRATIVE EXPENSES

(In thousands of EUR)	2016	2015
Professional fees	206	99
Computer and other equipment maintenance	121	95
Rentals	88	72
Communications networks	57	53
Security	56	62
Electricity and fuel	39	32
Audit	31	17
Telecommunication expenses	28	59
Membership fees and contributions	22	16
Office supplies expenses	17	40
Insurance	15	15
Miscellaneous expenses	13	94
Utilities	5	7
Representation expenses	5	6
Advertising and marketing	3	29
Postage	3	4
Court expenses	2	5
Backup premises expenses	-	6
Consulting fees	-	18
	711	729

10a. DEPRECIATION EXPENSES

(In thousands of EUR)	2016	2015
Property, plant and equipment (Note 18)	169	137
Intangible assets (Note 19)	79	74
	248	211

11. OTHER INCOME

(In thousands of EUR)	2016	2015
Capital gain	23	-
Collection from written-off loans	15	50
Other extraordinary income	10	-
Correction from the previous year	6	-
Lease income	3	28
	57	78

12. INCOME TAXES

a) Components of Income Taxes

(In thousands of EUR)	2016	2015
Current taxes	45	-
Deferred taxes	6	15
	51	15

b) Numerical reconciliation between tax expense and the product of accounting results multiplied by the applicable tax rate

(In thousands of EUR)	2016	2015
Result in income statement before tax	375	309
Depreciation expenses in income statement	248	211
Depreciation expenses for tax purposes	(407)	(372)
Other	9	(4)
Total	225	144
Capital gains	(502)	-
Loss for tax purpose	(277)	144
Loss from previous years to the taxable profit	-	(144)
Total capital gains for the year - tax base	502	-
Tax on capital gains	45	-
Tax in the tax return	45	-
Effective tax rate	12%	0%

c) Deferred tax

Generated in	Expires in	In thousands of EUR
2011	2016	1,456
2012	2017	136
		1,592

Deferred tax assets on tax losses from previous years were not recognized.

It was recognised the amount of deferred taxes of EUR 6 thousand as 9% of the difference between tax and accounting depreciation for 2016.

13. CASH AND DEPOSIT ACCOUNTS HELD WITH CENTRAL BANKS

(In thousands of EUR)	December 31, 2016	December 31, 2015
Cash in hand:		
- in EUR	401	726
- in foreign currency	93	207
Gyro account	6,391	3,402
Obligatory reserves with the Central Bank of Montenegro	7,424	5,847
	14,309	10,182

The Bank's obligatory reserves as at December 31, 2016 were set aside in accordance with the Decision of Central Bank of Montenegro on obligatory reserve of the banks to be held with the Central Bank of Montenegro (Official Gazette of Montenegro, No. 35/11, 22/12, 61/12 and 57/13, 52/14 and 7/15) (hereinafter: the Decision), which prescribes that Bank's allocate the obligatory reserve by applying rate of:

- 9.5% on deposits base which is consisted of demand deposits and deposits with agreed maturity up to one year, or up to 365 days and
- 8.5% on deposit base which is consisted of deposits with agreed maturity over one year, or over 365 days.

The Bank may hold up to 25% of the obligatory reserve in the form of Treasury bills issued by Montenegro.

Calculated obligatory reserves, the Bank set aside onto domestic accounts of obligatory reserves and/or onto the accounts of the Central Bank abroad. The obligatory reserve is held in EUR.

Till December 31, 2016:

- the Bank may hold up to 25% of the obligatory reserve in government treasury bills issued by Montenegro of any maturity, after which the Bank may up to 10% of the obligatory reserve hold in T-bills issued by Montenegro with maturity up to 182 days;
- For the amount of 15% of the obligatory reserve of the set aside requirement, the Central Bank pays fee calculated at a rate equal to EONIA minus 10 basis points per annum, with a note that this rate cannot be less than zero

For the maintenance of daily liquidity, the Bank may use up to 50% of the allocated funds of regulatory reserve. On the used amount of the regulatory reserve returned on the same day the Bank does not pay a fee. On the amount of the regulatory reserve not returned on the same day the Bank is required to pay a monthly fee at a rate determined by a special regulation of the Central Bank of Montenegro.

14. LOANS AND RECEIVABLES FROM BANKS

(In thousands of EUR)	December 31, 2016	December 31, 2015
Correspondent accounts held at foreign banks	17,875	31,452
	17,875	31,452

As at December 31, 2016, the Bank has exposure to two banks and a banking group of two entities in the amount exceeding 25% of regulatory capital, which is not in accordance with Article 58 of the Law on Banks which stipulates that the exposure to a single entity or group of related parties shall not exceed 25% of the regulatory capital. The Bank's compliance with regulatory indicators is given in Note 27.

15. LOANS AND RECEIVABLES FROM CLIENTS

(In thousands of EUR)	December 31, 2016	December 31, 2015
Loans:		
- privately-owned companies	56,861	27,027
- retail	5,365	6,915
- other – entrepreneurs and non-governmental organizations	211	176
- public service	349	-
	62,786	34,118
Comprising of:		
Short-term loans:		
- privately-owned companies	14,087	2,135
- retail	76	660
	14,163	2,795
Long-term loans:		
- privately-owned companies	42,774	24,892
- retail	5,289	6,255
- other – entrepreneurs and non-governmental organizations	211	176
- public service	349	-
	48,623	31,323
Interest receivables:		
- loans	403	368
Accruals:		
- interest on loans	171	132
- loan origination fees	(225)	(216)
	63,135	34,402
Less:		
Allowance of impairment of loans	(726)	(475)
Allowance of impairment of interest	(74)	(37)
	(800)	(512)
	62,335	**33,890**

Short-term loans to corporate entities are mostly approved for current assets with maturities from one month to 12 months, while long-term loans are granted for a period of 12 to 240 months and mostly relate to companies in the areas of hospitality, trade, mining and energy, services, etc.

Loans to retail customers include cash loans, loans for housing construction, tourist loans, mortgage loans, pensioner's loans and micro loans approved for the period from 12 to 240 months.

The geographical concentration of loans to customers in the Bank's loan portfolio mainly relates to clients domiciled in the territory of Montenegro, mostly in central region and in the coast.

The concentration of the Bank’s gross loan placements with clients per separate industries was as follows:

(In thousands of EUR)	December 31, 2016	December 31, 2015
Construction	17,067	16,014
Retail	5,365	6,915
Art and entertainment activities	3,938	1,806
Transport and storage	1,427	1,796
Trade	4,368	1,773
Manufacturing	1,158	1,570
Restaurant and accommodation services	15,891	1,147
State administration and mandatory social insurance	5,000	-
Supply of electrical energy	160	-
Mining	1,079	1,099
Health and social care	1,018	1,046
Professional, scientific and technical activities	5,967	527
Agriculture, forestry and fishing	106	165
Administrative and support service activities	40	58
Information and communication	29	36
Other service activities	173	166
	62,786	**34,118**

16. INVESTMENT SECURITIES

Securities available for sale

As at 31 December 2016 Securities available for sale amounted to EUR 10,132 thousand (did not exist as at 31 December 2015) and comprised bonds issued by the Ministry of Finance of Montenegro issued with interest rates from 3.875% to 4.00% and a maturity up to 2020.

Securities held to maturity

As at December 31, 2016, securities held to maturity amounted to EUR 1,750 thousand (2015: EUR 1,500 thousand) and comprise Treasury bills with maturity of 182 days, which are issued by the Ministry of finance of Montenegro. The balance consists of treasury bills purchased on auctions held in August 2016 with maturity date in March 2017, with annual interest rates from 0.45% to 2.45%.

The entire amount of bills was funded from obligatory reserve, which Bank holds with the Central Bank of Montenegro (Note 13).

17. INVESTMENTS IN SUBSIDIARIES

The basic capital of Universal Capital Development d.o.o. amounted to EUR 730 thousand (2015: 755 thousand), entirely in cash.

The basic capital of Universal Capital Development d.o.o. in 2015 consisted of cash investments in the amount of EUR 330 thousand and non-monetary investment in the amount of EUR 425 thousand which represents an immovable property acquired by the Bank pursuant to the Sale and Purchase Agreement (offices). In 2016, the Bank made a refund of non-monetary investments in the amount of EUR 425 thousand and replaced it with a cash investment in the amount of EUR 400 thousand.

18. PROPERTY, PLANT AND EQUIPMENT

Movements in property, plant, equipment and other assets for 2016 and 2015 are presented as follows:

(In thousands of EUR)	Buildings	Equipment and other Asset	Investment s in progress	Total
Cost				
Balance, January 1, 2015	55	1,299	1,014	2,368
Additions	2,303	193	105	2,601
Transfers to investments in subsidiaries	(425)	-	-	(425)
Transfers to intangible assets	-	-	(19)	(19)
Transfers	890	20	(910)	-
Balance, December 31, 2015	2,823	1,512	190	4,525
Additions	16	13	196	225
Transfers to intangible assets	-	(52)	(52)	
Transfers	-	-	(248)	(248)
Balance, December 31, 2016	2,839	1,577	86	4,502
Accumulated depreciation				
Balance, January 1, 2015	15	839	-	854
Depreciation (Note 10a)	8	129	-	137
Balance, December 31, 2015	23	968	-	991
Depreciation (Note 10a)	28	141	-	169
Disposals	-	(17)	-	(17)
Balance, December 31, 2016	51	1,092	-	1,143
Carrying value:				
- December 31, 2016	2,788	485	86	3,359
- December 31, 2015	2,800	544	190	3,534

As at December 31, 2016, the Bank does not have property under pledge to ensure repayment of loans and other liabilities.

19. INTANGIBLE ASSETS

Intangible assets mostly comprise licenses and software. The movements on intangible assets in the course of 2016 and 2015 were as follows:

(In thousands of EUR)	2016	2015
Cost		
Balance, January 1	851	784
Additions	248	67
Balance, December 31	1,099	851
Allowance for impairment		
Balance, January 1	646	572
Charge for the year (Note 10a)	79	74
	725	646
The carrying value as at December 31	374	205

20. OTHER OPERATING RECEIVABLES

Other operating receivables in amount of EUR 4,556 thousand (2015: EUR 4,260 thousand) mostly relate to assets acquired through foreclosure of loan collateral, which are owned by the Bank in the amount EUR 4,278 thousand (2015: EUR 4,220 thousand). The acquired assets are recorded at the lower of the total amount of receivable and the estimated value of the asset.

21. DEPOSITS FROM CLIENTS

(In thousands of EUR)	December 31, 2016	December 31, 2015
Demand deposits:		
- privately-owned companies	33,570	34,946
- state owned companies	4	1
- funds	106	16
- regulatory agencies	33	31
- entrepreneurs	84	16
- retail customers	22,388	15,271
- non-profit organizations	52	5
- other	24	6
	56,261	50,292
Short-term deposits:		
- privately-owned companies	5,262	168
- regulatory agencies	100	100
- retail customers	1,932	177
	7,294	445
Long-term deposits:		
- privately-owned companies	16,400	17,583
- retail customers	17,984	3,561
	34,384	21,144
Deposits interest	233	261
	98,172	72,142

22. BORROWINGS FROM OTHER CLIENTS

(In thousands of EUR)	2016	2015
European Investment Bank	1,444	1,928
Accrued interest	76	23
	1,520	1,951
Investment-Development Fund	4,785	3,128
Accrued interest	-	8
	4,793	3,136
Wellrock Ventures Limited	584	-
Accrued interest	1	-
	585	
Total	6,890	5,087

As at December 31, 2016, borrowings in the amount of EUR 1,520 thousand (2015: EUR 1,951 thousand) relate to the liabilities to European Investment Bank arising from a loan intended for financing and development of small and medium enterprises. The interest rate on the taken loans from EIB ranges from 2.19% to 3.66%. Maturity is from seven to eleven years. The Bank has no obligation of fulfilment of financial indicators upon the specified loans.

As at December 31, 2016, borrowings in the amount of EUR 4,793 thousand (2015: EUR 3,136 thousand) relate to the liabilities to Investment-Development Fund arising from several long term loans. The interest rate on the taken loans from EIB ranges from 1% to 4%. Maturity is from 3 to 10 years. The Bank has no obligation of fulfilment of financial indicators upon the specified loans.

As at December 31, 2016, borrowings in the amount of EUR 585 thousand relate to the liabilities to Wellrock Ventures Limited with maturity up to March 31, 2020 with the annual interest rate of 0.1%.

Maturity upon years is presented in the following tables:

European Investment Bank:

(In thousands of EUR)	2016	2015
Up to 1 year	497	478
Up to 2 years	346	492
Up to 3 years	320	384
Up to 4 years	219	316
Up to 5 years	62	250
Over 5 years	-	8
	1,444	1,928

Investment-Development Fund:

(In thousands of EUR)	2016	2015
Up to 1 year	807	494
Up to 2 years	756	561
Up to 3 years	713	516
Up to 4 years	634	475
Up to 5 years	644	412
Over 5 years	1,231	670
	4,785	3,128

23. DERIVATIVE FINANCIAL LIABILITIES AS HEDGING INSTRUMENT

In 2016, the Bank has invested significant funds in securities. Cash is provided by Swap deal contract, in which the Bank sold GBP and bought 10,000.00 thousand EUR, and contracted repurchase of GBP at a pre-agreed exchange rate. In stated transaction, the Bank has protected itself from fluctuations in exchange rates, because during the entire duration of the swap contract it had closed currency position.

Swap is classified as a financial asset at fair value through income statement. Swap receivables and liabilities are recorded in off-balance sheet and as at 31 December 2016 amounted to EUR 757 thousand net (2015: did not exist), while the effect of reducing the contracted exchange rate in relation to the reporting date are recorded in the income statement through net losses from financial instruments held for trading (note 8).

24. OTHER LIABILITIES

(In thousands of EUR)	December 31, 2016	December 31, 2015
Suppliers	45	17
Foundation capital placement	11	9
Advances received	42	3
Temporary account	136	91
Other liabilities	4	-
	238	120

25. SUBBORDINATED DEBT

As at 31 December 2016, the Bank has a subordinated debt in amount of EUR 1,002 thousand (31 December 2015 did not exist) related to funds received from SDS Management DMCC in the amount of EUR 751 thousand, with an interest rate of 0.05 % and maturity of 25 August 2022 and NER Holding LTD in the amount of EUR 251 thousand with an interest rate of 0.05% and maturity 27 Jun 2022.

26. SHARE CAPITAL

As at December 31, 2016, the Bank's share capital consists of 16,002 ordinary shares (December 31, 2015: 16,002 ordinary shares), of individual nominal value of EUR 1.

The Law on Banks (Official Gazette of Montenegro, No. 17/08, 44/10 and 40/11) defines the minimum amount of initial capital of Bank in the amount of EUR 5 million.

The ownership structure of the Bank’s equity as at December 31, 2016 and 2015 was as follows:

	2016			2015		
Shareholder name	Number of shares	In thousands EUR	% share	Number of shares	In thousands EUR	% share
Sigma Delta Holdings	8,663	8,663	54.13%	12,022	12,022	75.13%
Ner Holding LTD	3,986	3,986	24.90%	-		-
Sigma Delta Investments	2,288	2,288	14.30%	2,288	2,288	14.30%
UCB-collective custody account no.1	550	550	3.44%	-	-	-
Pairaktaridis Emmanouil	455	455	2.84%	455	455	2.84%
Seriatos Gerasimos	20	20	0.12%	20	20	0.12%
Aviplus Ou	-	-	-	627	627	3.92%
Predrag Drecun	-	-	-	550	550	3.44%
Others	40	40	0.29%	40	40	0.29%
	16,002	16,002	100.00%	16,002	16,002	100.00%

27. COMPLIANCE WITH REGULATORY REQUIREMENTS OF THE CENTRAL BANK OF MONTENEGRO

In accordance with the regulations of the Central Bank of Montenegro, the Bank is obliged to maintain minimum solvency ratio of 10%. The Bank is required to maintain certain ratios pertaining to the volume of its activities and composition of risk assets in compliance with the Law on Banks and regulations of the Central Bank of Montenegro.

	The realized indicators of business performance	
(in thousands of EUR)	**2016**	**2015**
Foundation capital (minimum amount of EUR 5 million)	16,002	16,002
Regulatory capital of the Bank (minimum amount of EUR 5 million)	6,144	5,674
The solvency ratio (the minimum amount of 10%)	12.77%	15.65%
Daily liquidity ratio as at December 31 (minimum coefficient of 0.9)	1.64%	2.6%
Decade liquidity ratios for the decade ending as at December 31 (minimum coefficient of 1)	1.69%	2.64%
The Bank's exposure to a single entity or group of related entities (limit 25% of regulatory capital of the Bank)	53.17%	288.81%
The sum of large exposures (limit 800% of regulatory capital of the Bank)	240.95%	631.85%
The total exposure to related parties of the Bank (limit 200% of regulatory capital of the Bank)	15.40%	21.22%
The total exposure to an employee of the Bank (limit 1% of regulatory capital of the Bank)	0.94%	1.39%
Total exposure to a person who is member of the Board of Directors, Audit Committee or the Executive Director (limit 2% of regulatory capital of the Bank)	0.11%	0.97%
Total exposure to a shareholder who have a qualified participation in the bank, including exposure to legal entities which are controlled by such shareholder (limit 20% of regulatory capital of the Bank)	8.27%	0.26%
Total exposure to a shareholder who does not have a qualified participation in the bank, including exposure to legal entities which are controlled by such shareholder (limit 10% of regulatory capital of the Bank)	0.31%	0.81%

As at December 31, 2016, the Bank has exposure to two banks and a banking group of two entities in the amount exceeding 25% of regulatory capital, which is not in accordance with Article 58 of the Law on Banks which stipulates that the exposure to a single entity or group of related parties shall not exceed 25% of the regulatory capital.

The Bank is making significant efforts to reduce the level of exposure to a single entity or group of related parties by depositing funds to a larger number of banks. The Bank reduce the level of exposure from 288.81%, amounted at 31 December 2015, to 53.17%, amounted 31 December 2016.

28. OFF-BALANCE SHEET ITEMS

	December 31, 2016	**December 31, 2015**
Irrevocable commitments for loan approval	1,114	539
Irrevocable letters of credit issued for payments abroad	20	-
Issued payable guarantees	2,997	3,111
Off-balance sheet assets that are classified (gross)	**4,131**	**3,650**
Provisions for losses on off-balance sheet assets	**(9)**	**(10)**
Off-balance sheet assets that are classified (net)	**4,122**	**3,640**
Forward foreign currency sales	(757)	-
Other off-balance sheet items exposure of banks	3,384	-
Collaterals securing receivables	91,300	71,538
Off-balance sheet assets that are not classified	**93,927**	**71,538**
Total off-balance sheet items	**98,049**	**75,178**

29. RELATED PARTY TRANSACTIONS

Law on Banks ("Off. Gazette of Montenegro" no. 17/08, no. 44/10 and no. 40/11) defines that significant influence on the Bank's operation have persons appointing at least one representative on the Board of Directors or a similar body , either through shareholding, with the consent of the owners or in any other way. In accordance with the Law on Banks, related party transactions are presented in the following tables:

(In thousands of EUR)	December 31, 2016	December 31, 2015
Loans and receivables		
- individuals	481	657
- legal entities:		
-Almara d.o.o. Podgorica*	-	1,266
-Monte Rock d.o.o. Podgorica	15,000	15,000
-Adriatic Properties d.o.o Budva	12,507	-
-Golden Estate d.o.o Podgorica	4,400	-
-Hit Montenegro d.o.o. Budva	2,600	-
-SDS Management DMCC Dubai	850	-
-Epidaurus Hotels d.o.o. Zagreb	398	-
-Nova Pobjeda d.o.o Podgorica	4	-
Total loans and receivables	36,240	16,923
Deposits:		
- individuals	313	392
- legal entities:		
-Golden Estate d.o.o. Podgorica	3,478	74
-SDS Management DMCC Dubai	3,232	-
-Adriatic Properties d.o.o. Budva	1,404	1,714
-Peneseda d.o.o. Podgorica	672	697
-Hit Montenegro d.o.o. Budva	432	-
-Monte Rock d.o.o. Podgorica	255	205
-Sigma Delta Holdings d.o.o. Podgorica	87	11
-Nova Pobjeda d.o.o. Podgorica	79	143
-Adriatic Yachting services d.o.o. Budva	41	-
-Sigma Delta Investments d.o.o. Podgorica	38	-
-UCD Development	25	-
-First Financial Holdings d.o.o. Podgorica	15	268
-Epidaurus hotel d.o.o. Zagreb	6	-
-Noble Power group limited*	-	16,821
-Almara d.o.o. Podgorica*	-	600
-Seven X aviation d.o.o. Podgorica*	-	5
-First Holidays d.o.o. Podgorica*	-	1
Total deposits	10,077	20,931
Loans/(Deposits), net	26,163	(4,008)
Other receivables:		
-Nova Pobjeda d.o.o. Podgorica	444	-
	444	-
Interest income:		
- individuals	19	53
- legal entities:		
-Monte Rock d.o.o. Podgorica	591	-
-Adriatic Properties d.o.o. Budva	140	-
-SDS management DMCC Dubai	20	-
-Hit Montenegro d.o.o. Budva	11	-
-Golden Estate d.o.o. Podgorica	10	-
-Nova Pobjeda d.o.o. Podgorica	-	1
-Almara d.o.o. Podgorica*	-	126
	791	180

29. RELATED PARTY TRANSACTIONS (Continued)

Fee income:		
- individuals	-	-
- legal entities:		
-Adriatic Properties d.o.o. Budva	5	32
-Monte Rock d.o.o. Podgorica	5	-
-Epidaurus hotel d.o.o. Zagreb	3	-
-Hit Montenegro d.o.o. Budva	2	-
-Sigma Delta Holdings d.o.o. Podgorica	-	2
-First Financial Holdings d.o.o. Podgorica	-	5
-Seven X aviation d.o.o. Podgorica*	-	3
-Nova Pobjeda d.o.o. Podgorica	-	5
-Mont Voyage d.o.o. Podgorica	-	59
	15	106
Total income	806	286
Interest and fees expenses:		
- individuals	-	5
- legal entities:		
-Adriatic Properties d.o.o. Budva	-	6
-SDS Management DMCC Dubai	1	-
-Peneseda d.o.o. Podgorica	-	41
Total expenses	1	52
Net income	805	234

*As at 31 December 2016, the party is not related with the Bank

Top management and board of directors gross wages and compensations in 2016 amounted to EUR 143 thousand (2015: EUR 88 thousand).

30. LITIGATIONS

As at December 31, 2016, the Bank was involved in several litigations filed by legal entities and individuals. According to the assessments made by the Bank's Legal Department, as at December 31, 2016, the total amount of claims against the Bank amounted to EUR 867 thousand (2015: EUR 809 thousand).

The Bank makes provision when exist high probability of cash outflows on the basis of litigation. As at 31 December 2016, the Bank does not expect a negative outcome of the proceeding and consequently provisions are not formed for adverse outcome of legal disputes.

In addition, the Bank filed several litigations against legal and individuals to collect the receivables in the amount of EUR 1,960 thousand (2015: EUR 136 thousand).

31. EXCHANGE RATES

The official exchange rates used in the translation of the statement of financial position components denominated in foreign currencies into EUR as at December 31, 2016 and 2015 were as follows:

	December 31, 2016	December 31, 2015
USD	0.9486	0.9152
CHF	0.9311	0.9247
GBP	1.1679	1.3550

32. SUBSEQUENT EVENTS

At the General Meeting of the Bank held on 3 March 2017 were adopted, among other things, the following decisions:
- The decision to reduce the share capital by reducing the nominal value of the shares to cover the loss,
- Decision on approval of the prospectus for the bond issue,
- The decision on issuance of corporate bonds.

The Bank plans to issue subordinates bonds in the amount of EUR 4,000 thousand with a maturity of 5 years and 6 months. The deadline for the bond issue is 90 days from approval of the prospectus, which have a yield at a fixed interest rate of 1% per annum. By issuing these bonds, the Bank will increase its Tier 2 - additional capital and the solvency ratio.

In addition to the above events, Management believes that there are no other significant events after the reporting date that would have impact on the financial statements for 2016.